

# A <sup>0</sup>VIEW OF BANK BRANCH AUDIT DOCUMENT & EXECUTION

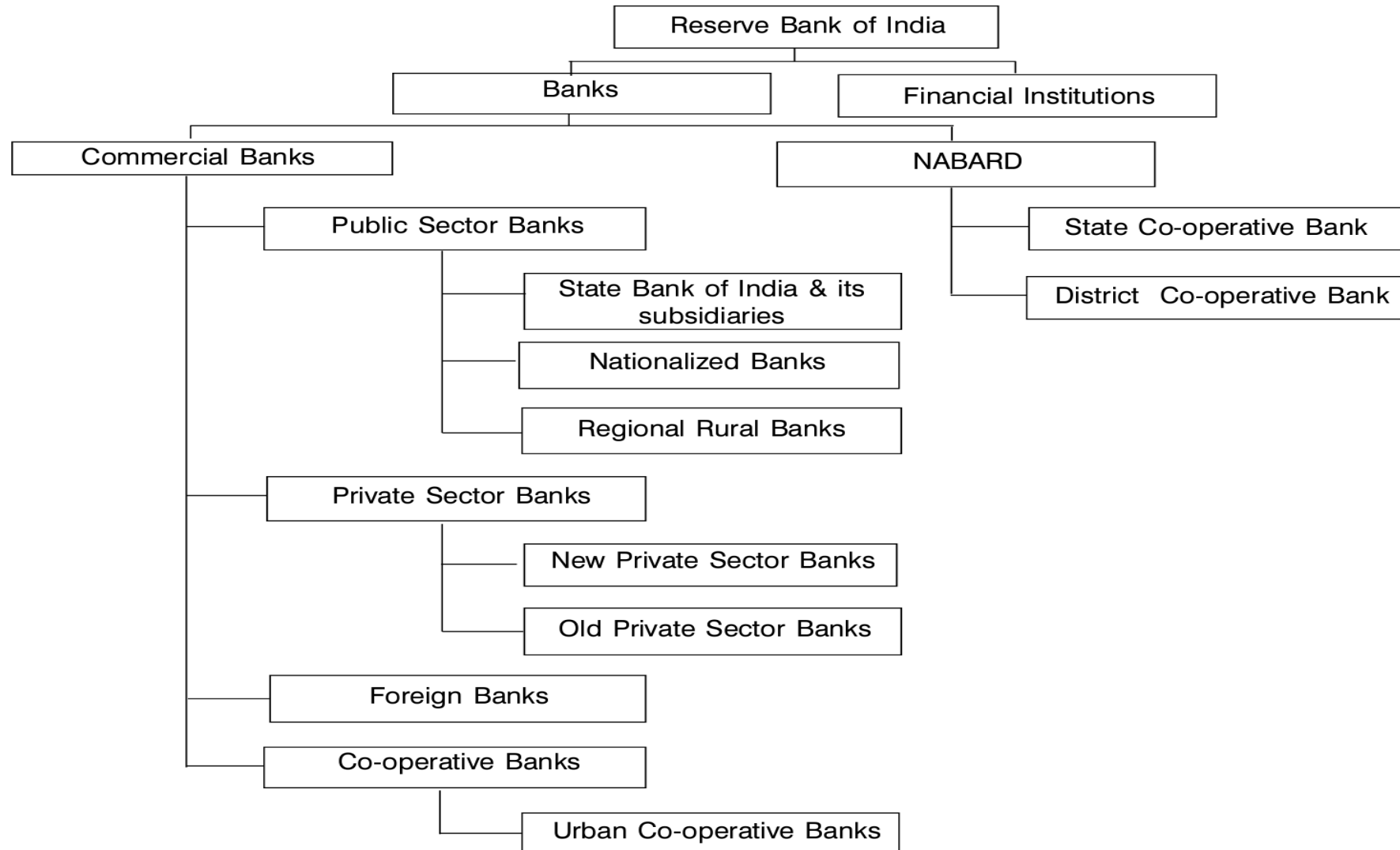
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ICAI, HYDERABAD

# The Banking structure in India-An overview



# The legal framework for Banks

1. The Reserve Bank of India Act, 1934
2. Banking Regulation Act, 1949
3. Banking Companies (Acquisition and Transfer of undertakings) Act of 1970 & 1980
4. State bank Of India Act, 1955
5. State Bank Of India ( Subsidiary banks) Act, 1959
6. Regional Rural banks Act, 1976
7. The Companies Act, 2013
8. Information Technology Act, 2000
9. Credit Information Companies regulations Act, 2005
10. Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act , 2002

# THE ESSENCE OF FINANCIAL INSTITUTIONS

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- methods of ***making payments*** in order to facilitate the exchange of goods and services;
- mechanisms for ***pooling resources*** to fund enterprises;
- ways to ***transfer economic resources*** over time and across distances, as in lending and investing;
- methods of ***managing risk***, such as insuring, diversifying, and hedging;
- ***price information***, such as interest rates and securities prices, to help coordinate decentralized decision making in various sectors of the economy;
- ways to ***handle incentive problems*** that interfere with efficient business transactions. Loan covenants that protect lenders by restricting borrowers' freedom of action are one way to handle incentive problems.

# WHAT IS CHANGING BANKING

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- Competition
  - FinTech
- Technology
  - A cultural shift to optimize customer satisfaction
  - Changing business models
  - Mobile banking has forced banks to reimagine businesses
- Innovation
- Rising Expectations
  - Customer demographics determine products: Speed is the essence of transaction
  - Customer Retention is a challenge
- Increasing regulatory burden

# BUT, IN ESSENCE, WHAT DO ( OR SHOULD) BANKS OFFER

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- Trust
  - Enmeshed with risk taking/safety
- Ease of Transaction
  - User interfaces: relationship building
- Guarantee of continuity
  - Stable
  - Consistent

# THE OVERARCHING PERSPECTIVE OF BANK AUDITS

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- Are Banks Safe ?
- Are Banks Sound ?
- Do the Financial statements truly and fairly reflect the banks financial position?
- Are proper governance practices in place?

# THE THREE CORNERSTONES OF AUDIT :TESTED

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- Independence
  - From the management
- Objectivity
  - Must have sufficient knowledge of the business
  - Generate confidence to challenge decisions and argue judgements
- Professional skepticism
  - Partly by intuition, partly by experience, partly by training, partly by environment



# BANK AUDITS: HOW ARE THEY DIFFERENT

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- Time available to audit
- High expectation for expertise and domain knowledge
- Limited understanding of audit processes by the Branch management
- The raw material and the final product is Money: Audit should be sensitive to this.
- Banks are crucial pillars of the economy and very sensitive to “black swan” events.  
Auditors have to be doubly careful

# WHERE IS OUR QUALITY TESTED?

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- With our personnel
- With the internal system of quality control while conducting the audit
  - SQC I
    - a) The firm has sufficient **competent** personnel
    - b) Personnel are equipped with the **required knowledge** of relevant subject matter and industries
    - c) Have **ability and experience** for gaining experience with related reporting and regulatory requirements
    - d) Accessibility of **subject matter experts**, if required
    - e) **Ability of completing such engagement within the respective deadline**
  - A firm must have policies and procedures in place necessitating appropriate documentation for providing evidence of the operation of every element of the system of quality control.
  - **Both the Audit Plan and the conclusions must stand the test of evidence in accordance with the SQCs**

# THE REGULATORY OVERHANG

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- Para 29.2 IRAC norms: RBI has directed Banks to launch formal complaints on Bank Branch auditors who are negligent or Deficient in the conduct of the audit. AND may report to

- MCA
- RBI
- CAG
- ICAI

Who will judge us?

The top management of the bank

The branch officials

The SCAs

RBI Inspectors?

Courts?

- While the engagement Partner is responsible for the conduct of the audit, documenting the engagement team responsibilities makes them accountable
- The audit must also stand the scrutiny of QRB and the peer review Boards

# PRIME THE TEAM

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- Understand the objectives of the audit before reaching the Branch
- Read through the Master circulars et., especially in view of fresh amendments
- Discuss roles and responsibilities within the team
- Since time is a constraint, planning saves wastage of time
- Helps to write to the Branch to profile our work

# TO KEEP TRACK OF

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- Thorough understanding of Master Circulars, with special emphasis on IRAC norms
- Notifications, FAQs, Press Releases
- RBI Inspection report , if the inspection is on the branch
- Knowledge of law ( Negotiable Instruments Act, Contract Act, etc)
- Closing Instructions
- Technical Standards of ICAI

# ON ARRIVAL AT THE BRANCH

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- Compile a List of all reports and certificates
- List the persons to whom this has to be sent
- Document the plan for Substantive procedures to be carried out
- List the Analytical Procedures – esp., to track material misstatements
- Have a copy of the final audit plan on file at the end of Day 1
- Review plan daily

# UNDERSTAND THE BUSINESS OF THE BRANCH

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- This should take about the first hour of the audit: Document aspects of the business
- Create a top sheet to include

Description	20-21	21-22	22-23
Advances			
Deposits			
Income			
Expenditure			
Net profit			
Rating of the Branch			

# SOME ANALYTICAL TOOLS TO UNDERSTAND THE BUSINESS OF THE BRANCH

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- Int paid/Total Deposits
- Int Earned/Total Advances
- Growth of balance Sheet Totals over the years
- Gross NPA/total Advances
- Expenditure ( net of Int paid) / income Earned



# ADVANCE PROFILING

- Profile the top ten advance Categories of the branch

S No	Category of advances	2022-23	2022-23	2021-22	2021-22
		Rs . lakhs	No of accts	Rs . lakhs	No of accts
1	Cash Credit				
2	Overdraft				
3	Term loans				
4	Crop loans				
5	Housing loans				
6	Jewel loans				
7	Personal loans				
8.	Any others				
	Total Advances				

# ADVANCE PROFILING CONTD

- List Large advances > 10% of Total Advances or Rs.10 crores incl FB&NFB

S.No	Account name	Amt outstanding	FB	NFB	Classification of Asset	% to Total Advances

# DOCUMENT MATERIALITY ASSUMPTIONS( NO OF ACCOUNTS)- ADVANCES

(RS. LAKHS)

	< 5	5-50	50-100	100-500	500-1000	1000-2500	>2500	Gross NPA	Restructured Accounts
21-22									
22-23									
% to be verified									
Method of choosing the sample									

# REVIEW PREVIOUS AUDIT REPORTS

Previous year audit report	Yes or No / DDMMYY
Risk based Internal Audit	
Revenue Audit	
Inspection	
Concurrent Audit	
Stock Audit	
Vigilance Audit	
Systems Audit	
RBI inspection	

# THE AUDIT PLAN SHOULD

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- Nature timing and extent of planned risk assessment procedures- *Identifying and Assessing the risks of material Misstatement through Understanding the Entity and its Environment.- SA 315*
- Nature timing and extent of planned further audit procedures at the assertion level – *Auditors response to assessed risks*
- *Other planned audit procedures that are required to comply with the other SAs. - SA330*

# WHAT ARE WE LOOKING FOR..A SAMPLE LIST

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- Non compliance with RBI circulars: and policies and procedures of the bank
  - Naturally, needs a thorough reading
- Material misstatement of Income, Expenses, Assets and Liabilities
  - Determine levels of materiality for each of the baove class and document the same
- Unidentified Contingent Liabilities and claims
  - A perusal of banks correspondence in various disputes
  - Track counterclaims on the bank and document material counterclaims

# WHAT ARE WE LOOKING FOR.. A SAMPLE LIST

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- KYC/AML compliance norms
  - While a small sample will do must check compliance in a few cases. Inspection reports help
- Weaknesses in internal control
- Tracking End use of funds
  - Map sanction letters and ensure Enduse is not barred by Bank/RBI

# DOCUMENTING DISCUSSIONS

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- Should be done by end of day, preferably
- Should definitely be done on resolution of the discussion
- Identify the branch official with whom the discussion has been done
- Summarise both the discussion , opinion of the branch officials and the conclusions reached
- Record if conclusions are reached in variance with the guidelines and reasons for departure
- Discussion documentation **MUST** be complete before leaving the branch.



# DOCUMENTING DISCUSSIONS

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- If there are significant matters , document separately reasons for listing as significant matters
  - MOCs
  - Qualifications, if any
  - Matters taken to LFAR, instead of MOCs
  - Issues of materiality
  - Difference of opinion on the quality, classification and provisioning of the asset
  - Significant breach of IT controls , say from the report of the IT audit and not remedied
  - Results of stock audit not incorporated in the judgement of the NPA provision
  - Difference of opinion of the Restructuring dates (COD)
  - Ever greening
- Do NOT document initial and final opinions : in case there is a change of opinion after discussions with branch officials. The final opinion would do. Take care that the branch's opinion is recorded and read out to him/her.
- Take copies of correspondence with HO on important issues.

# AUDIT DOCUMENTATION

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- Keep SA 230 in focus

Nature, timing and extent of Audit procedures

- a. Liabilities take much lesser time to verify than assets
- b. Record the name of the person in the team performing the tests..Very important
- c. Record the name of the person reviewing the report.. Could be the same person as b above

# SOME LISTS TO BE COMPILED

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- List of the Audit Team members and a diary of attendance including departments allocated and time spent
  - Ideally, this diary must be concurrent but practically must be ready by end of day.
- List of branch officials who are responsible/ are interacted with
- List the annual returns/Financial statements to be certified and understand the requirements to design the audit plan : Keep copy of ALL certified statements.
- Name & Address of the CSA and summary of discussions held with him, if any.

# SOME LISTS TO BE COMPILED

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- List the delegation of authorities
- Write a note on audit plan conforming to SA 230
- Generate a tracker, electronically on issues raised and resolved. Provide access to review on a concurrent basis.
- Write down minutes of meetings with bank officials by the end of day/audit
- List the significant matters arising out of the audit, judgement exercised in reaching conclusions
- List the review process of the audit conducted

# LIST SCOPE LIMITATIONS

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- Information requested not furnished
  - This is important as in the time available, branch may not be able to provide the information
  - Record reasons of the Branch as to why the information is not available
  - Judge impact and materiality before including in the audit report
- Report limitations in Access to records incl
  - Previous Audit reports/Concurrent Audit/Stock Audit/RBI inspection/LFAR/IT audit/Stock Audit
  - HO comments on inspection Audit

# TAKE INTO ACCOUNT THE CBS

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- Familiarise with the Early Warning Signals Appendix II of Master Directions no. RBI/DBS/2016-17/28 DBS.CO.CFMC.BC.No.1/23.04.001/2016-17 dated July 1, 2016 (updated as on July 03, 2017) on “Frauds – Classification and Reporting by commercial banks and select FIs”
- Check Data integrity of transmission and storage
- Review Management practices and check manual documents which is the basis for input into the system
- Cross Verification of records, reconciliation statement and various controls between online and offline records

# TAKE INTO ACCOUNT THE CBS

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- Most of the accounting assumptions are built in the CBS.
  - For eg: There is system generated provisioning: RBI vide circular no. RBI/2020-21/37 Ref. No. DoS.CO.PPG./SEC.03/11.01. 005/2020-21 dated September 14, 2020 on “Automation of Income Recognition, Asset Classification and Provisioning processes in banks”,
  - Ensure Asset Classification report is generated EOD, every day.
  - Ensure Valuations/conclusions in audit reports are factored in the NPA calculations
  - Report manual interventions on system generated reports
  - Wrong IRAC classifications are significant audit risks
  - Especially, in restructured accounts and monitoring of DCCO
- IT controls are largely centralized
- Staff ignorance of the IT infrastructure... providing limited access to records
- Especially check the log of editable manual inputs

# HOW MUCH OF THE CBS SHOULD I UNDERSTAND

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- Well, pretty much
- And given the time, that is tough
- Understand that this is an area of risk but cannot be examined thoroughly to our satisfaction
- Rely on other IT audit conclusions, hopefully
- Start worrying more if the Branch management is not expertly familiar with the many modules of the CBS
- Track Exception Reports
  - For eg., Interest rate variations, Irregular advances, Advances not renewed, cash limits breached, inactive accounts activated, credits in expense accounts and debits in income account etc.,



# USEFUL

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- The article written by CA Ishwar Chandra in the march 2023 issue lists the functions which can be used in the different banking software environments..
- Familiarising with those functions helps

# EVIDENCE..THE CORE OF AUDIT

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- Collect evidence what is relevant
- Exercise skepticism in examining evidence
- Ensure evidence is properly authorized
- Dated evidence is of no use
- Must not be complicated to use

# EVIDENCE

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- Most important

Document justification and explanations where initial adverse observations are dropped. This would be a good defense for change of opinion, else is a source of trouble on review of work at a later date.

# DOCUMENT MANDATORY AUDIT & REVIEW REQUIREMENTS

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- Stock Audit
  - NPAs with balance >Rs. 5 crores are subjected Stock audit at Annual Intervals
- Legal Audit ,
  - periodically, incl verification of title deeds of all accounts >Rs. 5 crores
- Review of Regular Limits
  - Regular credit limits have to be renewed within 180 days
  - Short reviews should not be used to extend the period of 180 days
  - Track review of Adhoc sanctions
- Valuation
  - No requirement of periodical valuation except in cases of NPAs>Rs. 5 crores

## FRAUDS

Ensure that there is a sign off by the Branch Manager on the Frauds detected during the year and if none, he must affirm the. Same in the management representation Letter

Track frauds, if any detected in the previous year and status of action taken on the same

# Early Warning Signals.. Listed

- Default in undisputed payment to the statutory bodies as declared in the Annual report.
- ***Bouncing of high value cheques***
- Frequent change in the scope of the project to be undertaken by the borrower
- Foreign bills remaining outstanding with the bank for a long time and tendency for bills to remain overdue.
- Delay observed in payment of outstanding dues.
- ***Frequent invocation of BGs and devolvement of LCs.***
- Under insured or over insured inventory.
- Invoices devoid of TAN and other details.
- Dispute on title of collateral securities.
- **Funds coming from other banks to liquidate the outstanding loan amount unless in normal course. In merchanting trade, import leg not revealed to the bank.**

# Early Warning Signals.. Listed

- Request received from the borrower to postpone the inspection of the godown for flimsy reasons.
- Funding of the interest by sanctioning additional facilities.
- Exclusive collateral charged to a number of lenders without NOC of existing charge holders.
- Concealment of certain vital documents like master agreement, insurance coverage.
- Floating front / associate companies by investing borrowed money
- Critical issues highlighted in the stock audit report.
- ***Liabilities appearing in ROC search report, not reported by the borrower in its annual report***
- ***Frequent request for general purpose loans.***
- ***Frequent ad hoc sanctions.***
- Not routing of sales proceeds through consortium / member bank/ lenders to the company.

## Early Warning Signals.. Listed

- LCs issued for local trade/related party transactions without underlying trade transaction
- High value RTGS payment to unrelated parties.
- **Heavy cash withdrawal in loan accounts.**
- Nonproduction of original bills for verification upon request.
- Significant movements in inventory, disproportionately differing vis-a-vis change in the turnover.
- Significant movements in receivables, disproportionately differing vis-à-vis change in the turnover and/or increase in ageing of the receivables
- **Disproportionate change in other current assets**
- Significant increase in working capital borrowing as percentage of turnover
- Increase in Fixed Assets, without corresponding increase in long term sources (when project is implemented).
- **Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet**



# Early Warning Signals.. Listed

- Frequent change in accounting period and/or accounting policies
- Costing of the project which is in wide variance with standard cost of installation of the project
- Claims not acknowledged as debt high
- Substantial increase in unbilled revenue year after year.
- Large number of transactions with inter-connected companies and large outstanding from such companies
- **Substantial related party transactions**
- Material discrepancies in the annual report
- **Significant inconsistencies within the annual report (between various sections)**
- Poor disclosure of materially adverse information and no qualification by the statutory auditors
- Raid by Income tax /sales tax/ central excise duty officials
- Significant reduction in the stake of promoter /director or increase in the encumbered shares of promoter/director.
- Resignation of the key personnel and frequent changes in the management

# THE BUGBEAR OF GHOSH & JILANI COMMITTEE RECOMMENDATIONS

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- Work on the representation of the branch
- Clearly mention matters which are not tested or not capable of being tested adequately at the Branch level

# DOCUMENTATION FOR LFAR

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- Emphasis on transaction level testing
- Simultaneous look at processes
- Balance between an adverse remark and a qualification
- Check on Data Integrity on reports in the MIS to Central office

# AUDIT CONSIDERATIONS IN LFAR

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- Plan LFAR questionnaire filling up in parallel to the regular audit
- Quickly, arrive at questions that need not be answered. For eg., Money at call and Short notice, Investments etc.,
- Understand that LFAR on Advances takes maximum time
  - Most of the questions can be queried in the CBS to obtain the lists

# WHAT OUR FINAL AUDIT NOTES MUST HAVE

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- The letter of appointment /intimation from the bank
- The Audit Acceptance letter including
  - Declaration of Fidelity and Secrecy
  - Declaration of full time practice
  - Declaration of independence
  - Declaration of indebtedness
- The Engagement Letter

# WHAT OUR FINAL AUDIT NOTES MUST HAVE

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- Letter of Communication with the Previous Auditor
  - Necessary: follow up with call/email
- The complete reports and Certificates issued including
  - The Branch Audit report
  - Memorandum of Changes
  - Certified Financial statements
  - LFAR
  - Various Certificates>Returns required to be issued as per banks instructions
  - Tax Audit report
    - Track the number of copies to be certified

# WHAT OUR FINAL AUDIT NOTES MUST HAVE

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- Audit Plan
- Review Strategy and record the name of the person who reviewed the plan
- Names and Contacts of all persons who were engaged with
- External Confirmations should be on file
- Reports of Physical Verification of Cash, gold, documents etc.
- Conclusions on the Analytical Procedures
- Management Representation letter

# A SUMMARY OF THE MOCS ISSUED

S No	Nature of Issue	Debit Account	Credit Account	Amount	Remarks
	Rectification of Income recognition				
	Reclassification of NPA's ( fresh )				
	Change in the status of Old NPA's				
	Account reclassifications within P&L: and A&L				
	Reclassification of Loans and Advances where done differently by the branch				
	Assets put to use and not capitalized				



# WHAT THE FINAL AUDIT FILE MUST BE

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- Clear
- Organised
- Pertinent
- Neat
- Safe
- Duly authorized
- Summary of Conclusions
- Self explanatory: Capable of assuring an independent reviewer, sometime in future, that the audit has been conducted with knowledge, expertise and judgement has been exercised with care and review.

# THANK YOU & QUESTIONS

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# INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING NORMS(IRAC)

Presented By  
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# NON-PERFORMING ASSETS

- ◉ interest and/ or instalment of principal remains overdue for a period of more than 90days in respect of a term loan,
- ◉ the account remains 'out of order' , in respect of an Overdraft/Cash Credit (OD/CC),
- ◉ the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- ◉ the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
- ◉ the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,

# DUE DATE

- ◎ **Specification of due date/repayment date**
- ◎ The extant instructions on IRACP norms specify that an amount is to be treated as overdue if it is not paid on the due date fixed by the bank. It has been observed that due dates for repayments are sometimes not specifically mentioned in the loan agreements, and instead a description of due dates is mentioned, leaving scope for different interpretations. Henceforth, the exact due dates for repayment of a loan, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. shall be clearly specified in the loan agreement and the borrower shall be apprised of the same at the time of loan sanction and also at the time of subsequent changes, if any, to the sanction terms/loan agreement till full repayment of the loan. In cases of loan facilities with moratorium on payment of principal and/or interest, the exact date of commencement of repayment shall also be specified in the loan agreements. These instructions shall be complied with at the earliest, but not later than December 31, 2021, in respect of fresh loans. In case of existing loans, however, compliance to these instructions shall necessarily be ensured as and when such loans become due for renewal/review. (para 34 Of MC.on IRAC)
- ◎ **Para 2 of RBI 2021-22/125,**  
**DOR.STR.REC.68/2121.04.048/2021-22 dt. 12.11.2021**

# OUT OF ORDER(C.C/O.D.)

- An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 90 days

**or**

- ii. the outstanding balance in the CC/OD account is less than the sanctioned limit/drawing power but there are no credits continuously for 90 days, or the outstanding balance in the CC/OD account is less than the sanctioned limit/drawing power but credits are not enough to cover the interest debited during the previous 90 days period.
- **Note- the words “ as on balance sheet date - deleted w.e.f 31.03.2022**

# NON-PERFORMING ASSETS (CONTD.)

- ◉ In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter. (modified on November 12,2021, as under)
- ◉ *In case of interest payments in respect of term loans, an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days.*
- ◉ These instructions shall be effective from March 31, 2022. Accordingly, in respect of any borrower account which becomes overdue on or after March 31, 2022, its classification as NPA shall be based on the account being overdue for more than 90 days.
- ◉ Classification of borrower accounts as SMA as well as NPA shall be done as part of day-end process for the relevant date and the SMA or NPA classification date shall be the calendar date for which the day end process is run.(RBI cir. Dt Nov 12,2021)
- ◉ Availability of Security /Net worth to be ignored for classification into NPA
- ◉ **Note: It should be noted that the Banks are required to Automate the process of identification of NPAs, Income Recognition and Provisioning norms by June 30,2021 (RBI cir. Automation of Income Recognition, Asset Classification and Provisioning processes in banks . No. RBI/2020-21/37 Ref. No. DoS.CO.PPG./SEC.03/11.01.005/2020-21 )**

# NON PERFORMING ASSETS (CONTD.)

## ○ **Agricultural Advances-**

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. For the purpose of these guidelines, “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops, would be treated as “short duration” crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee (SLBC) in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him. (RBI/FIDD/2020-21/72 Master Directions FIDD.CO.Plan.BC.5/04.09.01/2020-21 September 04, 2020 (Updated as on October 20, 2022- for what constitutes Agricultural advances)
- The above norms should be made applicable **only to Farm Credit** extended to agricultural activities as listed at Annex - 2. In respect of agricultural loans, other than those specified in the Annex - 2, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.
- Reschedulement of Farm loans due to natural calamities(as notified by SLBC\*) will not render the loan an NPA \* MC- FIDD.CO.FSD.BC.NO.9/05.10.001/2018-19 dt.17/10/2018



# NON PERFORMING ASSETS (CONTD.)

- ◉ **Government Guaranteed Advances:**

(1) Central Govt. (2) State Govt.

- ◉ The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income.
- ◉ State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.

# NON PERFORMING ASSETS (CONTD.)

## **Advances to Primary Agricultural Credit Societies (PACS)/Farmers' Service Societies (FSS) ceded to Commercial Banks**

- ◉ In respect of agricultural advances as well as advances for other purposes granted by banks to PACS/ FSS under the on-lending system, only that particular credit facility granted to PACS/ FSS which is in default for a period of two crop seasons in case of short duration crops and one crop season in case of long duration crops, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS. The other direct loans & advances, if any, granted by the bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

### **Advances against Term Deposits, NSCs, KVPs/IVPs, etc.**

- ◉ Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts. Advances against gold ornaments, government securities and all other securities are not covered by this exemption

# ADVANCES WITH TEMPORARY DEFICIENCIES (TECHNICAL NPAS)

- ◉ The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, nonsubmission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:
- ◉ a) Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

- ◉ b) A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.
- ◉ c) Regular and ad hoc credit limits need to be reviewed/regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as nonavailability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

# CLASSIFICATION OF ADVANCES (NPAS)

- ◉ **(1) Sub standard (2) Doubtful & (3) Loss**
- ◉ **Sub standard**-which has remained NPA for a period less than or equal to 12 months.
- ◉ **Doubtful**- an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months
- ◉ **Loss Asset** - A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. Or where the value of security is less than 10% of the outstanding amount
- ◉ **Technical NPAs**
- ◉ (i) Where stock/ receivables statement are more than 6 months old i.e such statements not received since August 2022
- ◉ Review /renewal of Limits is more than 180 days overdue
- ◉ Adhoc limits sanctioned are not regularised for a period of 180 days or more
- ◉ Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be or in cases declared as Fraud. Such NPAs may be straightaway classified under doubtful category.
- ◉ **Asset classification to be Borrower wise and not Facilitywise**

# INCOME RECOGNITION

- ◉ The policy of income recognition has to be objective and based on the record of recovery. Therefore, the banks should not charge and take to income account interest on any NPA. **This will apply to Government guaranteed accounts also.**
- ◉ However, interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
- ◉ Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.
- ◉ It is clarified that if loans with moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest corresponding to the interest accrued during such moratorium period need not be reversed. (Cir. Dt Nov 12,2021)

# INCOME RECOGNITION (CONTD)

- ◉ If any advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realised. This will apply to Government guaranteed accounts also.
- ◉ In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

## **Appropriation of recovery in NPAs**

- ◉ Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.
- ◉ In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

# APPROPRIATION/UPGRADATION

## Appropriation of recovery in NPAs

- ◉ Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned
- ◉ In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner

## Upgradation of NPAs:

- ◉ In case of borrowers having more than one credit facility from a lending institution, loan accounts shall be upgraded from NPA to standard asset category only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities.
- ◉ Care should be taken to ensure that the credits are from genuine sources only and not by way of sanction of Fresh loans



# PROVISIONING FOR NPAS

- The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines. (para 5.1.1 of circular)
- **Loss assets-** 100% of the outstanding ignoring value of security
- **Doubtful assets-** 100% of Unsecured portion in case of D1 &D2 Categories and in case of D3 100% to be provided irrespective of the value of security
- D1(upto one year doubtful)- 25% of Secured portion
- D2(one to three years as Doubtful )-40% of secured

## Note:

- With a view to bringing down divergence arising out of difference in assessment of the value of security, in cases of NPAs with balance of ₹5 crore and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board would be mandatory in order to enhance the reliability on stock valuation. Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.
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# PROVISIONING FOR NPAS (CONTD.)

- ⦿ **Sub Standard-** 15% of the outstanding amount
- ⦿ In case of Unsecured exposures -25% (Unsecured exposure is defined as an exposure where the realisable value of the security, as assessed by the bank/approved valuers/Reserve Bank's inspecting officers, is not more than 10 percent, *ab-initio, of the outstanding exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly discharged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters etc. )*
- ⦿ **Standard Assets:**
- ⦿ a) Farm Credit to agricultural activities and Small and Micro Enterprises (SMEs) sectors at 0.25 per cent; ( **care Medium enterprises are not to be considered**)
- ⦿ b) advances to Commercial Real Estate (CRE)<sup>1</sup> Sector at 1.00 per cent;
- ⦿ c) advances to Commercial Real Estate - Residential Housing Sector (CRE - RH)<sup>2</sup> at 0.75 per cent
- ⦿ d) housing loans extended at teaser rates as indicated in Paragraphs 5.9.9;
- ⦿ e) restructured advances - as stipulated in the prudential norms for restructuring of advances.
- ⦿ f) Advances restructured and classified as standard in terms of the Master Direction - Reserve Bank of India (Relief Measures by Banks in Areas affected by Natural Calamities) Directions 2018 - SCBs, as updated from time to time, at 5%.
- ⦿ g) All other loans and advances not included in (a) - (f) above at 0.40 per cent.

# EXEMPTION, ETC

- ◉ The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.
- ◉ The bills discounted under LC favouring a borrower may not be classified as a Nonperforming assets (NPA), when any other facility granted to the borrower is classified as NPA. However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA

# EXEMPTION ETC, CONTD

- Accounts where there is erosion in the value of security/frauds committed by borrowers- . In cases of such serious credit impairment, the asset should be straightaway classified as doubtful or loss asset as appropriate: a) Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category. b) If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset.

# PROVISIONING FOR NPAS (CONTD.)

- It is clarified that the Medium Enterprises will attract 0.40% standard asset provisioning. (MSME definition refer RBI cir. FIDD.MSME & NFS.BC.No.3/06.02.31/2020-21 dated July 2, 2020 on 'Credit flow to Micro, Small and Medium Enterprises Sector'. )--- also refer FIDD.MSME & NFS.BC.No.7/06.02.31/2022-23 May 19, 2022 As per the latter circular the existing Entrepreneurs Memorandum (EM) Part II and Udyog Aadhaar Memorandum (UAM) of the MSMEs obtained till June 30, 2020 shall remain valid till June 30, 2022 for classification as MSMEs; and ii) the validity of documents obtained in terms of O.M. No.12(4)/ 2017-SME dated March 8, 2017 (RBI Circular FIDD.MSME & NFS.BC.No.10/06.02.31/2017-18 dated July 13, 2017), for classification of MSMEs upto June 30, 2020, has been extended upto June 30, 2022

# PROVISIONS IN CASE OF FRAUD

- ◉ Banks should normally provide for the entire amount due to the bank or for which the bank is liable (including in case of deposit accounts), immediately upon a fraud being detected
- ◉ However, to smoothen the effect of such provisioning on quarterly profit and loss, banks have the option to make the provisions over a period, not exceeding four quarters, commencing from the quarter in which the fraud has been detected

# RBI CIRCULARS

- Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dt. April 1, 2022 (RBI/2022-23/15 DOR.STR.REC.4/21.04.048/2022-23 April 1, 2022)
- Priority Sector definition - RBI/FIDD/2020-21/72 Master Directions FIDD.CO.Plan.BC.5/04.09.01/2020-21 September 04, 2020 (Updated as on October 20, 2022)
- MSME definition etc- (i) RBI/2020-2021/10 FIDD.MSME & NFS.BC.No.3/06.02.31/2020-21 July 2, 2020
- (ii) RBI/2020-2021/26 FIDD.MSME & NFS.BC.No.4/06.02.31/2020-21 August 21, 2020
- (iii) RBI/2021-2022/161 FIDD.MSME & NFS.BC.No.16/06.02.31/2021-22 February 18, 2022
- RBI/2014-15/142 DBOD.No.BP.BC.27/21.04.048/2014-15 July 22, 2014- w.r.t Gold loans for Other than Agri.purpose
- RBI/2020-21/19 DoR.No.BP.BC/6/21.04.048/2020-21 August 6, 2020- LTV on Gold Loans
- RBI/2013-14/76 DBOD.No.Dir.BC. 14 /13.03.00/2013-14 July 1, 2013-  
Master Circular- Loans and Advances - Statutory and Other Restrictions ( para 2.3.12 Advances against Gold Ornaments & Jewellery

# PROVISION IN CASES COVERED BY ECGC ETC.

- Outstanding Balance Rs. 4 lakhs ECGC Cover 50 percent Period for which the advance has remained doubtful More than 2 years remained doubtful (say as on March 31,2023) Value of security held Rs. 1.50 lakh

<b>Outstanding balance</b>	<b>Rs. 4.00 lakhs</b>
Less: Value of security held	Rs. 1.50 lakhs
Unrealised balance	Rs. 2.50 lakhs
Less: ECGC Cover (50% of unrealisable balance)	Rs. 1.25 lakhs
Net unsecured balance	Rs. 1.25 lakhs
Provision for unsecured portion of advance	Rs. 1.25 lakhs (@ 100 percent of unsecured portion)
Provision for secured portion of advance (as on March 31, 2012)	Rs.0.60 lakhs (@ 40 per cent of the secured portion)
Total provision to be made	Rs.1.85 lakhs



- In case of CTTMSE/ CRFTLIH cover, the calculation is identical except the coverage is 75% of the Unrealisable amount limited to ₹37.50lakhs

# Thank You

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