

CHAPTER- I

INTRODUCTION

1.1 Background Information

Through there is much controversy as to the origin of the word 'Bank', some believe that originated from the Latin word 'Bancus' meaning a bench. Similarly, some believe that it originated from the French word 'Banque' and some to Italian word 'Beca' all meaning a bench. Some have stronger belief that it originated from the Germany word 'Banck' meaning collect of fund.

The history of modern banks begins from Bank of Venice established in 1157AD, Bank of Bracelona established in 1401, Bank of Genoa established in 1407, bank of Amsterdam established in 1609 and Bank of England which was established in 1694. The ancestors of modern day's banks have been attributed to the merchants, the goldsmiths and the money lenders.

It is assumed that the history of coinage in Nepal begin from the 5th century A.D. the advent of 12th century marked a new period of economic history of Nepal. Silver coinage was introduced in the period which widened the scope for trade. In the year 879/80 A.D. a law cast merchant named 'Shankhader' introduce a new era after paying all the debt that existed in the country. In 1877 A.D. Prime Minister Ranoddip singh introduce many financial and economic reforms. 'Tejaraht Adda' was established at that time. The basic purpose of establishing this Tejarath Adda was to provide credit facilities to the general public at a very concessional intrest rate. It was disbursed credit to the people on the basis of collateral of gold and silver. Hence,the Tejarath Adda is regarded as the foundation of modern banking in Nepal. However 'Kausi Tosa Khana' established

during the regime of king Prithivi Narayan Shas is also considered as the first step toward initiating banking development in Nepal.

The formal and modern bank of Nepal, Nepal Bank limited came into existence under the Nepal Bank Act 1937. The opening of the Nepal Bank Act 1937 states the objectives of setting up the Nepal Bank Ltd. as follows. 'In the absence of any bank of Nepal, the economy progress of the country was being hampered and causing inconvenience to the people, and therefore, with the objectives of fulfilling that need by providing service for the people and for the betterment of country, this law is hereby promulgated for the establishment of the bank and its operation.'

Nepal bank Ltd. played a dual role of commercial bank and the central bank. Until the establishment of Nepal Rastra Bank on 26th April 1956, it carried all the function of central bank. Nepal Bank was semi government bank so it was unwilling to go to many sectors where the government felt the need to provide banking service. Hence, Rastriya Banijya Bank, a fully government owned bank was established on 23rd January 1966.

Until 1984, the Nepalese financial sector were dominated by the above two commercial bank. Commercial banking Act 1974 was amended in 1984 to increase competition among commercial bank. Hence, provision was made to allow private sector including foreign investment to open commercial bank in Nepal. As a result Nepal Arab Bank Ltd. (Nabil Bank) was established on July 12, 1984, with the partnership of Dubai Bank Ltd., Dubai. Now the numbers of commercial banks operating in the country are 25 and another 2 has recently got the license to operate and some banker are already in the pipeline to commence their businesses. Before 1985 only public enterprises such as two Development

Banks: NIDC and ADB and in the form of non-banking financial institution: Employees Provident Fund and National Insurance Corporation were established. So, to increase the financial activities of the country, 'Bank and Financial Act – 2063' was introduced which brought more than 175 financial institutions in the country.

1.2 Focus of the Study

This study focuses on off balance sheet items. In a banking system, there is not a uniform practice to record off balance sheet transactions because they do not have any direct financial impact on the bank's financial transactions. Off balance sheet items are commitments made to certain parties. Such types of transactions can be recorded in a separate register in a single entry system. On the other hand, they can be recorded in a double entry system by passing a contra entry or an artificial entry. Off balance sheet usually means contingent assets and liabilities not shown on a balance sheet. It could involve a lease or a separate subsidiary or a contingent liability such as a letter of credit.

Obligations that are contingent liabilities of a bank, and thus do not appear on its balance sheet. In general, off balance sheet items include the following: direct credit substitutes in which a bank substitutes its own credit for a third party, including standby letters of credit, irrevocable letters of credit that guarantee repayment of commercial paper or tax-exempt securities, risk participations in bankers' acceptances, sale and repurchase agreements, and assets sales with recourse against the seller, interest rate swaps, interest rate options and currency options and so on.

1.3 Statement of the Problem

Joint Venture commercial banks are operating in Nepal after the NEPAL GOVERNMENT adopted the open, liberal and market oriented economic policy. While preparing this report realize that Off-Balance-Sheet activities are very much important activities of banks. It is one of the quick and major earning activities of the bank. It helps to attract customers, and retaining them.

Off-Balance-Sheet activities include income generating activities within short period. But still, Off-Balance-Sheet activities are less obvious and often are invisible to all but the best-informed investor or regulator. It is still considered as footnotes to financial statements. Why it is so and what are the problems? It is a very important question. To answer the question, an analysis of there off balance sheet activities is important. So in the present study, the researcher is going to analysis the “off-balance sheet items” with special reference to BOK. The researcher attempts to ascertain the answers of the following questionnaires:

-) What impact do the off-balance sheet items have on the Financial Institution’s future profitability and solvency performance?
-) What does there off balance-sheet activities include and how have they helped to attract and retain the customers?
-) What role do the off-balance sheet items play in the income generation of a commercial bank?

1.4 Objectives of the Study

The general objective of this dissertation is to analyze the impact of the off balance sheet activities of the selected bank, i.e. Bank of Katmandu Ltd with its main focus on Import L/C. The specific goals of the proposed study are mentioned below:

-) To identify the Contribution on Income from Off-Balance-Sheet activities.
-) To analyze the Contingent liabilities created by Off-Balance-Sheet activities.
-) To analyze the risk involved in Contingent liabilities created by Off-Balance-Sheet activities.
-) To find out the effectiveness of Off Balance Sheet items and the recommendation and suggestion about it.

1.5 Significance of Study

BOK is one of the major financial institutions supporting to boost of economy in the new height of Nepal. This study provides some information to analyze the data and some occurring problems for specific field. In the context of Nepal, very few studies and research have been made related to off-balance sheet activities. Out of this, there is some importance of the study.

-) To the bank (BOK)
-) To the targeted entrepreneur and banker.
-) To the policy makers.
-) To the interested person and scholars.

1.6 Limitations of the Study

This research explains and analyses the subject matter with the help of well-known or already established analytical methods and techniques, therefore as a conclusion oriented research it does not concern much with fundamental and decision oriented research. In considering the above matters, the limitations are:

- This study will only concentrate on Off-Balance-Sheet activities with a larger focus on the Import L/C.
- Study will only analyze Contingency liability created by Off-Balance-Sheet activities.

- It only focuses on the period of 5 years (i.e. FYs 2004/05 to 2008/09).
- This analysis is mainly based on secondary data, published by the bank.
- The data published from various sources differ; they do not tally and at many times, total is not equal. However, in this study, reports of BOK are taken as authentic source of data.
- All the analysis in this study has been conducted based on the data as of end of the fiscal year i.e. mid July of respective years. Any abnormality in this date may affect the conclusion of the study.

1.7 Organization of the Study

This study has been comprised into five chapters, each devoted to some aspects off balance sheet activities of BOK. The titles of each of these chapters are summarized and the contents of each of these chapters of this study are briefly mentioned here.

Chapter I: Introduction

Chapter II: Review of Literature

Chapter III: Research Methodology

Chapter IV: Presentation and Analysis of Data

Chapter V: Summary, Conclusion & Recommendations

The first chapter, deals with the subject matter of the study consisting introduction, statement of problem, objectives, importance, research methodology and chapter scheme of the study.

The second chapter, review of literature includes some work, analysis and discussion already made in the field of banks in various planning periods and

finally, a brief review of previous research works specially made in respect of disbursement and collection procedure.

The third chapter, research methodology deals with research design, period covered, types and sources of data, data collection procedure, method of analysis and analytical tools used.

In fourth chapter collected data through various sources have been presented. It mainly consist the analysis of various types of data regarding off Balance–sheet activities .Various financial and statistical tools and techniques have been used to analyze and interpret the data. This chapter is the key chapter for the present study.

The fifth and the final chapter is concerned with the suggestive framework that consists with the overall findings, issues and gaps, conclusions ,findings and recommendations of the study. At the end of the study, bibliography and appendices have also been incorporated

CHAPTER – II

REVIEW OF LITERATURE

2.1 Introduction

Review of literature comprises of previous research study articles concerned with this study and other studies with a view for supplement the present research and such review adds to the dimension of the study. This chapter deals with review of books, review of reports, review of research papers, review of articles, review of Unpublished Publication and relevant act.

This chapter is comprehensive study on the conceptual framework review of books, journals and various researches regarding, off-balance sheet items and details of the letter of credit (L/C) of BOK. Review of Literature can be studied by dividing it in the following ways:

- Conceptual Framework
- Review of Related Studies

2.2 Conceptual Framework

In this section, various books are reviewed that are written by the different writers that make clear about the conceptual foundation of off-balance sheet items and details of the letter of credit (L/C). It helps to assess new idea by examining views of different writers and scholars.

2.2.1 Review of Books

Most of us are aware of On-Balance-Sheet activities because they appear on Financial Institutions published. For example, Financial Institution's deposits and holdings of bonds and loan are On-Balance-Sheet activities. By comparison, Off-Balance-Sheet activities are less obvious and often are invisible to all but the best-

informed investor or regulator. In accounting terms, Off-Balance-Sheet items usually appear “Below the bottom line,” frequently just at footnotes to financial statements. In economic terms, However, Off-Balance-Sheet items are Contingent Assets and Contingent Liabilities that affect the future, rather than the current, shape of and Financial Institution’s balance sheet. As such, they have a direct impact on the Financial Institution’s future profitability and solvency performance. Consequently, efficient management of these Off-Balance- Sheet items is central to controlling overall risk exposure in and modern Financial Institution. From a valuation perspective, Off-Balance-Sheet assets and liabilities have the potential to produce positive or negative future cash flows. As a result, the true value of and Financial Institution’s capital or net worth is not simply the difference between the market value of assets and liabilities on its balance sheet today but also reflects the difference between the current market value of its Off-Balance-Sheet or contingent assets and liabilities.

“An item or activity is an Off-Balance-Liability if, when the contingent event occurs, the item or activity moves onto the liability side of the balance sheet” *(Bedi. & Hardikar,(1995). Practical Banking Advances. London:USB Publishers).*

Banks sell various performance guarantees, especially guarantees that their customers will not default on their financial and other obligations, Examples of such guarantees include Letter of Credit and Standby Letters of Credit. Should a customer default occur, the Bank’s contingent liability becomes an actual liability and it moves onto the liability side of the Balance Sheet? Indeed, bank managers and regulators are just beginning to recognize the measure the risk of Off-Balance-Sheet activities and their impact on the bank’s value.

A truer picture of the banks economic solvency should consider the market value of both its visible On-Balance-Sheet and Off-Balance-Sheet activities. Specially, the bank manager should value contingent or future assets and liability claims as well as current assets and liabilities. When the current market value of the bank's contingent assets is less than its contingent liabilities, that portion is an additional obligation, or claim, on the net worth of the banks. Thus, economically speaking, contingent assets and liabilities are contractual claims that directly impact the economic value of the bank. Indeed, from both the stockholders' and regulators' perspective. Large increases in the value of contingent liabilities can render a bank economically insolvent just as effectively as can losses due to mismatched interest rate gaps and default or credit losses from On-Balance-Sheet liabilities (Gupta, 2002).

2.2.2 Review of Articles

A contingent liability is a likely or possible liability. It may arise on the occurrence of a particular event and turn out to be an actual liability. The total contingent liabilities e.g. liabilities in respect of guarantees given by the company have to be taken into account. The company may be called upon to make payment in the event of the failure of the party for whom guarantees have been given.

The contingent commitments should not be unduly large, as they may make the company vulnerable to a risk out of proportion to its resources. Wherever possible, such liabilities should be analyzed to find out which of them are likely to materialize, and when. If there is a fair chance of the company being called upon to pay on account of its commitments in the near future, say, within a year, it will be prudent to include such items in the figure of current liabilities. Contingent liabilities not being actual liabilities are shown by way of a footnote in the balance sheet, so it is also called Off-Balance-Sheet activities

Contingent liabilities also referred to as off balance-sheet items, should be analyzed as part of the branch's overall risk management assessment. Potential exposure, funding sources, the adequacy of risk management, and internal controls for off-balance-sheet risks are specific matters that should be considered. As a regular part of their operation, some branches are involved in originating financial contracts that may result in the acquisition of certain assets and liabilities at some future date, under certain conditions. Generally accepted accounting principles do not consider these contracts in themselves to be assets or liabilities and, thus, do not recognize them on the face of the balance sheet. These off-balance-sheet items are quite diverse in nature and purpose and may include such instruments as firm loan commitments, standby letters of credit, foreign exchange, financial futures, forward contracts, options, interest rate swap contracts, and other derivative products (*Branch and Agency Examination Manual, September 1999*).

Greater competition, marketing innovations, and government deregulation have changed the focus of attention from contingent liabilities. In addition to assessing the risk in off-balance sheet *instruments*, examiners must also assess the risk of off-balance-sheet *activities*. Branches are now involved in a wide spectrum of banking activities designed to generate fee income, such as securities clearance and brokerage activities, data processing services, and investment and management advisory services. As the branches find more avenues of non-traditional banking activities available to them, they may expand the scope of services offered to customers. These new activities may involve risks, which are difficult to quantify, such as legal risk, or reputational risk, (*Branch and Agency Examination Manual, September 1999*).

2.2.3 Consideration on Contingent Liabilities

Consideration interest is predicated upon an evaluation of the impact contingencies may have on a bank's condition. Contingent liabilities that are significant in amount and/or have a high probability of becoming direct liabilities must be considered when the bank's ratings are assigned. The amount of contingent liabilities and the extent to which they may be funded must be considered in the analysis of the liquidity component of the CAMEL rating system. Determination of the management component may appropriately include consideration of contingencies, particularly Off-Balance-Sheet lending practices. Contingent liabilities arising from Off-Balance-Sheet fee producing activities have increased in significance as a means of enhancing bank earnings. In rating a bank's earnings, the impact of this type of fee income on earnings should be analyzed with consideration given to the present amount, quality, and expected future level of such income, (*International Definition- www.thebanker.com*).

The extent to which contingent liabilities may ultimately result in charges against capital accounts is always part of the examination process and this analysis is important in the assessment of the capital rating. Examiners should consider the degree of Off-Balance - Sheet risk in their analysis of the bank's overall capital adequacy and the determination of compliance with NRB Rules and Regulations. The NRB Rules and Regulations may not explicitly include Off-Balance-Sheet activities in the leverage capital calculations, but it does indicate that Off-Balance-Sheet risk is one of the factors that will be considered in determining whether a higher minimum amount of capital should be required for any particular bank. Many Off-Balance-Sheet risks are explicitly included in the risk-based capital calculations.

The total amount of all contingent liabilities is to be included in the memorandum section of the Capital Calculation schedule of the examination report. A distinction is made between Category I and Category II contingent liabilities in determining adjustments to be made to capital. The examination procedures for Category I contingent liabilities are regarded as Adversely Classified Contingent Liabilities while those for Category II contingencies are regarded as the heading for Potential and Estimated Losses in Contingent Liabilities (Wolf, 2002).

2.2.4 Potential Losses in Contingent Liabilities

Category I contingent liabilities are defined as those which will give rise to a concomitant increase in bank assets if the contingencies convert into actual liabilities. Such contingencies should be evaluated for credit risk and, if appropriate, listed for Special Mention or subjected to adverse classification. This examination treatment does not apply to Category II contingent liabilities where there will be no equivalent increase in assets if a contingency becomes a direct liability. Examination treatment of Category I contingencies is covered under the heading Adversely Classified Contingent Liabilities in the Off-Balance Sheet Lending Activities Section.

Category II contingent liabilities are those which are not expected to result in an increase in assets should future developments convert the contingencies into actual liabilities. A bank's exposure normally depends solely on the probability of the contingencies becoming direct liabilities. To reflect the degree of likelihood that a contingency may result in a charge to capital accounts, the terms "Potential Loss" and "Estimated Loss" are used. A loss contingency is an existing condition, situation, or set of circumstances that involves uncertainty as to possible loss that will be resolved when one or more future events occur or fail to occur. Potential loss refers to contingent liabilities in which there is substantial and material risk of

loss to the bank. An estimated loss from a loss contingency (for example, pending or threatened litigation) should be recognized if it is probable that an asset has been impaired or a liability incurred as of the examination date and the amount of the loss can be reasonably estimated.

The amount of Category II contingent liabilities are included with Category I contingencies in the memorandum section of the Analysis of Capital schedule of the examination report. Any Potential Loss identified is also reflected in the memorandum section. Estimated Losses are reflected in this schedule as adjustments to capital in determining adjusted primary capital and adjusted total capital. Estimated Losses are not included in adjustments to assets. The major and riskier portion seen on the contingent liability is the Letter of Credit, so on Letter of Credit (Specially Import Letter of Credit) (Vaidya, 1999).

2.3 About Letter of Credit (L/C)

In the ages, when barter became impossible due to the ample increase in demand, supply and trade, the commercial parties then invented the way to trade their goods and services across the world by the help of a Bank. In international trade is selling the goods manufactured in one country to the market of another country. International trade is expanding day by day and now the world has become so close that the manufactures have foreign market available at their over office & the customers have foreign goods available at their own market people have been so dependent that the world without long-distance trades cannot be imagined. In long distance trades, traditional type of instant pay cash-take delivery transaction cannot be conducted. Moreover, the buyers and the sellers cannot be conducted. Moreover, the buyers and the sellers may not know each other (Crasse, 1963).

In such they hesitate to carry on trade without confirming reliability of their counter part. The buyer wants to pay only after receipt of the goods and the seller wants to dispatch the goods only after receipt of the payment such problems between the buyers and sellers have been resolved after the introduction of "Letter of Credit". A Letter of Credit is a written conditional under-taking issued by a Bank in accordance with the request and instructions of the buyer to the seller to effect payment up to a stated sum of money within a prescribed time limit and against the presentation of the document provided the terms and conditions of the credit and complied with (Gitman, 1972).

According to the Uniform Customs and Practice of Documentary Credit 1993 Revisions International Chamber of Commerce (ICC) publication No. 500 (UCPDC-500) the Letter of Credit (L/C) means" An arrangement whereby the goods are shipped and the relevant bill of exchange (Draft is drawn by the seller on the buyer and / or document(s) is sent to the seller's Bank with clear instructions for collection through one of its correspondent Bank located in the domicile of the buyers"(Uniform Customs and Practice of Documentary Credit 1993 Revisions International Chamber of Commerce (ICC) publication No. 500 (UCPDC-500).

L/C provides security to both buyer and seller. The seller can rightfully demand payment from the issuing Bank presenting the document. If he/she feels any term in L/C cannot be fulfilled, he/she has an option avoid shipment of the goods. On the other hand, the buyer the L/C. He/She can ask for any documents fulfilling all such terms & conditions, which can prove those specific goods, have been shipped & he/she can get them with the documents. If the documents do not fulfill his/her terms, he/she has the option to reject the documents. Thus, conducting trade

through L/C is safe provided the buyer is careful in selecting the terms and conditions and the seller is conditions in preparing the documents.

2.3.1 Purpose of Letter of Credit

-) It is a widely accepted method of setting the standard of international financial trade transaction.
-) It brings an element of confidence to the parties involved.
-) It gives a form of security to both the buyer and seller as the payment is delivered through the banking channel upon compliance of the prescribed terms and conditions in the L/C (Gupta, 2000).

2.3.2 Types of Letter of Credit

To suit the nature of requirement of the parties, the Letter of Credit is classified into various types based on the different features. The broad classification of L/C is:

-) **Revocable:** A revocable L/C is the credit which gives maximum flexibility of modifying or canceling by buyer, thereby giving less security to the seller, hence become most unpopular and rarely used. In this credit the buyer's Bank or buyers can alter terms of the credit or cancel the credit without any prior notice to the seller or seller's Bank.
-) **Irrevocable:** As the name itself suggests, irrevocable is a L/C, which cannot be cancelled or revoked by a single party unless and until both the parties involved including the Bank agree there to (Rose, 2002).

Depending on the terms and conditions, L/C can be further classified as under:

-) Sight L/C (Confirmed Unconfirmed)
-) Usance L/C

-) Revolving L/C
-) Red Clause/Green Clause L/C
-) Back-to-Back L/C

2.3.3 Process to Open Import Letter of Credit

a) Scrutinizing of Application

-) L/C application must be filled properly: The L/C application is a standardized format to apply for the opening of Letter of Credit. In this form, name of the beneficiary (Seller), name of applicant (Buyer), Type of shipment (Partial allowed or not), Mode of Payment, Shipment Mode, Signature and Official stamp of the applicant should be mentioned properly. Under Open General License (OGL) only L/C can be opened.
-) The form no.3 should be filled and signed properly: The form no. 3 means BBNF.3 (Bideshi Binimaya Niyamawali Form No. 3). This form is also needs to submit during the application for the new L/C.
-) The firm registration and income tax/VAT must be updated: Applicants have to submit updated Income Tax/Vat/or PAN certificate along with the application of the L/C.
-) Total amount of goods and type of goods should be clearly mentioned in the form of L/C.
-) Signature of authorized person and the stamp of the company should be verified

b) Process for Approval

When the application is certified, it is sent to get approval from the concerned authority: After application is received, the staffs of the bank needs to make a proposal along with client's liability report and needs to forward to his immediate superior. If the case is within limit and without any ones dues it will be approved shortly. Generally officer of the Trade Finance department approves the proposal

or he also forward to the manager. In case of non-limit holders or new client approval is made through concerned authority. In this case the proposal is forwarded to different levels. This type of proposal is analyzed more than other. And only higher-level authorized person makes approval. When application and approval is obtained L/C has to be processed and passed in the same day. A separate register is to be maintained clearly showing the time application received, processed from the department. When it was approved and received by the department and finally passed. Proper monitoring and follow up is to be done by the department

c) After Approval has been obtained

Depending on the client and the nature of goods, the margin for L/C is taken. Generally the margin is taken as per the directives of the Nepal Rastra Bank. Has the margin been taken as per approval before establishing L/C? It should be confirmed that the margin has been taken and that is for safety. It is necessary to take the NRB statutory margin. No L/C can be issued without taking statutory margin as decided by Nepal Rastra Bank. The commission and telex charges have to charge. Commission and telex charge is charged on every L/C. The amount of commission differs from one to another, but the telex charge is generally fixed for all L/C. The L/C liability has to be booked properly. When issuing the letter of credit, bank takes over the liability and it is accumulated in bank's liability account. The form no.3 has to be separated from the application and sent to NRB.

d) Formation of L/C

After the above process, L/C format has to be made according to the application and other documents. Generally the format of L/C will be same globally because they have followed the UCP 500 guidelines. Select the Transmission mean and make the format accordingly. Generally L/C is sent through SWIFT or E-mail (Dahal, 2002).

e) Transmission of L/C (Jha, 1940)

-) L/C can be sent through mail, courier, telex and SWIFT.
-) L/C can be through any medium.
-) The date & time should be noted.

2.3.4 Amendment on (L/C)

Following points has to be considered for getting amendment on L/C:

-) Is there a proper request for amendment? The bank can make amendment only after the request of buyer.
-) Does an authorized person sign the amendment? After amendment request has been received, authorized person can amend L/C only after getting signature.
-) Is the form no. 3 filled and signed properly? After making amendment the form no. 3 needs to be filled again.
-) Does the amendment violate any NRB directives? There are certain restrictions regarding amendment of L/C. So, the amendment of L/C should not violate any directives of Nepal Rastra Bank.

2.3.5 Cancellation of L/C

Applicant requests the issuing bank for the cancellation of L/C. Then the issuing Bank informs the advising Bank informs the beneficiary for consent. Under the mutual understanding of buyer and seller, the L/C is cancelled (Diamond, 1960).

2.3.6 Document required under Import L/C

-) Draft. (Bills of Exchange)
-) Commercial Invoice.
-) Certificate of Origin.
-) Insurance Copy (If value of goods is CIF).
-) Documents. (Airway Bill / Bill of Lading / Transport Document)
-) Packing List.

Documents required for releasing the goods from customs For Industry 2% margin is taken and for Trading 10% margin is taken for customs purpose. B.B.N.F. no. 4 is filled in quadruplicate for distribution as follows: (Gupta, 2000)

-) First two copies to importers, for submission to customs office for clearance of goods.
-) Third copy to be sent to NRB.
-) Fourth copy to be retained by the Bank.
-) Each copy of documents mentioned in L/C along with copy of L/C & proforma Invoice are separated.
-) These documents are compiled and kept in envelope for sealing.

2.3.7 Settlement of L/C after arrival of Original Documents

-) Are all the documents as per the L/C terms & conditions? Bank also needs to check the discrepancies on the document. If there are any discrepancies either bank or importer does not accept the Documents. Then payments need to be held.
-) Confirm the exchange rates with the Treasury Department giving them the details of the clients.
-) If the documents have discrepancies in them, intimate to the client and send a telex to the negotiating Bank mentioning the discrepancies. Because, neither bank nor client wants to pay to the seller if documents have discrepancies.
-) Refusal of discrepant documents has to be informed within seven days from the receipt of documents as per UCP-500.

2.4 Review of Thesis

The need to borrow is greater today than ever before, partly because of the dependence of people upon complex money and credit economy that is subject to

many uncertainties and partly as a result of desire for a constantly rising standard of living. He has also expressed his view on loan collection. 'The weaker the credit granting function is, the greater that task on the collection arise only because credit has been used. The credit granting and collection functions are not only interdependent but also interwoven. The more lenient the deliberate policy of risk selection, the more formidable is the collection task and the stricter the granting of credit, the less the burden on the collection function. (Beckman,1962)

The type of relationship to be investigated depends upon the objective and purpose of evaluation. The purpose of evaluation of financial statements diggers among various groups (creditors, shareholders, potential investors, management, government, labour leaders and so on) interested in the results and relationships reported in the financial statements. For example, short term creditors are primarily interested in judging the firm's ability to pay its currently- maturing obligation.(Khan, My and Jain, Pk 1983)

The investment (credit) policies of banks are conditioned to great extent by the by the national policy framework, every banker has to apply his own judgment for arriving at a credit decision, keeping his bankers credit policy also in mind.(Sing & Sing, 1983)

The banks are such types of institution, which deal with money. They deal with cash, credit and credit instruments. Good circulation of credit is very much important for the bank. Understand and unevenly flow of credit with adhoc decisions harms the economy and the bank as well.

In an article, Thakur, A. K. (2002), entitled "Risk management of commercial bank and financial institution" raises the issue of risk management in the banking sector. According to him, "Risk should be taken as one of the challenges of the

banking industry but it is not sufficient to minimize the potential disasters. Banking risk should be managed as a separate part of the management.”

In an article, Bhattra, M.(2002), is trying to indicate the problem of banks bad debt and non performing assets. According to him, “If a bank cannot recover its loan lending, bank’s cash flow will be badly affected.” Similarly it can affect the close relationship between depositors.

In an article, Karki, Uma (2002), “Challenges of non-performing loan management in Nepal” has mentioned the causes of increasing trend of non-performing loan. She Identifies the major causes such as “ poor loan analysis, guarantee oriented loan system, depreciation on valued assets, misuses of loan, lack of regular supervision of loan.”

In an article, Ghimire, M (2004), “comparative analyze the role of RBB” is trying to analyze the role of RBB in the Nepalese banking industry. “He is trying to show the share of RBB in various aspect of Nepalese financial market such as in banking market, in the total deposit of commercial banks in Nepal, in loan market, in the capital fund and in the foreign exchange transaction.”

In an article, Pradhan, M.L. (2004), “Importance of credit information bureau and it’s activities” is trying to identify the need of credit information bureau. In this article he is trying to dig out about the establishment of credit information bureau and major activities which are assured by the Nepal Rastra Bank act 2058 section 58.

An investment of money that is expected to generate additional money. Every investment entails some degree of risk; it requires a present certain sacrifice for a future uncertain benefit. The book describes various ways to select the investments that will provide the maximum future return at an acceptable level of risk. It examines such marketable financial instruments as common stocks, preferred

stocks, bonds, put options, call options and futures contracts on the traditional commodities, financial futures and other investments, as well as the risks associated with each. It analysis these assets, the markets in which they are traded, the laws governing the trading, the valuation of the assets, the construction if a diversified portfolio and other important investment management techniques. (Francis, J.C, seventh edition)

The writers in their books opine that the factors like statutory directive, deposit mix, competition and quality of lending officials affect a bank's credit policy. Considering these factors, the credit policy should be carefully established, communicated properly to the lending officers. A sound credit policy should be based on the objectives like having good assets, contributing to the economic development, giving guidance to the lending officers, and establishing a standard for control. The proper implementation of such policy is ensured by periodic follow up. This helps take corrective actions if any drift between actual and standard is seen. The corrective action may vary as per the nature of deviation from proper education to lending officer to amendment of the policy.

2.4.1 Review of past thesis (Dissertation)

Chand, G.B. (1999), has submitted his thesis on "credit disbursement and repayment of agriculture development Bank Nepal". The problem of this research is the bank does not benefit small farmers (i.e. problem of balance development), the collection of credit is slow so it hinders the flow of capital required to develop economic growth. The main objectives of this research is to see the repayment situation, to find out the rate of growth of investment, to explain possible causes of non and delayed repayment. On the basis of finding the bank is recommended for the following points.

-) There is systematic relationship between credit disbursement and repayment. The coefficient of correlation value as calculated is 0.94, which shows significant relationship.
-) Repayment situation is satisfactory on production inputs and agro-based industry, warehouses and marketing percentage of repayment due to the farm mechanization and irrigation and tea horticulture and livestock, poultry and fisheries is much less satisfactory.
-) As a recommendation given by Chand, ADB should play a significant role in such direction as to fulfill the credit demands of rural areas. For effective credit recovery from the borrowers or clients, credit should be channeled through the borrowers groups.

Shrestha, B.N. (2001), has submitted a thesis named “Study of industrial credit provided by NIDC in Sunsari district”. The study found that the financial assistance provided by NIDC in different industrial sectors in Sunsari district, the attitude of industrialists in regard to the performance of NIDC, to give suggestions to improve the role of NIDC.

On the basis of finding one of the most important policies of NIDC has adopted in investing its fund to the industries in security oriented rather than industrial development oriented, it seems that NIDC lack definite systematic and clear-cut long term financing policy, repayment and follow up activities followed by NIDC are not efficient as no taken side by side .

Gautam R. (2003), in his thesis entitled “investment analysis of finance company of Nepal” analyze that the interest rate of credit, the repayment of credit, collection of credit and so on. The study found that the use of funds towards the hire purchase credit is decreasing rapidly, As the direct data of good and bad credit was not available than the credit loss provision used to analyze the credit quality,

credit loss is increasing every year significantly and should be controlled, the loss provision of some company is more alarming on individual analysis, the company having above average credit loss provision should rethink on their investment and repayment policy.

Pandey, M.P. (2001), in his study about “loan disbursement and collection of ADB” says that the bank must take loan outstanding into consideration at the time of targeting loan disbursement and collection. For loan recovery, he has expressed his view that in the case of borrowers who are able but do not their due loans, the banks must examine the borrower’s past repayment records and corrective action must be rearranged after scrutinizing the exact causes of inability.

He suggest the bank that strict supervision must be made for issuing the memorandum letter supervisor must visit the field whether the borrowers utilize the total loan amount for concerned purpose. Supervisor must motivate the borrower to utilize the full amount in loan purpose.

Since overdue loan supervision is very weak, he has recommended the institution of a special cell in the bank as well as outside the bank to correctly monitor the progress of pos loan supervision to the appropriate authorities and create an atmosphere of strict financial discipline both in the borrowers as well as the bank.

Aryal, k. (2003), in his thesis “ A evaluation of credit investment and recovery of financial public enterprises in Nepal” ; A case study of ADB/N. says that high interest rate of non-institutional sources, people are unable to pay their credit at fixed time. These institutions compel them to transfer their property to money lender resulting himself or herself as a landless person.

ADB/N is one of the major financial institution supporting for the people for the different purpose like agro, industries, tea, coffee, livestock farming etc. ADB/N provides the credit for individual and co-operative sector to all region of the

country. Credit outstanding amount is increasing day by day but the collection amount is not good. However ADB/N has increased its effort to collect its credit. It is said that those people who really need do not receive sufficient amount of credit from ADB/N. so Mr. aryal choose this bank to analyze the credit disbursement and recovery pattern of ADB/N.

The study found that actual credit disbursement collection and outstanding are increasing in decreasing rate, yearly increase in credit disbursement is higher than that of collection, positive relation between credit disbursement and collection that is 0.996, targeted credit collection and disbursement fixed by planning and project department is not significantly different than the actual, most of the customers are unaware of the policy of the bank. On the basis of finding the bank is recommended for the following points.

-) The borrowers should be informed about the credit, its use and its payment procedures and schedule.
-) Greater attention should be informed about the credit collection and to collect old outstanding amount of credit and renewal of it.
-) To accelerate the collection, credit should be followed continuously in a regular interval of time.
-) The behavioural of the personal should be strictly supervised in granting credit in proper investment proposal because of most of the bad credit disbursement is due to weak decision of the personnel.

Regmi, P.(2005), in his thesis entitled “credit management of commercial banks with reference to NB Bank and Bank of kathmandu.” His research major objectives relevant to my research are to analysis the credit and advances provided by two banks, to analyze the repayment of credit, to give suitable suggestions for improvement of present performance conditions and solution of different problems. The study found that Banks have invested money in granting credit and

advances but the recovery process of the bank is slow. Efficiency in the management of credit is not satisfactory. As the overdue credit of the bank is increasing regularly and the income of the bank is on decreasing trend, it increases risk on the safety of the depositors. Therefore for the sake of security of bank depositors, NRB has ordered to all the banks to increase the capital. As the income of the banks are decreasing in the recent last years, its impact is directly on the shareholder's income that is also decreasing in the last years of research period. On the other hand, the impact of overdue credit is seen clearly in the shareholders income also. Overdue credit has helped to decrease the income of shareholders.

Parajuli, R.(2007), in his thesis“ credit management of commercial banks in the context of financial sector reform program” states that the credit policy of a firm provides the framework to determine whether or not to extend credit and how much credit to extend. His major objectives are to find out the relevancy of the financial sector reform program, to measure the comparative output of credit management in joint venture bank and government bank, to examine the level of the non performing loan investments that exists with the banking industry.

The study found that concept of financial reform emerged since 1980s with the economic liberalization. HMG/N and NRB published the economic and monetary policy to support such reform as the result of these policies, various joint venture banks established in the private sector. NRB further liberalized the restrictive measures for providing banking and non-banking financial institutions and especially development banks and the finance companies were given more freedom in their business operation..

Adhikari, R.(2008), in his thesis“ risk and return analysis with reference to listed commercial Banks." He concludes that most of the investors invest keeping the return in mind but they are found unable to calculate the risk factor of security. Some of the investors use their funds in two or more securities but it is found that

they do not make analysis before selecting security. They invest their funds in different securities on the basis of assumption and expectation. This study enables investors to put the return they can expect and the risk they may take into better perspective.

2.5 Research Gap

The purpose of this research is to develop some expertise in one's area, to see what new contribution can be made and to receive some ideas, knowledge and suggestions in relation to 'Off-Balance Sheet activities of BOK'. Thus, the previous studies can't be ignored because they provide the foundation to the present study. In other words, there has to continuity in research. This continuity in research is ensured by linking the present study with the past research studies. To fulfill this gap, this research is selected. To complete this research work many books, journals and articles are followed as guideline to make the research easier and smooth but till the date any dissertation could not find on the area. In this regard, here the researcher is going to analyze the different OBSs, which is considered only on BOK. Recent five years data (FY 2004/05-2008/09) has been used to get more accurate conclusion. Primary data obtained from face to face interaction with the employee of BOK.

This study has used all possible financial and statistical tools to cover the objectives of this study. Correlation coefficient to check the relationship between the sampled variables, coefficient of determination to know about the dependency of dependent variable on independent variable and hypothesis test (T-test) to prove significant or insignificant relationship between correlated variables is used in this study. Hence, this study is significantly different form previous study. Effort on this particular subject will be found properly genuine and it will be recognized valuable study in this particular subject.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Introduction

Research Methodology is a systematic way to solve the research problems. It describes the methods and process applied in the entire aspects of the study. It refers to the various sequential steps (along with a rationale of each step) to be adopted by a researcher in studying a problem with certain objectives in view. Thus the overall approach to the research is presented in this chapter. This chapter contains the research design, sample size, sample selection procedure, data collection procedure, data processing tool and techniques, variables etc

Research methodology refers to the various sequential steps to be adopted by researcher in studying a problem with certain objectives of view. It describes the methods and process applied in the entire subject of the study. It is the way to systematically about the research problem (Kothari, 2001: 39).

Research methodology is the plan, structure and strategy of investigations conceived to answer the research question or test the research hypothesis (Wolf and Pant, 2002; 51). Human beings cannot remain satisfied with the same things for a long time. They are always curious to learn more and do something new and special by raising questions like why, how, when, where, what etc. To answer these questions, they should gather information and analyze them to achieve their goals or satisfaction. The research for gaining the knowledge about method of goal achievement, which we desire, is known as research methodology (Joshi, 2001: 12-13).

3.2 Research Design

A research design is the conceptual structure within which research is conducted. It is an integrated system that guides the researcher in formulating, implementing, and controlling the study.

This study is based upon historical financial activities of Bank of Katmandu Ltd. Various statistical and financial tools have been utilized for analyzing the different variable related to off-balance sheet items and details of the letter of credit (L/C). Since, the study is obviously based on certain research design. This study emphasizes on descriptive and analytical study of collected data over a period of time and it gives suggestion on the improvement. So this study is based on descriptive and analytical research designs.

3.3 Population and Sample size

Now days, a number of commercial banks have been set up in the different parts of the country. Here, out of them, only Bank Of Kathmandu Ltd. is taken into consideration for the purpose owing to various reasons, covering five years period from the FYs 2004/05 to 2008/09.

3.4 Nature and source of Data

Both primary and secondary data have been used in this research report. Primary data are basically based on supplementary questionnaires. Unstructured dialogues and discussions are also helpful for this purpose.

Secondary data have been taken form the published journal, financial statement and research paper of BOK. These include the annual report, credit journal, and budget book. Other sources of secondary data relating to this study are collected form the publication of Ministry of Finance, publications of national planning

commission, central bureau of statistics, Auditor general reports, newspapers, previous unpublished dissertations, websites, research related reports.

3.5 Data collection procedure

Secondary data are collected from annual report of BOK for FYs 2004/05 to 2008/09, Journals, MIS division of BOK, Letter of Credit Division of BOK etc. through regular field visit in BOK. Some valuable information is also collected from personal interaction with managerial level employee of BOK. Primary data are collected from officials by the help of structural questionnaires through structural interview, personal face to face interview.

Data are collected to draw inferences and conclusions for this research. A comprehensive method is followed to get 100% data (i.e. primary and secondary data and both sources). Both quantitative and qualitative technique are used to find out and describe what is happening By asking questions and describe the characteristics of the variable of interest in a situation. Primary raw data are analyzed through qualitative analysis.

3.6 Methods of Data Analysis

For the purpose of analysis, financial statement of concerned institution, the profit and loss account and balance sheet of the bank have been analyzed. For analysis, the following tools have been used:

1. Financial Tools
2. Statistical Tools
3. SWOT Analysis
4. Tables
5. Bar Diagram

3.7 Description of the Analysis Tools:

The various tools used to analyze the data are described below:

3.7.1 Financial Tools

The financial tool used here is the most popular and widely used financial tool today in the world i.e. Ratio Analysis.

3.7.1.1 Ratio Analysis

Ratio analysis is a powerful tool of financial analysis. In financial analysis, a ratio is used as an index or yards stick for evaluating the financial position and performance of a firm. Ratio helps to summarize the large quantities of financial data and to make qualitative judgment about firm's financial performance. Webster's New College Dictionary, defined as "The indicated quotient of two mathematical expressions" and as "the relationship between two or more things" Webster's New College Dictionary, 8th edition, Spring Field, Mass: G & C, Merriam, 1975, p.958.

The proportion of different items can be identified with the help of Ratio Analysis. With the help of ratio analysis, it will be easier to measure the proportion of different items as per the requirement.

A. Liquidity Ratios

Difference between current assets and current liabilities is known as working capital, which provides the liquidity in business organization. Liquidity provides health, strength, honor, generosity and beauty as conspicuously and undeniably as the want of it creates illness, weakness, disgrace, meanness and ugliness. It is extremely essential for a business organization to be able to meet its obligations as they become due, so it should maintain sufficient liquidity neither excess nor less.

As it measures the ability of the firm to meet its short-term obligations, it reflects the short-term financial strength and weakness of the firm.

A high degree of liquidity shows inability of proper utilization of fund whereas the lack of liquidity shows the signal of poor creditworthiness, loss of creditor's confidence or even in legal tangles resulting in the closure of the company. So the firm should maintain appropriate liquidity over the immediate future to meet its short-term liabilities as they fall due.

Methods to calculate Major Ratios of Contingent Liabilities are

i. Letter of Credit to Total Contingency Liability

It examines the proportion of Issued Letter of Credit with total contingent liability. Letter of Credit is much more sensitive liability among the contingent liability. The formula used is:

$$\frac{\text{Total Letter of Credit (Outstanding)}}{\text{Total Contingent Liability}}$$

ii. Bid Bond (Guarantee) to Total Contingent Liability

It examines the proportion of Issued Bid Bond with contingent liability. Here Bid Bond means the Guarantee issued on behalf of the Client (Specially Construction Companies). The Formula used to calculate this relationship is:

$$\frac{\text{Amount of Bid Bond Outstanding}}{\text{Total Contingent Liability}}$$

iii. Performance Bond (Guarantee) to Total Contingent Liability

It examines the proportion of outstanding Performance Bon with contingent Liability. Performance Bond means a type of guarantee

issued by bank on behalf of the contractor. The formula used to calculate this relationship is:

$$\frac{\text{Amount of Performance Bond}}{\text{Total Contingent Liability}}$$

iv. Forward Exchange Contract to Total Contingent Liability

Examines the proportion of Forward exchange contract with Total Liability. Forward exchange contract means the contract for the future exchange rate, which will be in future. The formula used to calculate this relationship is:

$$\frac{\text{Amount of Forward Exch. Contract}}{\text{Total Contingent Liability}}$$

v. Bills Under Collection to Total Contingent Liability

Under collection are also components of contingent liability. If outstanding bills were became fault that will convert into liability, and the bank have to bear all the loss concern with this. The formula used to calculate this relationship is:

$$\frac{\text{Amount of Bills under Collection}}{\text{Total Contingent Liability}}$$

vi. Acceptance and Endorsements to Contingent Liability

Acceptance and endorsements are the liability already accepted by the bank. If those become fault, they will be converted to permanent liability. The formula used to calculation is:

$$\frac{\text{Amount of Acceptance and Endorsements}}{\text{Contingent Liability}}$$

vii. Other Contingent Liabilities to Total Contingent Liability

Other contingent liabilities are the miscellaneous contingent liabilities. These liabilities are also important to take in consideration. The method used to calculate the relationship is:

$$\frac{\text{Amount of Other Contingent Liabilities}}{\text{Total Contingent Liability}}$$

viii. Counter Guarantee with Internationally Rated Banks to Total Contingent Liability

Sometimes Banks gives counter guarantee to other banks on behalf of the client. If the client failed to perform promised work then the bank (Guarantee giver) will be liable. The method used to examine this relationship is:

$$\frac{\text{Amount of Counter Guarantee}}{\text{Total Contingent Liability}}$$

ix. Advance Payment Guarantee to Total contingent Liability

Advance payment Guarantee is much more crucial than other. Advance payment guarantee is a guarantee issued by bank on behalf of its client. Main purpose of the APG is to take payment in advance before finishing of job. If the client does not finish job then the bank will be liable to bear the costs. The method used to calculate the relationship is:

$$\frac{\text{Amount of Advance Payment Guarantee}}{\text{Total Contingent Liability}}$$

x. Total Guarantee with Total Contingent Liabilities

Total guarantee is one of the major parts of the contingent liabilities. By its name guarantee means if any client fails to settle the obligation the bank will be liable. This relationship is calculated by following method:

Total Guarantee
Total Contingent Liability

3.7.2 Statistical Tools

For supporting the study statistically tools such as arithmetical mean, standard deviation, correlation coefficient, regression, trend analysis hypothesis table diagrams, have been used under it.

Average (Arithmetical Mean)

Arithmetical Mean simply calculates the average value of the given time period. It is helpful for further use to examine the data statistically.

Average/Mean (A)

$$A = \frac{1}{n} * \sum_{i=1}^n x_i$$

Where x_i = amount in time points; $i=1, 2 \dots 5$;

n =number of time points

Standard Deviation

It measures the absolute variability of the distribution. The greater the standard deviation, for the greater will be the magnitude of the deviations of the values from their mean. A small standard deviation means a high degree of uniformity of the observations as well as homogeneity of a series; a large standard deviation means just the opposite. Thus, if we have two series with identical or nearly identical means, it is Amount of: Advance Payment Guarantee Total Contingent

Liability Total Guarantee Total Contingent Liability the distribution with the smallest standard deviation that has the most representative mean. Hence standard deviation is extremely useful in judging the representative ness of the mean.

The method used to calculate the standard deviation is:

$$= \frac{\sum x^2}{N}$$

Where, = Standard Deviation

N = No. of Observations

x = (X – X_̄) Actual value – Average

Correlation Analysis:

Correlation analysis measures the relationship between the variables. There are several methods of measuring correlation. In this research, Karl Person's correlation is used Karl Person correlation is simply denoted by the symbol 'r'.

The closer 'r' is +1b to -1, the relationship between the variables and the closer is to 0, the less close the relationship study of the correlations between two makings. In this research, the correlation between two variables is examined applying following formula;

$$r = \frac{N \sum XY - \sum X \sum Y}{\sqrt{N \sum X^2 - (\sum X)^2} \sqrt{N \sum Y^2 - (\sum Y)^2}}$$

Where,

X and Y are two variables

r = coefficient of variations

N = No. of observation

Also, in this research probable error is calculated to measure the extent of dependent variable that can be explained by the independent variable. Probable error (PE) is calculated as following

$$PE = 0.6745 \frac{1-r^2}{\sqrt{N}}$$

Where,

PE = Probable Error

Regression Analysis

Regression equation is the least square relation of dependent variable in respect to independent variable. In this study collection is termed as dependent variable and disbursement is assumed as independent variable. The parameter of regression equation indicates the fixed volume of dependent variable when independent variable is zero and changes in independent variable with per rupee change in independent variable. In the study an attempt will be made to measure the changes in collection with a change in loan disbursement. The normal regression equation is;

Let the line between the dependent variable 'Y' and the independent variable 'X' be represented by

$$Y = a + bX \dots \dots \dots (i)$$

Where,

a = Value of y when X=0

b = amount of change that comes y for a unit change in X or slope of line.

To determine the straight line, we have to determine the value of 'a' and 'b'. To find the value of 'a' and 'b' we have to solve the following equation,

$$\sum Y = na + b \sum X$$

And, $\sum XY = a \sum X + b \sum X^2$

Where,

n = No. of Observation

$$r = \frac{\sum XY - \frac{\sum X \sum Y}{N}}{\sqrt{(\sum X^2 - \frac{(\sum X)^2}{N})(\sum Y^2 - \frac{(\sum Y)^2}{N})}}$$

Least Square Trend Analysis

This method is most widely used in practice. It is a mathematical method and with its help a trend line is fitted by the provided data. The line obtained by this method is also called “line of best fit”. The straight line trend is represented by the equation:

$$Y = a + b X$$

$$a = \frac{\sum Y}{N}$$

$$b = \frac{\sum XY}{\sum X^2}$$

Where,

Y = Dependent Variable

a = Intercept of the computed trend figure of the variable Y.

b = Slope of the trend line.

X = Variable representing time.

Test of Hypothesis

Hypothesis is a conjectural statement about the relationship between two or more variables, which needs to be investigated for the truth by valid and reliable data. The research of this study strongly holds that the hypothesis formulated meets the above mentioned. In this study t- test is shown the effectiveness of planning and project department of the ADBL because test is operated to measure that there is

any significant different in target and achievement of loan collection and disbursement of the bank. The hypothesis of this research work is;

Null Hypothesis (H₀): There is no significant difference between the mean ration of targeted and actual loan disbursement.

Alternative Hypothesis (H₁): There is significant difference between the mean ration of target and actual loan disbursement.

And,

Null Hypothesis (H₀): There is no significant difference between the mean ration of target and actual loan collection.

Alternatives Hypothesis (H₁): There is significant difference between the mean ration of target actual loan collection.

Test statistic under Ho, the test statistic;

$$|t| = \frac{\bar{X}_1 - \bar{X}_2}{\sqrt{S^2 \left(\frac{1}{N_1} + \frac{1}{N_2} \right)}} \sim t_{N_1 + N_2 - 2}$$

Where,

\bar{X}_1 = mean of Targeted Amount

\bar{X}_2 = mean of Actual Amount

N_1 = No. of observation of Target

N_2 = No. of observation of Actual

$N_1 + N_2 - 2$ = Degree of Freedom

S^2 = Combined population variance

$$S^2 = \frac{1}{N_1 + N_2 - 2} [\sum(X_1 - \bar{X}_1)^2 + \sum(X_2 - \bar{X}_2)^2]$$

Decision: If calculated $|t| \leq \text{tabulated } t$, Null hypothesis will accept other wise reject null hypothesis in favor of alternatives hypothesis.

Tables

A table is presentation of data in row and column form. The presentation of table is concerned with labeling techniques to make the context clear. The raw data collected should be tabulated so that it will be revealing. The better the organization and sequencing of that data, the better it will be revealing. If the data is displayed in table form, it becomes easier for its analysis.

Figure

The term figure usually includes graphs and charts. These presentations help clarify and understand the data at a glance. In other words, figure assists to the reader in understanding the subject.

CHAPTER – IV

PRESENTATION AND ANALYSIS OF DATA

The purpose of this chapter is to carry out secondary data analysis. The main objective of this thesis is to analyze, examine and highlight the impact of off balance sheet items on the income of Bank of Kathmandu Ltd. and to recommend suggestion for better improvement. Presentation and analysis of data is the major part of the research study. So that to achieve our objective of the study, we analyze the data with the help of above financial and statistical tools.

4.1 Objective Analysis

The general objective of this dissertation is to analyze the impact of the off balance sheet activities of the selected bank, i.e. Bank Of Kathmandu Ltd with its main focus on Import L/C. The major objective of this study is to find the contribution of off balance sheet items on the income of the bank. The objective is also to analyze the risk factor involved while generating this income. Since off balance sheet items generate income in a short period of time, usually less than a year, the risk involved is also very high. So the major concern of any bank should be to minimize the risk factor involved. The major contributors of off balance sheet items are listed below.

Letter of Credit

LC's contribute a major portion as contingent liabilities for BOK. LC's are normally very safe instruments as two banks are involved in transactions. Trust Receipt loans are used during LC trading. Trade finance has always been a major source of income for most of the Nepalese banks and same is the case for BOK.

Forward Exchange Contract

The exposure in forward exchange contract was more than 70 million in the year 2004/05 and it remained nil in the year 2005/06. This can be attributed to two different reasons.

- xi.** Either BOK did not enter into any forward transactions in the year or
- xii.** The forward transactions did not create any liabilities in the year.

The forward transactions did not create any liabilities in the year. As, forward positions are taken by banks particularly to hedge against any future losses or to make profit from the more or less profitable deals in future, such positions can be regarded as speculative move. Non- of the schedules presented gave a clear picture of the income/loss from such trading activities.

The active trading in forward and futures is not common in Nepal. Banks normally play safe when it comes to trading. BOK is also following the same strategy. It may be due to less number of players in the national market and thus creating is a less attractive sector for investment.

Bills under collection

These bills are collectible in future but the obligation from bank side had already been completed. These also form a very negligible part of the total contribution.

4.2 SWOT Analysis

All of us have certain strengths and weakness. These may be either visible of latent strengths and weakness is internal to us and is within our control. We can manipulate these to suit a particular situation. On the other hand, opportunities and threats are beyond our control. They are external to us and pertain to the environment existing us. An organization should try to exploit the opportunities

and avoid threats. A successful organization is one, which may carry its Strength & Weakness with opportunity threat SWOT is basically a common sense approach to management that can be applied to any situation with a little bit of imagination.

Now let's see the SWOT Analysis of Bank of Kathmandu.

S = Strengths.

W = Weakness.

O = Opportunities.

T = Threats.

Strengths

- xiii.** Quality Services: Bank tries to render quality services to its customers. And up to some extent it becomes more flexible.
- xiv.** Place Utility: The branches of the banks are in every main business areas and also in some remote areas.
- xv.** Forward looking and innovative attitude from all the staff and management.
- xvi.** Trained & Skilled Manpower.

Weakness

-) Cut throat Competition.
-) Hesitation in Decision Making
-) Inflation of Business.
-) Less degree of Employee Controlling Habit.

Opportunities

-) A slow but steady growth of upper middle level people, who are more oriented towards Banking.

) A steady growth of industrial activity, which will increase the transactions.

Threats

) Growing competition is one of the Major threats to Bank of Kathmandu.

) Un-fair competition among banks.

) Deteriorating political and economical condition of the country.

It is highly recommended that the Management of Bank of Kathmandu also needs to do a SWOT Analysis taking all the variables into account to get a clear picture and to help it draw a future course of actions.

4.3 Calculation of Income generated from Off Balance Sheet Items:

4.3.1 Calculation of Contribution from Off-Balance-Sheet activities on Net Income.

Table: 4.1

Contribution from off-Balance Sheet activities

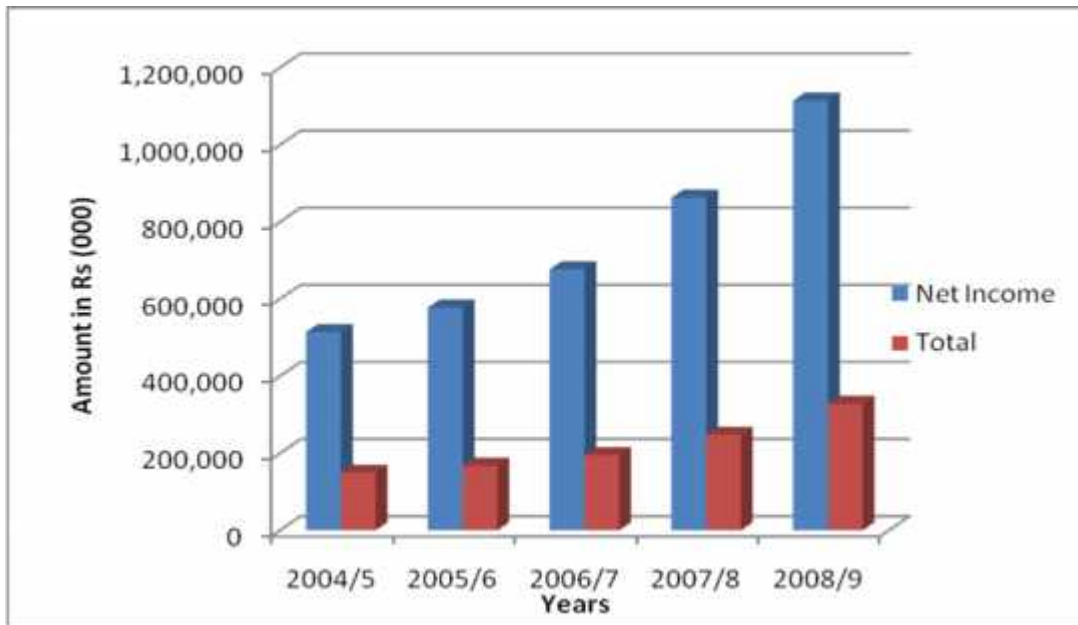
(Rs 000)

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Net Income	514,447	577,755	677,083	862,963	1,114,820
Income from off –Balance sheet Activities					
Commission and discount	72351	70776	97431	129416	150919
Exchange Gain	72114	78955	80826	93765	136036
Other Income	4476	16957	19003	23168	43222
Non operating Income	49	1090	-2780	811	-2027
Total	148,990	167,778	194,480	247,160	328,150
Contribution Percentage (%)	28.96	29.04	28.72	28.64	29.44

(Source: Appendix 3)

Figure: 4.1

Contribution of Net Income from off-Balance Sheet Items



From the above table 4.1 and figure 4.1, it shows that in Fiscal year 2004/05 the contribution on Net income from off balance sheet activities is 28.96%. In F/Y 2005/06, contribution on Net income from off balance sheet activities is increased by 0.08% to 29.04%. Again, in F/Y 2006/07 contribution on net income from Off Balance sheet items decreased by .32% to 28.72 %. And in F/Y 2007/08 contribution on net income from Off Balance sheet items decreased by .08% to 28.64%. Again, in F/Y 2008/09 contribution on net income from Off Balance sheet items negligibly increased to 29.44%.

4.3.2 Trend Analysis of Income from Off-Balance-Sheet Activities

Table: 4.2

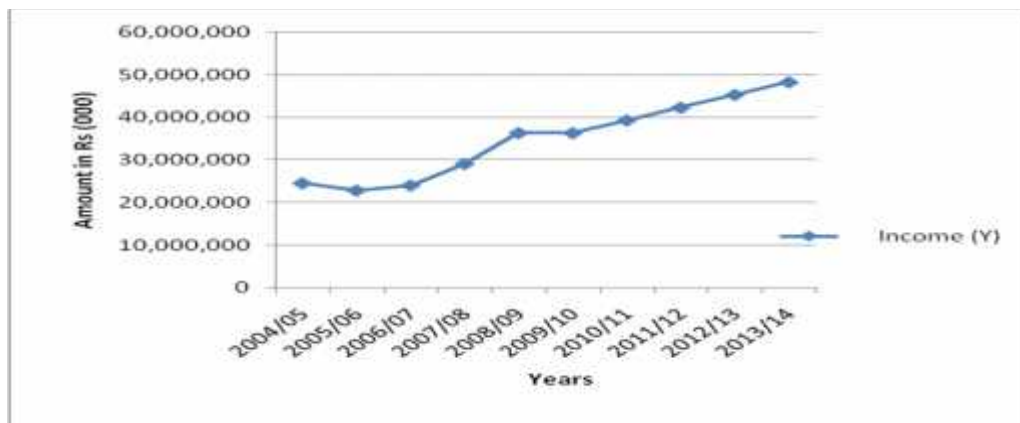
Income from Off-Balance Sheet Activities

Fiscal year	Income (Y)
2004/05	24,551,453
2005/06	22,853,317
2006/07	24,033,414
2007/08	29,098,098
2008/09	36,347,841
Forecasting :	
$Y = 27,376,824.60 + 2,983,755.70 X$	
From Appendix -V	
2009/10	36,328,091.70
2010/11	39,311,847.40
2011/12	42,295,603.10
2012/13	45,279,358.80
2013/14	48,263,114.50

(Source: Appendix-V)

Figure: 4.2

Trend Analysis of Income from OBS



From the above Trend analysis, it shows that the amount of income from Off-Balance- Sheet items is in increasing trend from 2004 till 2008. Based upon the same data, the researcher has made the prediction for the next five years which is also in the increasing trend. This shows that BOK is doing extremely well in terms of off balance sheet items and making it as fruitful as it can be.

These income generated by Off-Balance-Sheet items are very much precious to the bank. But, the Off-Balance-Sheet items also create contingent liabilities, which should be considered very much. So, the rest analysis will focus on Contingent Liabilities and the components of contingent liabilities.

4.3.3. Total Contingent Liabilities Generated By Off-Balance Sheet Items:

Table: 4.3
Contingent Liabilities Generated By Off-Balance Sheet

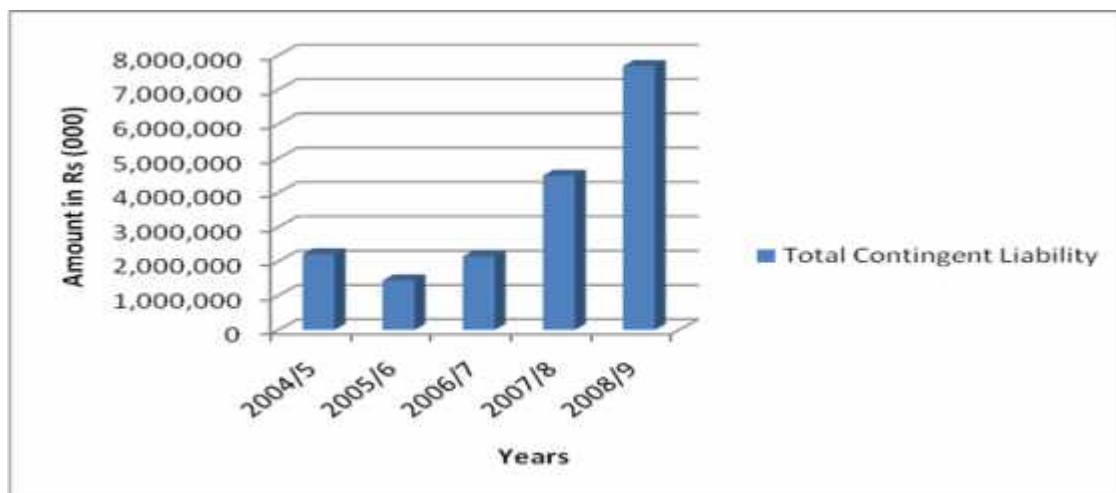
In Rs. 000

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Increment in (%)	0	-34.77	48.95	109.72	70.96

(Source: Appendix 4)

From the above table we can see that total contingent liabilities are in increasing trend except in the years 2005/6.

Figure: 4.3
Total Contingent Liability



From the above calculation we can see that proportion of total contingent liabilities are decreased in the year 2005/6 by 37.55%, then increased by 48.95%, 109.72% and by 70.96 in the year 2006/7, 2007/8, and 2008/9 respectively. Here we can see that amount of transaction through contingent liabilities fluctuating every year.

4.4 Analysis of Contingent Liabilities:

The mentioned ratios are calculated as per above method in the 3rd chapter i.e. Research Methodology.

4.4.1 Letter of Credit to Total Contingent Liability

Table: 4.4

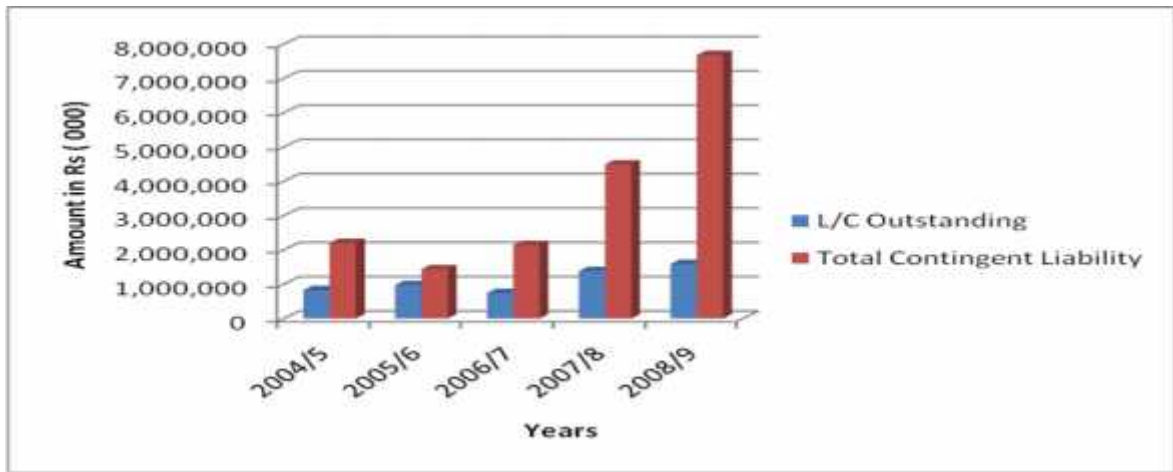
Letter of Credit to Total Contingent Liability

In Rs'000

Years	2004/05	2005/06	2006/07	2007/08	2008/09
L/C Outstanding	828,059	977,003	745,325	1,384,877	1,592,479
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Ratio (In Percentage)	37.55	67.91	34.78	30.82	20.73

(Source: Appendix 4)

Figure : 4.4
Comparison of L/C with Total Contingent Liabilities



From the above calculation we can see that proportion of Letter of Credit on contingent liabilities are 37.55% in year 2004/5, 67.91% in the year 2005/6, 34.78% in year 2006/7, 30.82 % in year 2007/8 and 20.73 % in year 2008/9. Here we can see that amount of transaction through letter of credit fluctuating every year.

4.4.2 Bid Bond Guarantee to Contingent Liabilities

Table: 5.5

Bid Bond Guarantee to Contingent Liabilities

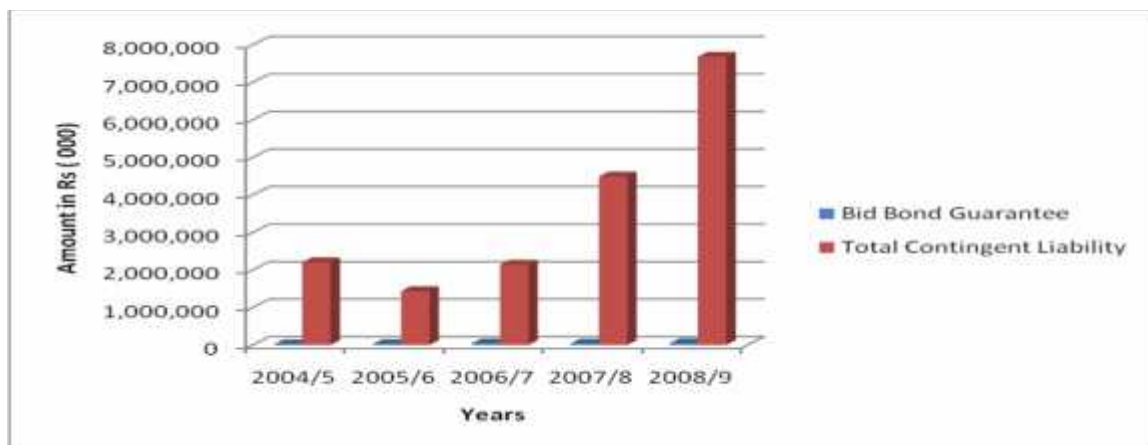
(Rs 000)

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Bid Bond Guarantee	17,910	24,517	43,102	40,528	47,777
Total Contingent Liability	2,205,49	1,438,687	2,142,87	4,494,14	7,683,24
Ratio(In Percentage)	0.81%	1.70%	2.01%	0.90%	0.62%

(Source: Appendix 4)

Figure: 5.5

Comparison of Bid Bond Guarantee with Contingent Liabilities



From the above figure we can compare that the proportion of one of the component of A contingent liability, Bid Bond Guarantee is much less. The proportion in F/Y 2004/5, 2005/6, 2006/7, 2007/8, 2008/9 is 0.81%, 1.70%, 2.01%, 0.90% and 0.62% respectively on contingent liabilities. It means that since the previous years proportion, Business of Bid Bond Guarantee is in decreasing trend. The reason behind the decreasing trend is that “A” class Construction Company is not associated with the Bank.

4.4.3 Performance Bond Guarantee to Contingent Liabilities

Table: 4.6

Performance Bond Guarantee to Contingent Liabilities

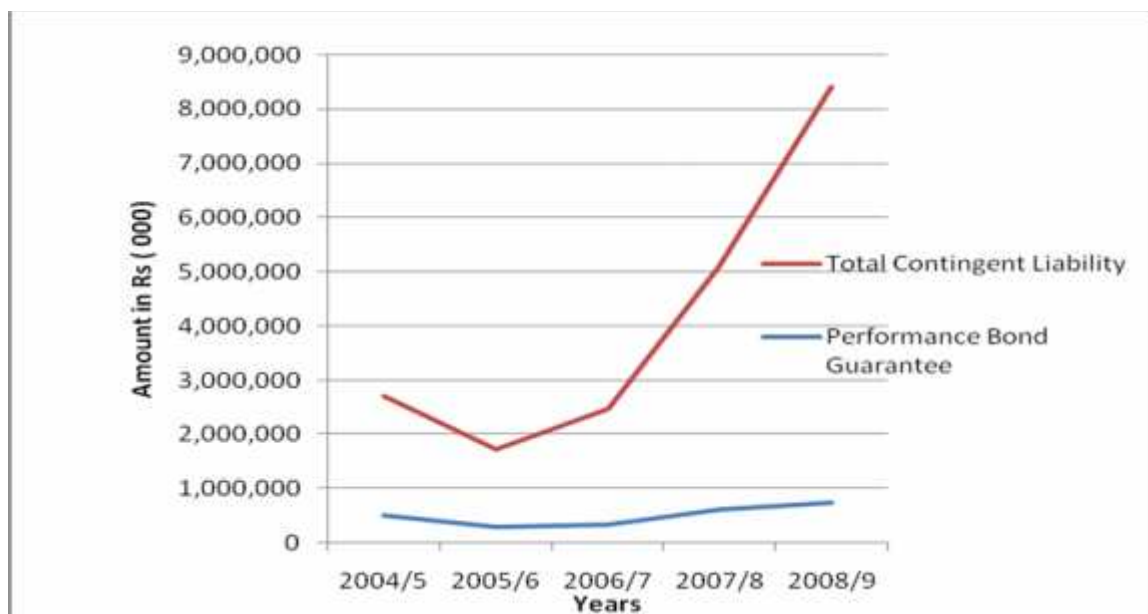
(Rs 000)

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Performance Bond Guarantee	498,439	288,235	330,252	607,688	736,883
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Ratio(In Percentage)	22.60%	20.03%	15.41%	13.52%	9.59%

(Source: Appendix 4)

Figure: 4.6

Comparison of Performance Bond Guarantee with Contingent Liability



From the above figure it we can compare that, the proportion of one of the component of contingent liabilities, Performance Bond Guarantee is much less and fluctuating. But it is in decreasing trend. In F/Y 2004/05 the ratio is 22.60%, in F/Y 2005/06 it is slightly decreased to 20.03%, it again decreased to 15.41%, 13.52% and 9.59% in F/Y 2006/7, 2007/08, and 2008/9 respectively in contingent liabilities.

Every F/Y the proportion and Business of Performance Bond Guarantee is in increasing and decreasing trend it means it is fluctuating though the increasing proportion is higher than decreasing proportion. The reason behind the increasing and decreasing trend is due to the percentage change in association of “A” class construction company with the Bank.

4.4.4 Counter Guarantee of Internationally Rated Banks to contingent Liabilities

Table: 4.7

Counter Guarantee of Internationally Rated Banks to contingent Liabilities

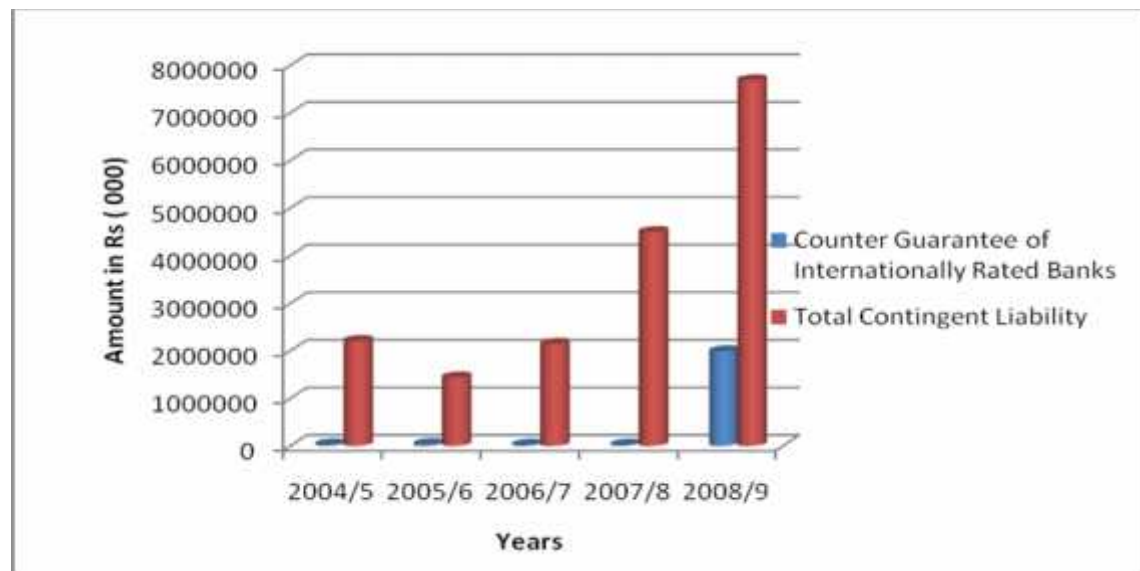
(Rs 000)

Years	2004/05	2005/06	2006/07	2007/08	2008/09
Counter Guarantee of Internationally Rated Banks	33115	39682	23061	26352	1989579
Total Contingent Liability	2205495	1438687	2142879	4494142	7683246
Ratio(In Percentage)	1.50%	2.76%	1.08%	0.59%	25.90%

(Source: Appendix 4)

Figure: 4.7

Counter Guarantee of Internationally Rated Banks to contingent Liabilities



The amount of the counter guarantee of internationally rated bank is in few portions of Contingent Liabilities. In the year 2004/05 the portion is 1.50%, in F/Y 2005/06 it increases to 2.76%, in F/Y 2006/07 it decreases to 1.08% ,2007/08 it decreases to .59% and in F/Y 2008/09 it increases to 25.90% portions on the contingent liabilities. It means that the bank has tried its best to minimize the risk in contingent liabilities for counter guarantee with internationally rated banks.

4.4.5 Advance Payment Guarantee to Contingent Liabilities

Table: 4.8

Advance Payment Guarantee to Contingent Liabilities

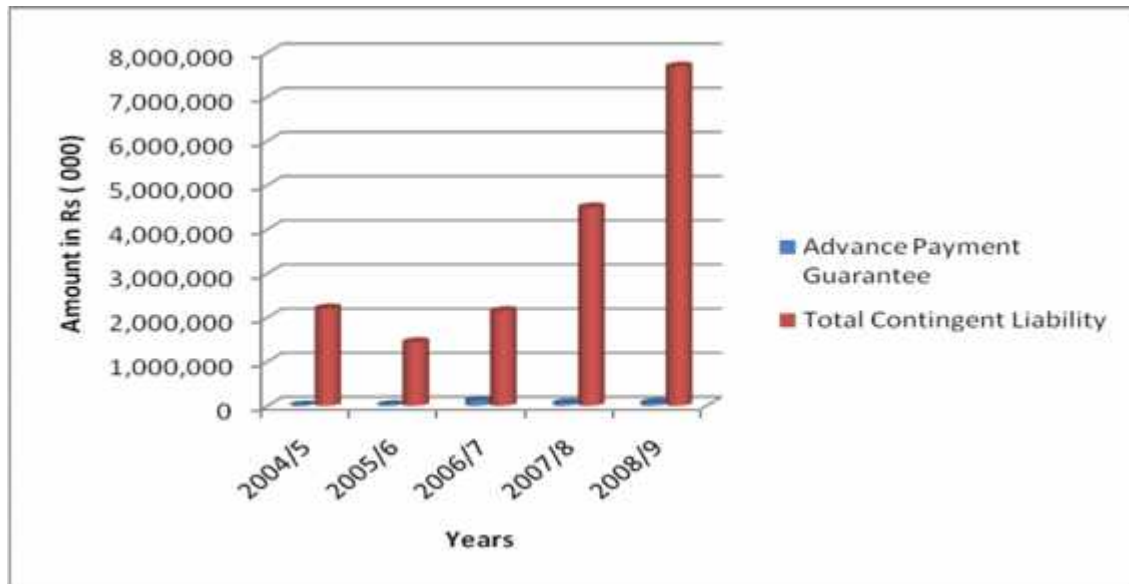
(Rs 000)

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Advance Payment Guarantee	4,213	17,120	115,940	54,968	62,990
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Ratio(In Percentage)	0.19%	1.19%	5.41%	1.22%	0.82%

(Source: Appendix 4)

Figure: 4.8

Comparison of Advance payment Guarantee with Contingent liabilities



From the above figure we can compare that the proportion of one of the component of contingent liabilities, Advance Payment Guarantee is much less. Having 0.19% in F/Y 2004/05, and then increased to 1.19% in F/Y 2005/06, highly increased to 5.41%, in F/Y 2006/07 then highly decreases to 1.22% in F/Y 2007/08, again it decreased to 0.82% in F/Y 2008/09 with comparison to

contingent liabilities. It means that Bank is trying as harder as it can to minimize its risk caused due to the contingent liabilities.

4.4.6 Forward Exchange Contract to Total Contingent liabilities

Table: 4.9

Forward Exchange Contract to Total Contingent liabilities

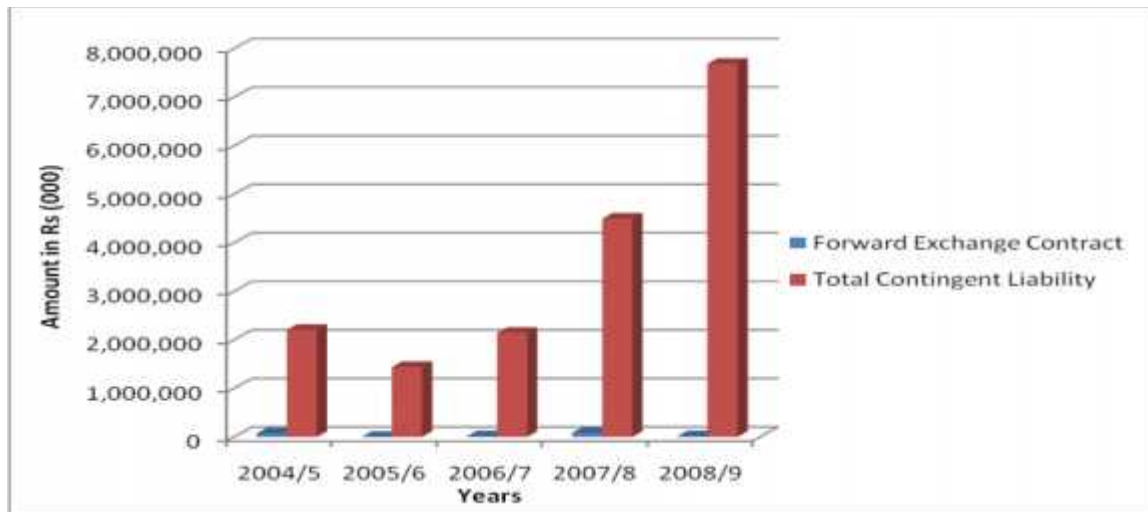
(Rs 000)

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Forward Exchange Contract	70,987	0	14,136	86,461	12,754
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Ratio(In Percentage)	3.22%	0.00%	0.66%	1.92%	0.17%

(Source: Appendix 4)

Figure: 4.9

Forward Exchange Contract to Total Contingent liabilities



The amount of Forward Exchange contract on the contingent liabilities in F/Y 2004/05 is 5.60% and 2005/06 it is decreases 3.24%. In F/Y 2006/07 amount of Forward Exchange contract on the contingent Liabilities is unavailable. In F/Y

2007/08 there is 1.70% amount of Forward Exchange Contract on contingent liabilities. In F/Y 2008/08 the rate decreased to 0.17% of contingent liabilities. So, Forward Exchange Contract, one of the components of the contingent liabilities has been fluctuating.

4.4.7 Bills Under Collection to Contingent Liabilities

Table: 4.10

Bills Under Collection to Contingent Liabilities

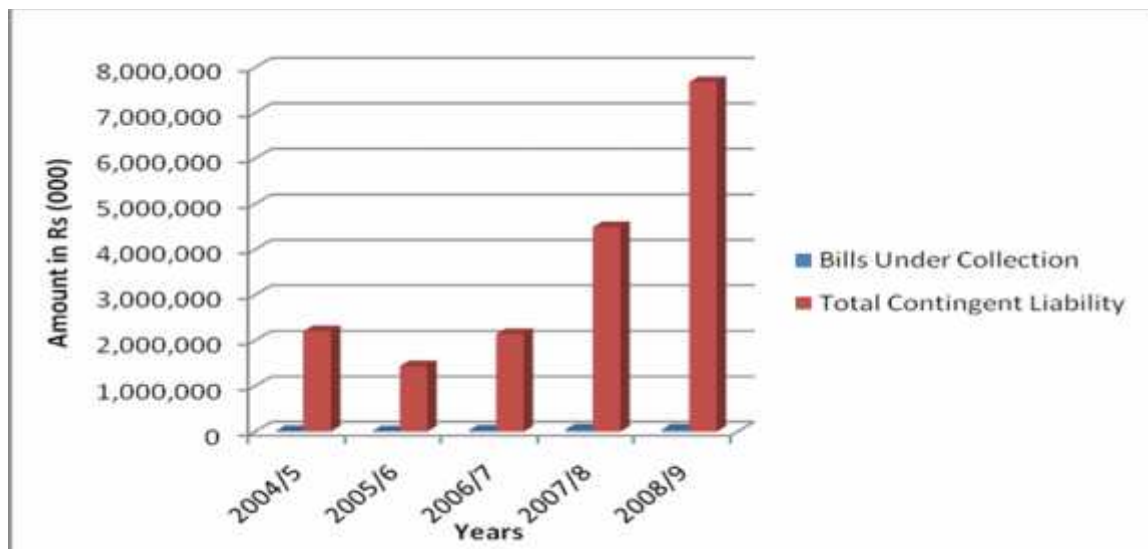
(Rs 000)

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Bills Under Collection	11,853	7,866	25,569	43,511	45,450
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Ratio(In Percentage)	0.54%	0.55%	1.19%	0.97%	0.59%

(Source: Appendix 4)

Figure: 4.10

Bills Under Collection to Contingent Liabilities



The amount of Bills under Collection on the contingent liabilities in F/Y 2004/05 is 0.54%. This component is in increasing trend. In F/Y 2005/06 it is 0.55% of the

contingent liabilities. On further F/Y 2006/07, F/Y 2007/08 and F/Y 2008/09 amount of bills under collection on the contingent liabilities is negligibly increased to 1.19%, and decreases to 0.97% and 0.59% respectively.

4.4.8 Acceptances and Endorsement to contingent liabilities.

Table: 4.11

Acceptances and Endorsement to contingent liabilities

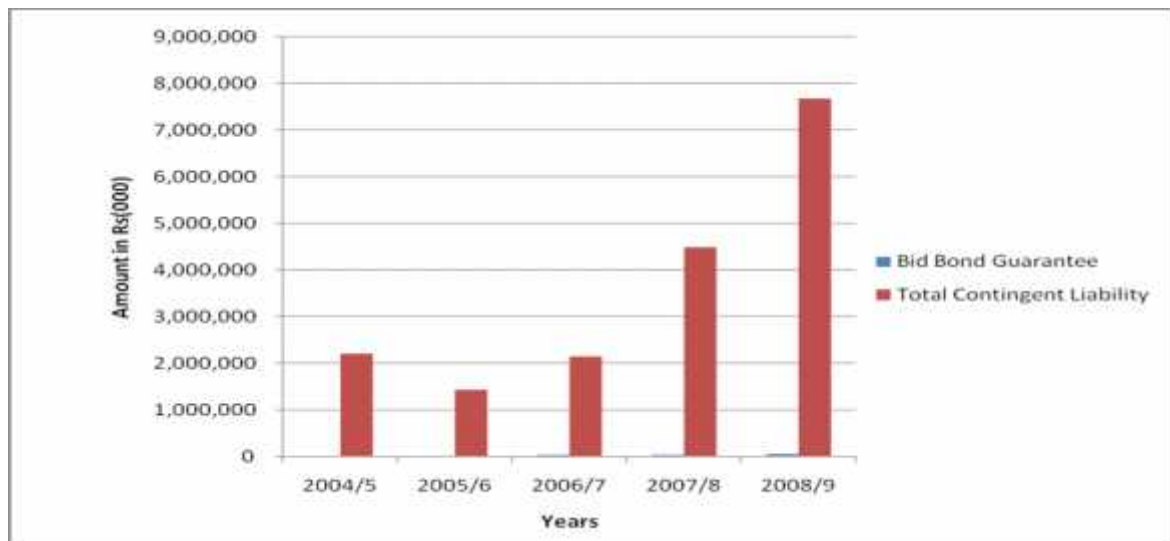
In Rs'000

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Acceptances and Endorsement	296,993	33,446	65,785	432,624	332,290
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Ratio(In Percentage)	13.47%	2.32%	3.07%	9.63%	4.32%

(See:Appendix 4)

Figure: 4.10

Comparison of Acceptances and Endorsement to contingent liabilities



Amount of Acceptance and Endorsement is 11.47% in the F/Y 2004/05. In F/Y 2005/06 it increases to 2.32%. In F/Y 2006/07 amount of Acceptance and

Endorsement increased to 3.07% to contingent liabilities. Again in F/Y 2007/08 it slightly increases to 9.63%. But in F/Y 2008/09 amount of Acceptance and Endorsement highly decreased to 4.32% to contingent liabilities. In F/Y 2004/05 and F/Y 2007/08 percentage of acceptance and endorsement to contingent liabilities was high but in F/Y 2008/09 it was highly decreased. And it is also in less percentage so it is not much riskier.

4.4.9 Total Guarantee to Total Contingent Liability

Table: 4.12

Total Guarantee to Total Contingent Liability

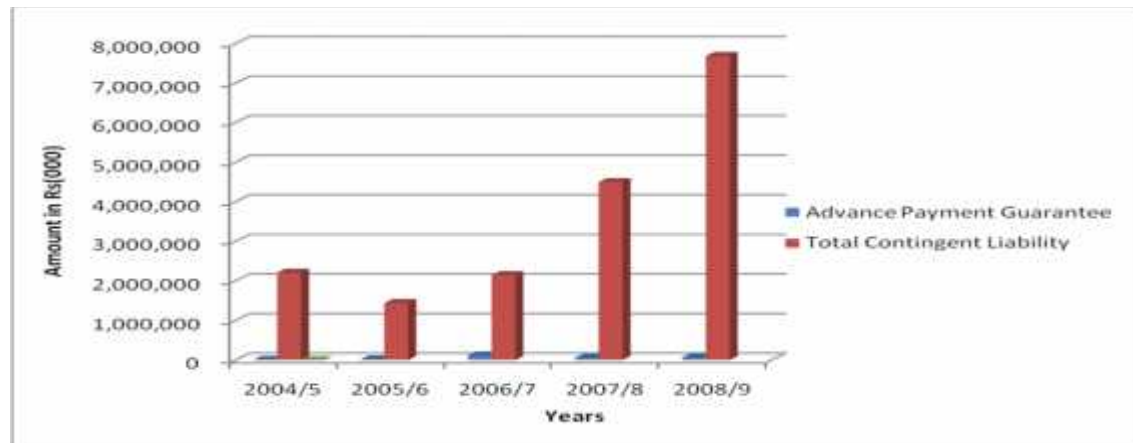
(Rs 000)

Years	2004/5	2005/6	2006/7	2007/8	2008/9
Total Guarantee	516,350	312,752	373,354	648,217	784,660
Total Contingent Liability	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246
Ratio(In Percentage)	23.41%	21.74%	17.42%	14.42%	10.21%

(Source: Appendix 4)

Figure: 4.12

Comparison of Total Guarantees with Total Contingent liabilities



The amount of total Guarantee is much more sensitive in contingent liabilities. It is one of the major components of contingent liabilities. There is not much

fluctuation in the guarantee amount with respect to total contingent liabilities. In F/Y 2004/05 percentage on contingent liability is 23.41%. In year 2005/06, amount of guarantee in contingent liabilities is decreased to 21.74%.

In F/Y 2006/07, it is negligibly decreased to 17.42% on contingent liabilities. After this, in F/Y 2007/08 the amount decreased to 14.42% in contingent liabilities. And in F/Y 2008/09 it slightly decreased to 10.21% on contingent liabilities. In overall view, one of the major portions of contingent liabilities is Letters of Guarantee.

Two Components of contingent liabilities Letter of Credit and Letter of guarantee are regarded as major components of contingent liabilities. So, they are analyzed in more detail.

4.4.10 Trend Analysis of Letter of Credit

Table: 4.13

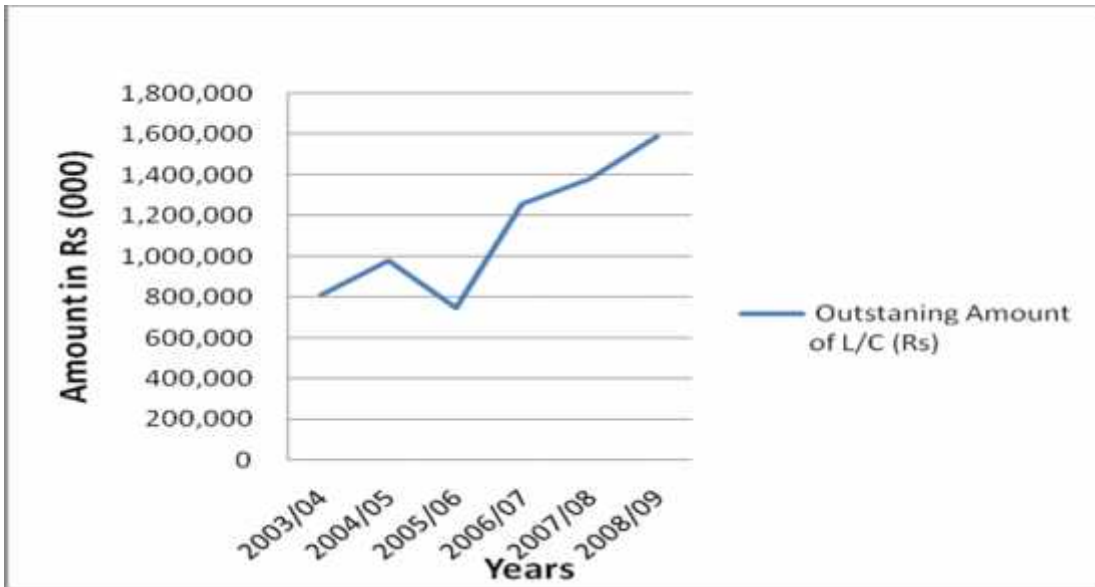
Trend Analysis of Letter of Credit

(Rs '000)

Year	Outstanding Amount of L/C (Rs)	Percentage Change(in %)
2003/04	808,659	0
2004/05	977,004	20.82
2005/06	745,326	-23.71
2006/07	1,257,033	68.66
2007/08	1,384,877	10.17
2008/09	1,592,479	14.99

(Source: Appendix 4)

Figure: 4.13
Trend of Letter of Credit



Outstanding Amount of L/C From the above data, it reveals that outstanding amount of L/C of Bank Of Katmandu Ltd. in the F/Y 2003/04 is Rs. 808,659. In the F/Y 2004/05, L/C has increased by 20.82% compared to previous year. In the F/Y 2005/06, L/C has decreased by 23.71%. In the F/Y 2006/07, L/C has increased by 68.66%. In the F/Y 2007/08, and 2008/09 L/C has again increased by 10.17% and by 14.99%.

So, the Bank has well performance in L/C transactions, although decrease in the year 2005/06, which is understandable considering overall decrease in business activities due to current economic conditions in the country.

4.4.11 Trend Analysis of Issued Guarantee

Table: 4.14

Trend Analysis of Issued Guarantee

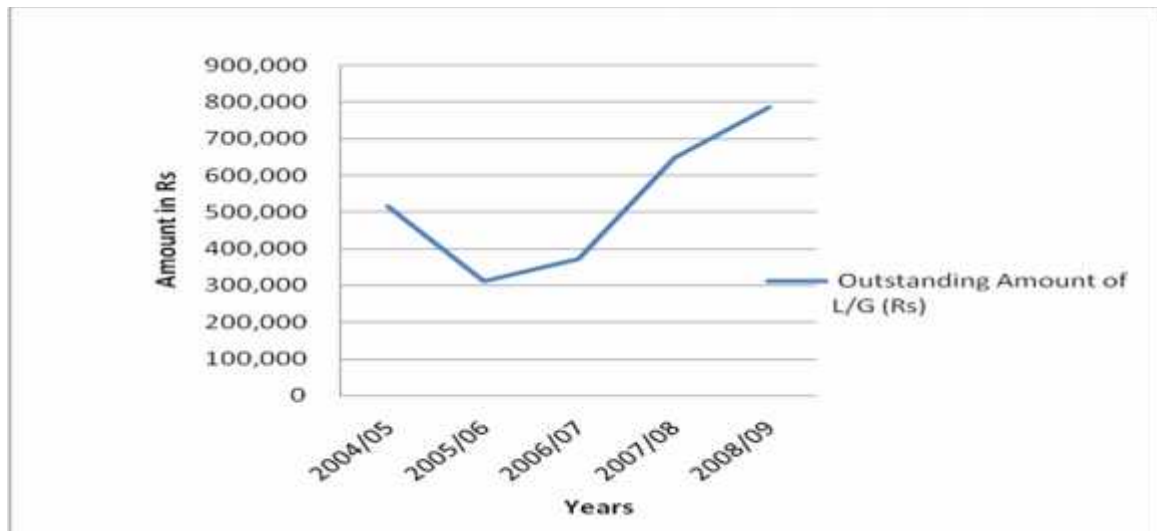
(Rs '000)

Year	Outstanding Amount of L/G (Rs)	Percentage Change(in %)
2004/05	516,350	0.00
2005/06	312,752	-39.43
2006/07	373,354	19.38
2007/08	648,217	73.62
2008/09	784,660	21.05

(Source: Appendix 4)

Figure: 4.14

Trend of outstanding Guarantee



In the F/Y 2004/05, amount of L/G of Bank of Kathmandu is. 516,350. In the F/Y 2005/06, L/G has decreased by 39.43%. In the F/Y 2006/07, L/G has increased by 19.38% , in the F/Y 2007/08 L/G has highly increased by 73.62%. In the F/Y 2008/09, L/G has again increased by 21.05%.

It reveals that the total outstanding L/G of Bank of Kathmandu, starting from F/Y year 2001/02 to F/Y 2005/06, there is much fluctuation in transactions, which results in fluctuation of contingent liability also

4.4.12 Combined Trend Analysis of L/C and L/G

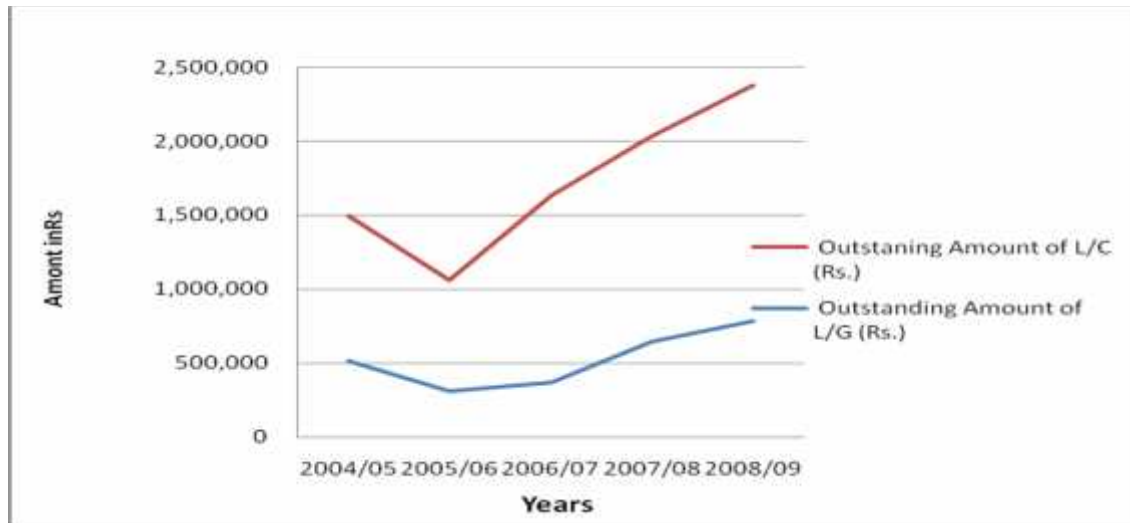
Table: 4.15
Combined Trend Analysis of L/C and L/G

(Rs '000)

Year	Outstanding Amount of L/G (Rs.)	Outstanding Amount of L/C (Rs.)
2004/05	516,350	977,004
2005/06	312,752	745,326
2006/07	373,354	1,257,033
2007/08	648,217	1,384,877
2008/09	784,660	1,592,479

(Source: Appendix 4)

Figure: 4.15
Comparison Letter of Credit and Letter of Guarantee



From above table and graph we can observe that Letter of Credit is decreasing in first few years and rapidly increasing onwards. In the year 2005/036 L/C has decreased and then increased in the year 2006/07. Similarly in the year 2007/08, it has increased and in the FY 2008/09, it has increased again. Letter of Guarantee however is in decreasing trend from year 2004/05 to 2005/06 and afterwards it is in increasing trend.

From year 2004/05 to 2005/06 amount of Guarantee and Letter of credit has declined but after this both are in increasing cycle. Due to these high levels of fluctuation of components of contingent liabilities, there is not much consistency in the contingent liabilities of the bank.

4.5 Statistical Measurements

The major components of contingent liabilities (Letter of Credit and Guarantee) are again tested that whether they are Co-related to each other or not.

4.5.1 Test of Co-relation between Letter of Credit and Guarantee

Table: 4.16

Co-relation between Letter of Credit and Guarantee

(Rs '000)

Year	Outstanding Amount of L/G (Rs.)	Outstanding Amount of L/C (Rs.)
2004/05	516,350	977,004
2005/06	312,752	745,326
2006/07	373,354	1,257,033
2007/08	648,217	1,384,877
2008/09	784,660	1,592,479

(Source: Appendix 4)

The result obtained from the Co-relation between Letter of Credit and Guarantee from the above-mentioned method is = 0.256135787

It interprets that there is negative relation between Letter of Credit and Guarantee. But the relation is in very low degree, which is negligible so, we can say that there is no relationship between Letter of Credit and Letter of Guarantee. But, both rise when overall business of the bank rise.

Till now as we have seen, there is not much consistency in contingent liabilities of the Bank of Kathmandu Ltd. So to further test here are some major Statistical tests.

4.5.2 Arithmetic (Mean) Average Measurement and Standard deviation of Total Contingent Liabilities

Table: 4.17

Mean, Standard Deviation and Coefficient of Variation

Mean	Rs. 3,592,890
Standard Deviation	724.03
Coefficient of variation	0.0000986

(Source: Appendix -7 & 8)

We observe that the arithmetical average of the total contingent liabilities for the 5 years is Rs. 3,592,890.

The calculated standard deviation is 724.03. The standard deviation discussed is an absolute measure of dispersion. But only the absolute measure is not sufficient to represent the variation. So, there is a relative measurement of the standard deviation, i.e. Coefficient of Variation.

The calculated coefficient of variation of Off-Balance Items is 0.0000986. As we know that lesser the coefficient of variation, less risky is the item. Since the coefficient of variation of the overall off balance sheet items of BOK is negligible, Bank of Katmandu is doing very well in managing its contingent liabilities and is at a very safe position while earning a good profit margin from its off balance sheet items.

4.6 Major Findings of the Study

On the basis of the analysis of data, the following major findings have been found.

-) Bank has offered various types of Off-Balance-Sheet services, which are very much important to customers and bank as well. The contribution on total earnings from Off- Balance-Sheet items is around 29.44% (FY 2008/09) of net earnings. It shows that there is no consistency in the position of off balance sheet items.

-) The earnings from the Off-Balance-Sheet services are also worthy to the bank because, the earnings comes in short duration, and most of the earnings comes from less risk.

-) From trend analysis of income from Off-Balance Sheet items is in increasing trend from 2004/5 to 2008/9. Based on the same data, the prediction for the next five years was made which shows that income from Off- Balance Sheet is in increasing trend. This shows that BOK is doing extremely well in Off-Balance Sheet items.

-) When serving Off-Balance-Sheet activities the contingent liabilities will be automatically created. The bank has to take much more consideration in the contingent liabilities. If any event will occur then the contingent liabilities

become the true liabilities to the bank. There are some past stories of being bankruptcy of foreign banks due to contingent liabilities.

-) When comparing the overall components of the contingent liabilities, it is found that there are two major portions (in terms of amount) of the contingent liabilities. They are “Letter of Credit” and “Letter of Guarantee” issued by bank. But, other components of contingent liabilities are found as not much fluctuating, not in huge amount and not much riskier.
-) During financial analysis and statistical measurement it is found that contingent liabilities of Bank Of Kathmandu Ltd. are fluctuating.
-) By comparing the bonds (bid bond and performance bond), it is found that the issuance of such bonds are also fluctuating which might result in higher risk and increases the risk of contingent liabilities. Hence, BOK should be more careful in issuing such bonds and try to minimize the risk.
-) Another component of contingent liability is the counter guarantee with other banks. BOK has tried to minimize the risk by minimizing the amount of counter guarantee with other internationally rated banks to a minimum of 2.25 on an average over the last five years.
-) BOK has also tried to keep the advance payment guarantee to a minimum level in order to minimize the risk. The advance payments guarantee sums up to a mere 1% on an average since the last five years.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

In this chapter, summary of this thesis study is presented. The present is a conclusion-oriented study of Off Balance Sheet of BOK, so conclusion and recommendations for future improvements are also offered.

5.1 Summary

While studying and preparing this report, the writer realized that Off-Balance-Sheet items are very much important activities of banks. It is one of the quick and major earning (around 29%) activities of the bank.

Off-Balance-Sheet items or Off-Balance-Sheet services are also very much important to the bank. It helps to attract their customers, and retain them. Off-Balance-Sheet items include income-generating activities within short period of time. Among the Off-Balance-Sheet items “Letter of Credit” and “Letter of Guarantee” (Guarantee) is very much beneficial to all the trading and construction business related customers. “Letter of Credit” is beneficial for overseas trade. The Bank acts as a middleman, which remarks the element of risk from the parties, the applicant and the beneficiary. It is a facility in which the Bank is responsible for the Payment once the goods have been dispatched. On the other hand, the beneficiary also gets the money on presenting the documents, stating that the goods have been shipped “Letter of Credit” reduces the risk of uncertainty of payment and receipt of goods, which makes it convenient for both the parties. It is a very useful facility provided by the Bank through which transactions are made possible within the countries.

On other hand Bank Guarantee (“Letter of Guarantee”) is very much useful to construction companies and other traders. In overall findings, till now the bank’s

contingent liabilities are in good condition. Bank should try to reform any block holes in its policy. And the Off-Balance-Sheet items also need to be done but very cautiously. Because, in one hand it generates revenue in quick time on the other hand it might convert its contingent liabilities to its real liabilities.

Finally, Mission and vision are two important anchors of organization in all this bewildering complexity because they give to the organization a focus and sense of direction. So the core organization values may, indeed, be the basic sheet anchor because mission as well as vision of excellence either comes from these values or must be reasonably consistent with them. The core values of the organization therefore assume great importance. If the core values are right, a good deal of dynamic behavior becomes feasible in organizations, not only at the top of the organizations but also at middle & lower Echelons. Now the question is what core values are right for the organization like Bank of Kathmandu? Different organizations may have different core values depending on their purposes and operation contexts. The study is organized in five chapters, viz, i) Introduction, ii) Review of Literature, iii) Research Methodology, iv) Data Presentation and Analysis and v) Summary Conclusion and Recommendations

5.2 Conclusions

Off Balance sheet items play a vital role in reflecting a true position of all institution. The fall of biggest giants like Enron and WorldCom can be conducted directly to show the worst possible circumstance due to off-balance sheet accounting. At the time of ownfall of Enron it was the 29th biggest organization in the world in terms of market capitalization. The trade in energy derivatives, funding in subsidiaries and leveraging the market position and lack of corporate governance led the company's downfall. Thus, the prime motive of this study is to analyze the position of Bank of Kathmandu with respect to off-balance sheet

accounting. The second rationale would be to draw a conclusion to recommend areas of improvement being based on the exposure of Bank of Kathmandu. Similarly, our final attempt would be to reflect the backdrop of our accounting standards (NAS) with respect to the position of Bank of Kathmandu. This study and its relevance are completely based on the principles of one of the greatest Accounting critic in the world Abraham Briloff. Briloff's three books Unaccountable Accounting, More Debits than Credits and the Truth about corporate accounting can be considered basis of this study.

Banking sector has always been the back bone of Nepal's Economy. They have been providing undivided service to all kind of customers. There are so many commercial banks in such a small country and as a result, the competition is getting tougher every day. Now with the open window policy and Nepal entering WTO, the competition will get even tougher with the arrival of internationally renowned and bigger banks. Hence BOK will have to focus on providing better service in short period. As we can see that BOK is doing great in terms of managing their off balance sheet items and making quick earning from them, they should focus more on these items keeping in mind the contingent liabilities.

5.3 Recommendations

Based on major findings and conclusion drawn, the major are provided below hoping that these recommendations will certainly be proved milestone to overcome existing issues in this field.

-) The study has revealed that the performance of BOK in Off-Balance Sheet activities is good. But the fact that the increasing in Letter of Credit in highly fluctuating trend cannot be overlooked. So the bank recommended

to identifying the reason behind their fluctuating pattern and working for ensuring that follow a smooth and regular increment.

-) The BOK has high amount of Claims on Bank but not accepted by Bank cannot easily meet the clients as per their demand. But the high amount of such balance could not be beneficial for the bank. So the bank should keep in the minimum level and/or zero level as far as possible.
-) The guarantee and bond trend is in increasing trend but not in same, sometime it is in decreasing trend so the bank should maintain the increasing trend. The bank should rapidly grow in guarantee and bond amount.
-) The amount of letter of credit target is always less than actual achievement rather than one fiscal year which seems that the organization cannot make effective target. So, the bank should do more exercise for effective and real target.
-) The target of guarantee amount is always less than actual achievement during the study period. The bank should make well target for guarantee. Effective target made effective implementation.
-) The correlation coefficient between letter of credit and contingent liabilities is positive, which is green signal for the organization. The bank should try to increase the relationship for better improvement.
-) The increasing trends of letter of credit are in strongly positive forwarded. That is better for profitability of the organization.
-) To achieve all the objectives of BOK the efficient Off –Balance sheet activities management is essential. The management of Off-Balance Sheet activities in BOK is not only necessary but also compulsory, for better performance of the organization. If BOK initiates steps to the appropriate management, certainly it will attain its set objectives successfully.

The economic liberalization policy adopted by Nepal Government has created an environment of strict competition even in the banking sectors. In this context, BOK is suggested to formulate and implement some sound and effective financial and non-financial strategies to meet required level of profitability as well as the social responsibility.

It is found that the modern banking technologies followed by commercial banks in Nepal are mostly beneficial to the high level depositors; BOK is suggested to make these technologies accessible to their all kinds of customers as far as possible.

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APPENDICES

Appendix – I BANK OF KATHMANDU LTD HIGHLIGHT OF 5-YEARS FINANCIAL POSITION BALANCE SHEET

Amt in Rs'000

Particulars	2004/05	2005/06	2006/07	2007/08	2008/09
<u>Assets</u>					
Cash Balances	161,469	184,019	219,043	536,747	565,066
Balance With Nepal Rastra Bank	249,563	349,296	883,496	606,049	1,324,108
Balance With Banks Financial Institutions	579,050	195,382	213,366	297,671	292,938
Money at Call and Short Notice	328,873	594,047	259,279	72,680	243,352
Investment	2,598,253	3,374,711	2,992,434	3,204,068	2,783,599
Loans, advances and Bills Purchase	5,912,579	7,259,083	9,399,328	12,462,638	14,647,297
Fixed Assets	95,230	110,745	320,846	387,274	417,041
Non Banking Assets	24,087	7,356	3,626	453	-
Others Assets	188,987	203,689	289,979	154,346	222,606
Total Assets	10,138,091	12,278,328	14,581,397	17,721,926	20,496,007
<u>Capital & Liabilities</u>					
Share Capital	463,580	463,580	603,141	603,141	844,398
Reserves and Surplus	296,448	376,152	390,134	738,932	897,193
Debenture and Bonds	200,000	200,000	200,000	200,000	200,000
Borrowings	6,000	553,180	730,000	100,000	100,000
Deposit	8,975,780	10,485,359	12,388,928	15,833,739	18,083,981
Bills Payable	4,370	11,622	25,777	51,576	51,125
Proposed and Dividend Payables	107,250	98,712	135,576	32,805	77,333
Income tax liabilities	-	-	-	-	-
Others liabilities	84,663	89,723	107,841	161,733	241,977
Total Capital + Liabilities	10,138,091	12,278,328	14,581,397	17,721,926	20,496,007

Appendix- III

BANK OF KATMANDU LIMITED

HIGHLIGHT OF 5-YEARS CONTINGENT LIABILITIES

Particulars	2004/05	2005/06	2006/07	2007/08	2007/08
1. Claims on Bank but not accepted by Bank	34,932	34,896	21,677	25,887	76,063
2. Letter of Credit(full amount)	977,004	745,326	1,257,033	1,384,877	1,592,479
a) Below 6 months	926,501	706,452	1,230,485	1,339,896	1,476,777
b)Above 6 months	50,503	38,874	26,547	44,981	115,701
3. Rediscounted Bills	0	0	0	0	0
4. Unmatured Guarantees/Bonds	516,350	312,752	373,354	648,217	784,660
a)Bid Bond	17,910	24,517	43,102	40,528	47,777
b)Performance Bond	498,439	288,235	330,252	607,688	736,883
c)Other Guarntee/Bonds	0	0	0	0	0
5. Unpaid Shares in Invstment	0	0	0	0	2,375
6. Forward Exchange Contract's Outstanding	70,987	0	14,136	86,461	12,754
7. Bills Under Collection	11,853	7,866	25,569	43,511	45,450
8. Acceptances and Endorsements	296,993	33,446	65,785	432,624	332,290
9.Underwriting Commitments	0	0	0		
10. Irrevocable Loan Commitments	0	0	0	1,450,808	2,524,881
11. Guarantee issued against Counter Guarantee of Internationally rated Banks	33,115	39,682	23,061	26,352	1,989,579
12. Advance Payment Guarantees	4,213	17,120	115,940	54,968	62,990
13. Financial Guarantee	254,772	240,039	246,324	340,437	259,725
14. ContingentLiabilities on Income Tax	5,276	7,560	0	0	0
15. Others	0	0	0	0	0
Total Contingent Liabilities	2,205,495	1,438,687	2,142,879	4,494,142	7,683,246

Appendix – IV

Trend of Income from Off-Balance Sheet Activities

Amount in 'Rs

Fiscal year	Year (X)	Income (Y)	XY	x ²
2004/05	-2	24,551,453	(49,102,906)	4
2005/06	-1	22,853,317	(22,853,317)	1
2006/07	0	24,033,414	0	0
2007/08	1	29,098,098	29,098,098	1
2008/09	2	36,347,841	72,695,682	4
Sum	0	136,884,123	29,837,557	10

Here, actual trend equation of the linear trend is $Y = a + bX$

The normal equations are:

$$\begin{aligned}\sum y &= na + b \sum x \\ \sum xy &= a \sum x + b \sum x^2\end{aligned}$$

Now, putting the value of normal equations from the above table

$$136,884,123 = 5a + b \cdot 0$$

$$29,837,557 = a \cdot 0 + 10b$$

Then,

$$a = \frac{136,884,123}{5} = 27,376,824.60$$

$$\text{and } b = \frac{29,837,557}{10} = 2,983,755.70$$

Thus the required trend is

$$Y = 27,376,824.60 + 2,983,755.70X$$

Forecasting the income from OBSs for the upcoming five years.

Amount in Rs

F/Y	Y= a +b X	Estimated Income(Y)
2009/10	$Y= 27,376,824.60 + 2,983,755.70 \times 3$	36,328,091.70
2010/11	$Y= 27,376,824.60 + 2,983,755.70 \times 4$	39,311,847.40
2011/12	$Y= 27,376,824.60 + 2,983,755.70 \times 5$	42,295,603.10
2012/13	$Y= 27,376,824.60 + 2,983,755.70 \times 6$	45,279,358.80
2013/14	$Y= 27,376,824.60 + 2,983,755.70 \times 7$	48,263,114.50

Appendix – V

Targeted and Actual Income from Off-Balance Sheet Activities

Amount in ‘000

Fiscal Year	Income From OBS		$(X_1 - \bar{X}_1)^2$	$(X_2 - \bar{X}_2)^2$
	Target (X_1)	Achievement (X_2)		
2060/61	2436.2572	2578.3569	216179.4324	182443.0268
2061/62	3096.5238	2825.5582	38148.1836	32375.5966
2062/63	2877.0450	3061.3881	583.8602	3124.5529
2063/64	2919.2034	2928.5522	323.8272	5919.4866
2064/65	3177.0120	3633.5966	76067.7361	394517.3985
Sum	14506.0414	15027.4528	331303.0395	618380.0614

Here,

$$\bar{X}_1 = \frac{\sum X_1}{n} = \frac{14506.0414}{5} = 2901.2082$$

$$\bar{X}_2 = \frac{\sum X_2}{n} = \frac{15027.4528}{5} = 3005.4904$$

$$\sum (X_1 - \bar{X}_1)^2 = 331303.0395$$

$$\sum (X_2 - \bar{X}_2)^2 = 618380.0614$$

$$S^2 = \frac{1}{N_1 + N_2 - 2} [\sum (X_1 - \bar{X}_1)^2 + \sum (X_2 - \bar{X}_2)^2]$$

$$= \frac{1}{5+5-2} [331303.0395 + 618380.0614]$$

$$= \frac{1}{8} \times 949683.1009$$

$$= 118710.3876$$

Appendix – VI

Coefficient of Correlation between total income and Letter of Credit

Amount in '000

Fiscal Year	Total Profit (X)	Letter of Credit (Y)	X ²	Y ²	XY
2004/05	2,610.70	977,004	6,815,754.49	6,647,924.304	6,731,316.359
2005/06	2,722.30	745,326	7,410,917.29	7,983,779.142	7,692,017.088
2006/07	2,963.18	1,257,033	8,780,435.712	9,372,101.997	9,071,446.361
2007/08	3,241.64	1,384,877	10,508,229.89	8,576,417,988	9,493,311.954
2008/09	3,255.38	1,592,479	10,597,498.94	13,203,024.25	1,182,873.70
Sum	14,793.20	5,956,719	44,112,836.32	45,783,247.68	44,816,829.46

We Know

$$\text{Coefficient of Correlation (r)} = \frac{n \sum XY - \sum X \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}}$$

$$= \frac{5 \times 44816829.46 - 14793.20 \times 15027.4528}{\sqrt{5 \times 44112836.32 - (14793.20)^2} \sqrt{5 \times 45783247.68 - (15027.4528)^2}}$$

$$= \frac{224084147.30 - 22230114.80}{1313.550 \times 1758.3801} = \frac{1780032.539}{2309721.411} = 0.7707$$

∴ The correlation Coefficient of Total Profit and Letter of Credit

$$(r) = 0.7707$$

Calculation of Probability Error

$$\begin{aligned} \text{P.E.} &= 0.6745 \times \frac{1-r^2}{\sqrt{n}} \\ &= 0.6745 \times \frac{1-(0.7707)^2}{\sqrt{5}} = \frac{0.2739}{2.2361} = 0.1225 \end{aligned}$$

Where,

N = Number of Year

P.E. = Probability Error

Appendix – VII

Average Measurement of Total Contingent Liabilities

(Rs'000)

Year	Total Contingent Liabilities(Rs)
2004/05	2,205,495
2005/06	1,438,687
2006/07	2,142,879
2007/08	4,494,142
2008/09	7,683,246
Total (X)	17,964,449
Mean Average (X)	3,592,890

We Know that,

$$\text{Mean Average (x)} = \frac{\sum x}{n}$$

$$= \frac{17,964,449}{5}$$

$$= 3,592,890.00$$

∴ The Average Measurement (Mean Average) of Total Contingent liabilities (X) = 3,592,890.

Appendix – VIII

Measurement of standard Deviation of Contingent Liabilities

X	Y = (X- x)	Y ²
2,205,495	(1,387,395)	1,92,486,488,600.00
1,438,687	(2,154,203)	464,059,056,500.00
2,142,879	(1,450,011)	210,253,190,000.00
4,494,142	901,252	81,225,516,750.00
7,683,246	4,090,356	1,673,101,221,000.00
Total		Y² = 2,621,125,472,850.00

We Know that,

$$\begin{aligned} \text{Standard deviation } (s) &= \frac{\sum y^2}{n} \\ &= \frac{2,621,125,472,850.00}{5} \\ &= 724.30 \end{aligned}$$

∴ The Standard deviation of contingent liabilities = 724.30.

BANK OF KATHMANDU LTD

HIGHLIGHT OF 5-YEARS FINANCIAL POSITION

Particulars.	Profit & Loss Account					Amt in Rs'000
	2004/05	2005/06	2006/07	2007/08	2008/09	
Income from Interest	607,095	718,121	819,004	1,034,158	1,347,755	
Interest Expenses	241,639	308,155	339,181	417,543	563,133	
Net Interst Income	365,456	409,965	479,823	616,615	784,622	
Commision & Discount	72,351	70,776	97,431	129,416	150,919	
Foreign Exchange income	72,114	78,955	19,003	93,765	136,036	
Other Income	4,467	16,967	80,826	231,168	43,222	
Non-operating Income	49	1,090				
Total Operating Income	514,437	577,753	677,083	862,963	1,114,820	
Staff Expenses	53,822	59,119	69,740	90,602	146,495	
Office overhead expenses	99,190	117,591	138,430	170,481	233,668	
Provision for doubtful debt	133,916	78,381	81,895	38,438	33,745	
Provision for staff Bonus	22,699	30,120	38,341	52,790	66,127	
Non-operating Expenses	518	0	411	810	(2,027)	
Total Expenses	310,145	285,211	328,817	353,121	478,008	
Profit before Tax	204,292	301,207	421,753	527,899	661,269	
Income tax Provision	64,763	98,767	121,025	166,402	199,535	
Net Profit After Tax	139,529	202,440	262,387	361,497	461,735	
Profit & Loss Appropriation A/C						
Profit & Loss carried down	146,021	342,503	270,699	17,991	22,156	
Statutory General Reserve	27,905	40,488	52,477	72,299	92,347	
Exchange Equalization Fund	1,232	2,517	2,013	2,507	6,780	
Capital Adjustment Fund	46,358	46,358	60,314	0	0	
Proposed Dividend	69,537	83,444	120,628	12,698	62,219	
Proposed Capitalization of profit bonus share	0	139,074	0	241,257	337,759	
BOK Bond-2069 Redemption Reserve	0	22,309	28,571	28,571	28,571	

APPENDIX - II