

JALANDHAR BRANCH OF NIRC OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



PRESENTATION ON BANK BRANCH AUDIT 2017

C.A. Sanjay Vasudeva
S. C. Vasudeva & Co.
Chartered Accountants



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Presentation Overview :



Bank Branch Audit

2017

- Preliminary Work / Familiarisation
- Advances:
 - Income Recognition
 - Provisioning
 - Asset Classification
- Special Features- Audit of Advances
 - Agriculture Advances
 - Projects under Implementation
 - Restructuring of Advances
 - Restructuring of Advances - Distressed Assets
- Other Critical Matters

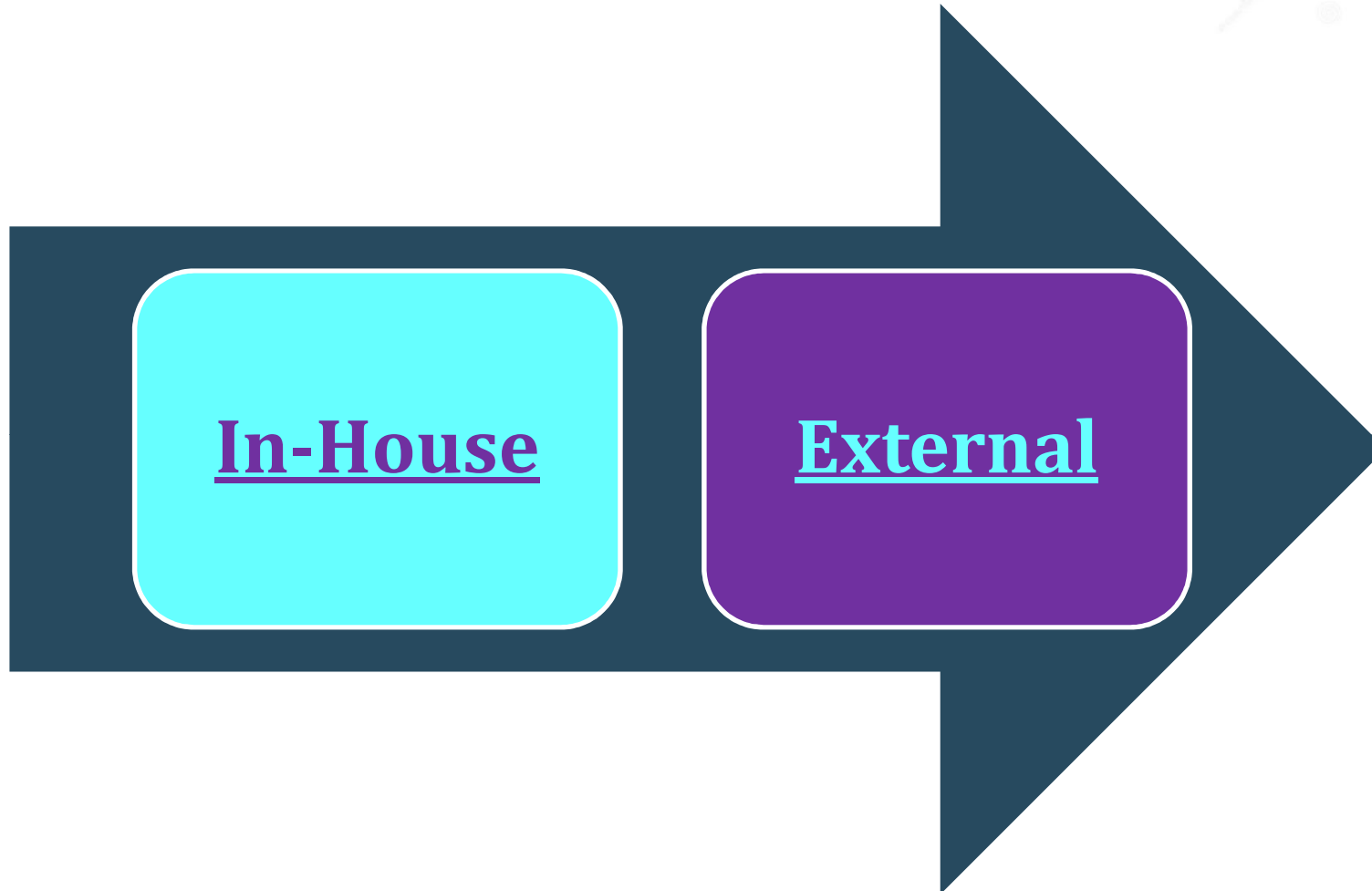




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Preliminary Work / Familiarisation

Preliminary Work / Familiarisation :



Preliminary Work / Familiarisation :



PRE REQUISITE TO ACCEPTANCE OF SUCH ASSIGNMENTS

1. Being equipped with adequate and updated knowledge of the relevant and applicable:
Statutory Impositions ,
Regulatory Requirements
ICAI Publications (Standards And Guidance Notes)
2. Having trained and skilled staff to conduct the assignment simultaneously at the different locations .
3. Time-bound deliverables

Preliminary Work / Familiarisation :



UNDERSTANDING STATUTORY IMPOSITIONS

Familiarity with the Laws governing the Banks

(Banking Regulation Act 1949, SBI Act/Subsidiaries Acts/ Regional Rural Banks Act, 1976/ the law governing Cooperative banks/ Banking companies , to the extent governed by the Companies Act 2013)

RESERVE BANK OF INDIA, being the regulator issues DIRECTIONS / GUIDANCE to banks through its CIRCULARS from time to time

Master Circulars, on each area of banking operations

Binding on the banks and

Override the Bank's Internal Instructions to the contrary

Preliminary Work / Familiarisation :



ICAI PUBLICATIONS:

1. STATEMENTS AND STANDARDS (mandatory in their application)
 - Accounting Standards, and
 - Standards on Auditing

2. GUIDANCE NOTES:
 - On audit of banks (2017 edition)
 - On reporting on fraud under section 143(12) of the Companies Act 2013
 - On depreciation under the Companies Act 2013 –revised – banking companies
 - On accounting for depreciation in companies in the context of SCHEDULE II to the Companies Act 2013
 - on tax audit under section 44AB of the IT Act, 1961

Preliminary Work / Familiarisation :



AREA DESERVING SPECIAL ATTENTION :

Initial review of Bank's system (CBS)

CIS Environment - Extensive dependence on IT to process transactions

Internal Controls and Additional Controls for CIS Environment

Compliance of various CO / HO / ZO Circulars

Basic Analytical Procedure

Previous year / latest reports of Concurrent Audit, Internal Audit, RBI Inspection and LFAR.

Understanding the De-centralised action at branches

Manual intervention / Daily Exception Reports

Preliminary Work / Familiarisation :



AREAS DESERVING SPECIAL ATTENTION :

MOC (Memorandum of Changes)

LFAR (Long Form Audit Report)

Other certificates/ attestation

Audit Report

Preliminary Work / Familiarisation :



AUDIT ENGAGEMENT AND REPRESENTATION LETTERS, SEEKING COMMUNICATION

Audit Engagement Letter

Letter of Requirement

Audit Plan

Audit Programme

Management response to audit requirements / Management Representation

Well planned
is
Half done

Preliminary Work / Familiarisation :



CIS Environment :

Parameterisation of the statutory and regulatory requirements and the involvement of the IT systems. Centralised/decentralized.

System driven information/data . System flashes a message for any sort of irregularity. Record of all log-ins and log-outs

Controls on execution and recording of various e-banking and internet banking products; and manual processing of items not covered

MIS reports

Major *exception reports* and the process of generation and its compliance.

Business Continuity and Disaster Recovery Plan.

Preliminary Work / Familiarisation :



CIS Environment - Branch Auditors' Role:

Must be familiar with the systems and procedures

Manual intervention to System generated statements/ information, need special attention

Certain factors to examine during audit, the parameters of which are defined through computerised environment:

- Potential NPA / Automatic NPA
- Capturing of 'out-of-order' Accounts.
- Correct Sector-wise classification [Primary / Other]
- Security Valuation & Additional Provisions etc.

Branch Auditor's Inability to verify the Centralised System

Preliminary Work / Familiarisation :



LFAR - Long Form Audit Report :

LFAR is a questionnaire, comprehensive in scope and coverage. It covers both Balance Sheet and Profit & Loss Account. **Make LFAR part of the audit programme.**

Main Audit Report (SA-700) and LFAR are two separate reports. Main Report is a self contained document and should not contain any references to LFAR. **Qualificatory remarks MUST be part of the main report.**

LFAR should be **precise and sufficiently detailed.** Avoid vague or general comments. Do not make current year's LFAR a replica of previous year.

Preliminary Work / Familiarisation :



LFAR – Questionnaire relating to HEADS and GENERAL QUESTIONS :

I.ASSETS

CASH
BALANCES WITH RBI,SBI AND OTHER BANKS
MONEY AT CALL AND SHORT NOTICE
INVESTMENTS HELD AT BRANCHES IN INDIA)
ADVANCES (WITH ANNEXURE FOR LARGE/IRREGULAR/CRITICAL ADVANCE ACCOUNTS)
OTHER ASSETS

II.LIABILITIES

DEPOSITS
OTHER LIABILITIES
CONTINGENT LIABILITIES

III. PROFIT AND LOSS ACCOUNT

IV. GENERAL

QUESTIONNAIRE APPLICABLE TO SPECIALISED BRANCHES

- A. For Branches dealing in Foreign Exchange Transactions
- B. For branches dealing in very large advances such as corporate banking branches and industrial finance branches or branches with advances in excess of Rs.100crores.
- C. For branches dealing in recovery of Non Performing Assets such as Asset Recovery Branches
- D. For branches dealing in clearing House Operations, normally referred to as Service Branches

Preliminary Work / Familiarisation :



LFAR – Questionnaire relating to ADVANCES:

Note: The answers to the following questions may be based on the auditor's examination of all large advances and a test check of other advances

- a) Credit Appraisal**
- b) Sanctioning/ Disbursement**
- c) Documentation**
- d) Review/ Monitoring/ Supervision**
- e) Guarantees and Letters of Credit**

Preliminary Work / Familiarisation :



LFAR – Questionnaire relating to ‘ADVANCES’:

Note: The answers to the following questions may be based on the auditor's examination of all large advances and a test check of other advances

Whether branch generally complied with the procedures/ instructions of the controlling authorities of the bank regarding loan applications, preparation of proposals for grant/ renewal of advances, enhancement of limits, etc., including adequate appraisal documentation in respect thereof

Instances of credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch

Instances where advances have been disbursed without complying with the terms and conditions of the sanction

Instances of credit facilities released by the branch without execution of all the necessary documents

Instances of deficiencies in documentation, non-registration of charges, non-obtaining of guarantees, etc

Advances against lien of deposits have been properly granted by marking a lien on the deposit

Procedure laid down by the Controlling authorities of the bank, for periodic review of advances including periodic balance confirmation/ acknowledgment of debts, followed by the Branch

Stock/ book debt statements and other periodic operational data and financial statements, etc., received regularly AND STOCK AUDITS

Advances to non-corporate entities

Inspection or physical verification of securities charged to the Bank

Preliminary Work / Familiarisation :



LFAR - Long Form Audit Report :

PRACTICAL ISSUES

Overall Health Status of the account / borrower. *Weak / Stressed*

Non-Compliance of Sanction Terms / Loan Policy / Restructuring Terms

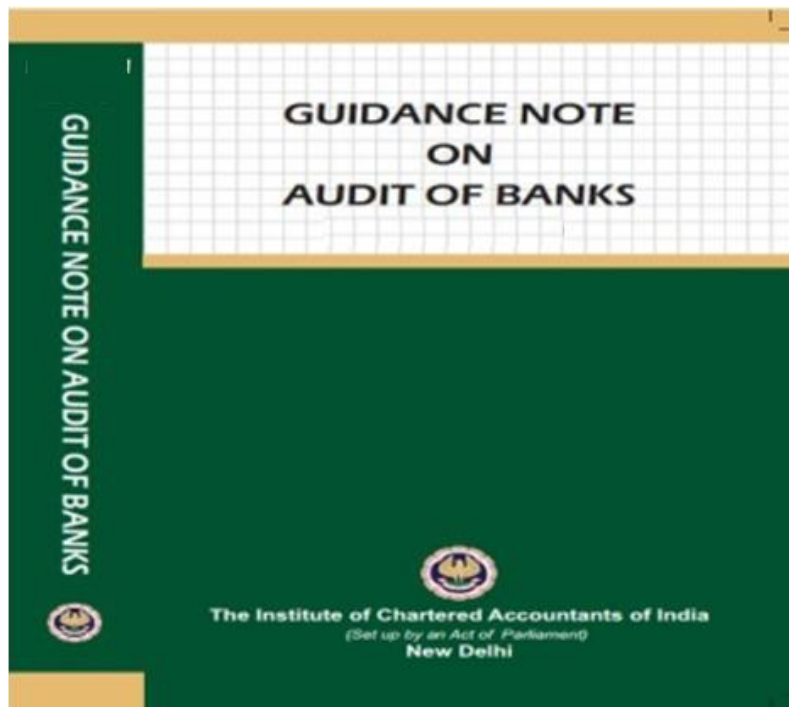
Documentation issues *related to Loan appraisal, sanction, documentation, security and guarantee*

Timely submission of Insurance / MSODs

Drawing Power Issues - *inappropriate / incomplete information; inappropriate calculation method*

End use of Funds / Diversion of Funds

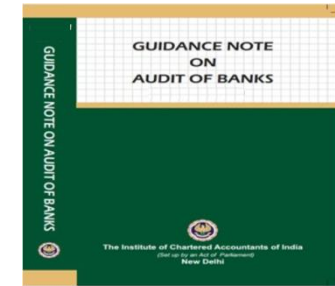
Frauds; - Discovered during the year and suggestions to minimise their occurrence.



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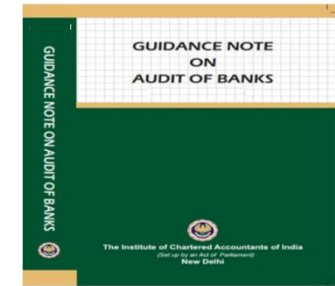
Guidance Note on Audit of Banks (2017 Edition)

Guidance Note – Overview:



- ❖ The GN brought out by the AASB of the ICAI every year Provides detailed guidance to the members on various aspects of bank audits.
- ❖ **List of aspects covered in GN**
 - ❖ Knowledge of the Banking Industry
 - ❖ Risk Assessment and Internal Control (including Special Considerations in a CIS Environment)
 - ❖ Demonetization
 - ❖ Audit of Advances - Agriculture / Other than Agriculture IRAC Provisions
 - ❖ Audit of Cash, Balances with RBI and Other Banks, and Money at Call and Short Notice
 - ❖ Fixed Assets and Other Assets
 - ❖ Borrowings and Deposits
 - ❖ Capital, Reserves and Surplus
 - ❖ Other Liabilities and Provisions
 - ❖ Contingent Liabilities and Bills for Collection
 - ❖ Treasury Operations – Foreign Exchange and Derivative Transactions
 - ❖ Profit and Loss Account
 - ❖ Disclosure Requirements in Financial Statements
 - ❖ Consolidation of Branch Accounts
 - ❖ Consolidation of Financial Statements
 - ❖ Inter-Office Transactions
 - ❖ Long Form Audit Reports
 - ❖ Special Aspects; Basel /III, Special Purpose Reports and Certificates
 - ❖ Compliance with Implementation of Ghosh & Jilani Committee Recommendations
 - ❖ Illustrative Format of Report of the Auditor
 - ❖ Illustrative Format of Engagement Letter
 - ❖ Illustrative Format of Written Representation Letter
 - ❖ Illustrative Bank Branch Audit Programme
 - ❖ Illustrative Checklist for the Verification of the aspects of the Treasury/Investments
 - ❖ List of Relevant Master Directions / Circulars issued by RBI & Other Relevant General Circulars

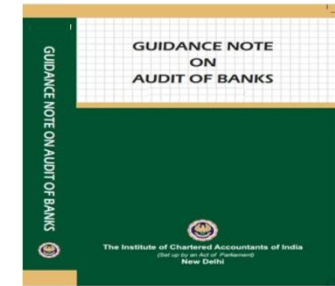
Guidance Note – Overview:



Knowledge of Banking industry

- ❖ Different types of banking institutions prevailing in India:
 - (a) Commercial Banks.
 - (b) Regional Rural Banks.
 - (c) Co-operative Banks.
 - (d) Development Banks (more commonly known as ‘Term-Lending Institutions’).
 - (e) Payment Banks.
 - (f) Small Finance Banks.
- ❖ All these banks have their unique features and perform various functions / activities subject to complying with the RBI guidelines issued from time to time. Banking Regulation Act, 1949, [Section 6] lists down the forms of business in which banking companies may engage.
- ❖ Commercial banks are the most wide spread banking institutions in India, provides a number of products and services to general public and other segments of economy.
- ❖ Two of its main functions (1) accepting deposits and (2) granting advances.
- ❖ RBI acts as the monetary authority and the central bank of the country. The provisions regarding the financial statements of banks are governed by the Banking Regulation Act.
- ❖ For a banking company, the requirements of the Companies Act, 2013 [*relating to the balance sheet, profit and loss account and cash flow statement*] shall also apply, in so far as they are not inconsistent with the Banking Regulation Act, 1949.

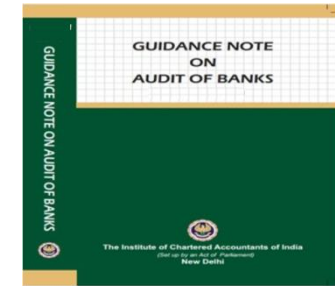
Guidance Note – Overview:



Risk Assessment and Internal Control

- ❖ **Identifying and Assessing the Risks of Material Misstatements**
- ❖ SA 315 requires the auditor to identify and assess the risks of material misstatement
 - ❖ at the financial statement level and the assertion level
 - ❖ for classes of transactions, account balances, and disclosures.
- ❖ **Understanding the Bank and Its Environment including Internal Control**, to enable the auditor to:
 - ❖ identify and assess risk;
 - ❖ to develop an audit plan so as to determine the operating effectiveness of the controls, and to address the specific risks.
 - ❖ to assist in issuing his report on internal financial controls in terms of Section 143(1)(i) of the Companies Act, 2013, wherever applicable.
- ❖ **Understanding the Risk Management Process.** It generally requires the following:
 - ❖ Oversight and involvement in the control process by those charged with governance.
 - ❖ Identification, measurement and monitoring of risks.
 - ❖ Control activities: A bank should have appropriate controls to manage its risks, including effective segregation of duties.

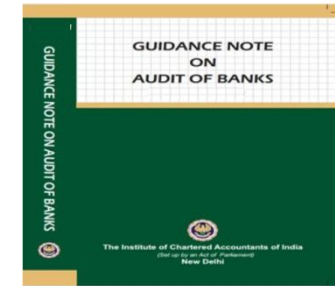
Guidance Note – Overview:



Risk Assessment and Internal Control

- ❖ **Establishment of the overall audit strategy:**
 - ❖ Identifying the characteristics of the audit engagement that define its scope, such as the financial reporting framework used, additional reporting requirements etc.
 - ❖ Consider the various RBI Circulars, Master Circulars and Master Directions.
 - ❖ Consider the requirements of various Accounting Standards, Guidance Notes and Standards on Auditing.
 - ❖ Ascertaining the reporting objectives of the audit engagement to plan the timing of the audit and the nature of the communications required.
 - ❖ Considering the important factors that will determine the focus of the engagement team's efforts.
 - ❖ Ascertain the nature, timing and extent of resources necessary to perform the engagement.

Guidance Note – Overview:



Risk Assessment and Internal Control

- ❖ **Risk of Fraud – SA 240:** Auditor's objectives are to identify and assess the risks of material misstatement due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately.
- ❖ **Auditor's Role w.r.t Fraud** - While obtaining an understanding of the bank and its environment, the auditor should make inquiries of management, internal auditors and others regarding the following:-
 - ❖ Management's assessment of the risk that the financial statements may be materially misstated due to fraud.
 - ❖ Management's process for identifying and responding to the risk of fraud in the bank, including any specific risks of fraud that management has identified or that have been brought to its attention.
 - ❖ Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud.
 - ❖ Management's communication, if any, to regulatory authorities.
 - ❖ Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
 - ❖ Actual, suspected, or alleged fraud that the bank is investigating.
 - ❖ Process the bank undertakes to respond to internal or external allegations of fraud affecting the bank.
- ❖ If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

Demonetisation

Withdrawal of the legal tender status of the INR 500 and INR 1,000 notes w.e.f. November 8, 2016:



Objective:

- ❖ Identifying and removing from circulation :
 - ❖ fake currency notes, also used for financing subversive activities such as drug trafficking and terrorism, and
 - ❖ Specified Bank Notes –SBN Currency notes in the denomination of Rs.1000 and Rs.500 (Specified Bank Notes –SBN), to the extent comprising unaccounted wealth.

Immediate effect of the initial Notifications

- ❖ Banks to stop issuing SBN from November 09, 2016;
- ❖ Banks to close for public dealings on 9/11/2016 for all transactions ;
- ❖ All ATMs, Cash Deposit Machines, Cash Recyclers and any other machines used for receipt and payment of cash to be shut on 9 & 10-11-2016; and
- ❖ Banks to Recall the SBN from ATMs and replace them with bank notes having legal tender character (in the denomination of Rs.100 or Rs. 50, until further RBI instructions), and ensure reconfiguring the ATMs accordingly ,prior to reactivation of the machines on 11th November, 2016.

Demonetisation

Withdrawal of the legal tender status of the INR 500 and INR 1,000 notes w.e.f. November 8, 2016:



As such, no separate validation/certification is called for and no separate reporting is required.

Auditor's Roles & Responsibilities

- ❖ Auditor should familiarize himself with various circulars/ notifications/ instructions issued by Government and RBI in connection with **demonetization scheme** of Government of India.
- ❖ Auditor should assess based on the observations of the concurrent auditor/ special auditor/ other auditor/ inspectors, etc., whether the bank has laid down a proper system to ensure compliance of the aforesaid requirements.
- ❖ In case of any material non-compliance observed, the auditor should exercise professional judgement in determining the manner of reporting of such non-compliance.

Auditor is not expected to carry out an investigation or verify each transaction, but to enquire Management, in course of implementation of Scheme, any act or omission that should be considered as a cause of concern, based on any Investigation, enquiry, review by RBI or any other agency, or Internal supervision, that needs to be highlighted.

❖ **LFAR Reporting**

- ❖ Auditor has to specifically examine and report (in LFAR) on the issues noted by the management, Internal & Concurrent auditors. Deviations in compliance with RBI Circulars & bank policies / procedures on –
 - ❖ Exchange of SBN
 - ❖ Deposits of SBN by customers
 - ❖ Daily / weekly withdrawal limits through ATM / Branch
 - ❖ Transfers of SBN to RBI
 - ❖ Issuance of New Notes
 - ❖ Filing of STR / CTR & various reports to RBI
 - ❖ To report no misuse of the process as was laid down by the RBI through its various circulars

Demonetisation

Withdrawal of the legal tender status of the INR 500 and INR 1,000 notes w.e.f. November 8, 2016:



Pursuant to Demonetisation,

[Vide RBI Notification dated November 21, 2016]

Additional 60 days allowed for NPA Classification

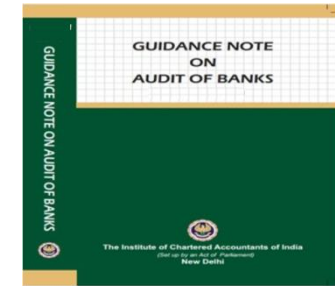
beyond what is applicable for the concerned regulated entity (RE) originally, in the following cases:-

- a) Running working capital accounts (OD/CC)/crop loans, with any bank, the sanctioned limit whereof is Rs. 1 crore or less;
- b) Term loans, whether business or personal, secured or otherwise, the original sanctioned amount whereof is Rs. 1 crore or less, on the books of any bank or any NBFC, including Micro Finance Institution. This **shall include housing loans and agriculture loans**;
- c) Loans sanctioned by banks to NBFC (MFI), NBFCs, Housing Finance Companies, and Primary Agriculture Credits and by State Cooperative Banks to District Control Co-operative Banks.
- d) The above guidelines will also be applicable to loans extended by DCCBs.

Additional 30 days allowed for NPA Classification in respect of (a) & (b) above.

RBI vide its Notification dated December 28, 2016; has further decided to provide additional 30 days, in addition to the 60 days mentioned above (Total 90 days) provided in notification dated November 21, 2016 in respect of (a) & (b) *(for business purpose)* above.

Guidance Note – Overview:



Borrowings :

- ❖ Borrowings usually take place only at head office of the bank.
- ❖ As such, this item generally does not figure in balance sheets of most branches of the bank.

Deposits :

- ❖ Primarily of two types – those repayable on demand (demand deposits) and those repayable after a fixed term (term deposits)
 - ❖ Current Account
 - ❖ Saving Account
 - ❖ Term Deposits; Fixed Deposits; Recurring Deposits
 - ❖ FCNR Accounts
 - ❖ Resident Foreign Currency Accounts
 - ❖ EEFC account
 - ❖ Non-resident Bank Accounts
 - ❖ Rupee Accounts (Exchange House)

The auditor is primarily concerned with obtaining reasonable assurance that all known liabilities are recorded and stated at appropriate amounts.

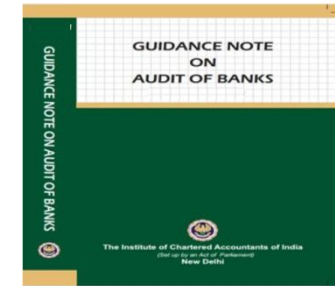
Review of Unclaimed Deposits/ Inoperative Accounts

- ❖ [RBI Circular no. DBOD No. Leg.BC.34/ 09.07.005/2008-09 dated August 22, 2008]

Compliance of TDS Provisions on Interest on Deposits

- ❖ Reference requirements of Sec 194 and Sec 195 of the Income-tax Act, 1961

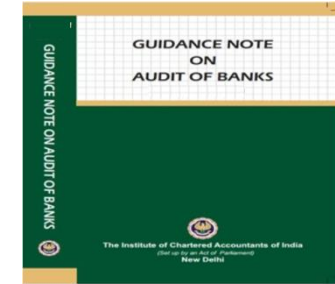
Guidance Note – Overview:



Unhedged Foreign Currency Exposure of Corporates

- ❖ Each bank has a policy that explicitly recognises and takes account of risks arising out of foreign exchange exposure of their clients vis-à-vis the banks' portfolios of such exposures
- ❖ Banks may also consider stipulating a limit on unhedged position of corporates on the basis of bank's Board approved policy.
- ❖ Attention is invited to RBI's Circular No. DBOD.No.BP.BC.85/21.06.200/2013-14 on "Capital and Provisioning Requirements for Exposures to entities with Unhedged Foreign Currency Exposure" dated January 15, 2014 and clarification DBOD.No.BP.BC.116/21.06.200/2013-14 dated June 3, 2014 providing requirements for exposures to entities with unhedged foreign currency exposure.
- ❖ Auditor to ensure that the Bank has:-
 - ❖ Obtained the UFCE information from all its branches (including foreign branches) in respect of large borrowers.
 - ❖ Obtained a certificate in respect of UFCE from entities **on a quarterly basis on self-certification basis**. However, at least annually, UFCE information should be audited and certified by the statutory auditors of the entity.
 - ❖ Computed "Capital and Provisioning Requirements for Exposures to entities with UFCE" at least on a quarterly basis, as per the applicable RBI guidelines.

Guidance Note – Overview:



Other Salient Features / Aspects :

❖ **Special Purpose Reports and Certificates -**

Linkage to

ICAI Guidance Note [Revised 2016] on “Reports and Certificates for Special Purposes”

❖ **Service Tax -**

In GN 2017; A new Chapter has been updated on account of latest Service Tax Provisions. The Chapter is vetted by Indirect Tax Committee

❖ **RBI Circular on Cyber Security Framework in Banks-**

[‘RBI/2015-16/418 DBS.CO/CSITE/BC.11/33.01.001/2015-16’ dated 02-06-2016]

- ❖ Banks should immediately put in place a cyber-security policy elucidating the strategy containing an appropriate approach to combat cyber threats given the level of complexity of business and acceptable levels of risk, duly approved by their Board.
- ❖ Confirmation to CSITE [of RBI] should be communicated at the earliest, and in any case not later than September 30, 2016.
- ❖ A Cyber Crisis Management Plan (CCMP) should be immediately evolved and should be a part of the overall Board approved strategy.
- ❖ Banks are required to report promptly (Within 2 to 6 hours) the cyber-attack incidents.

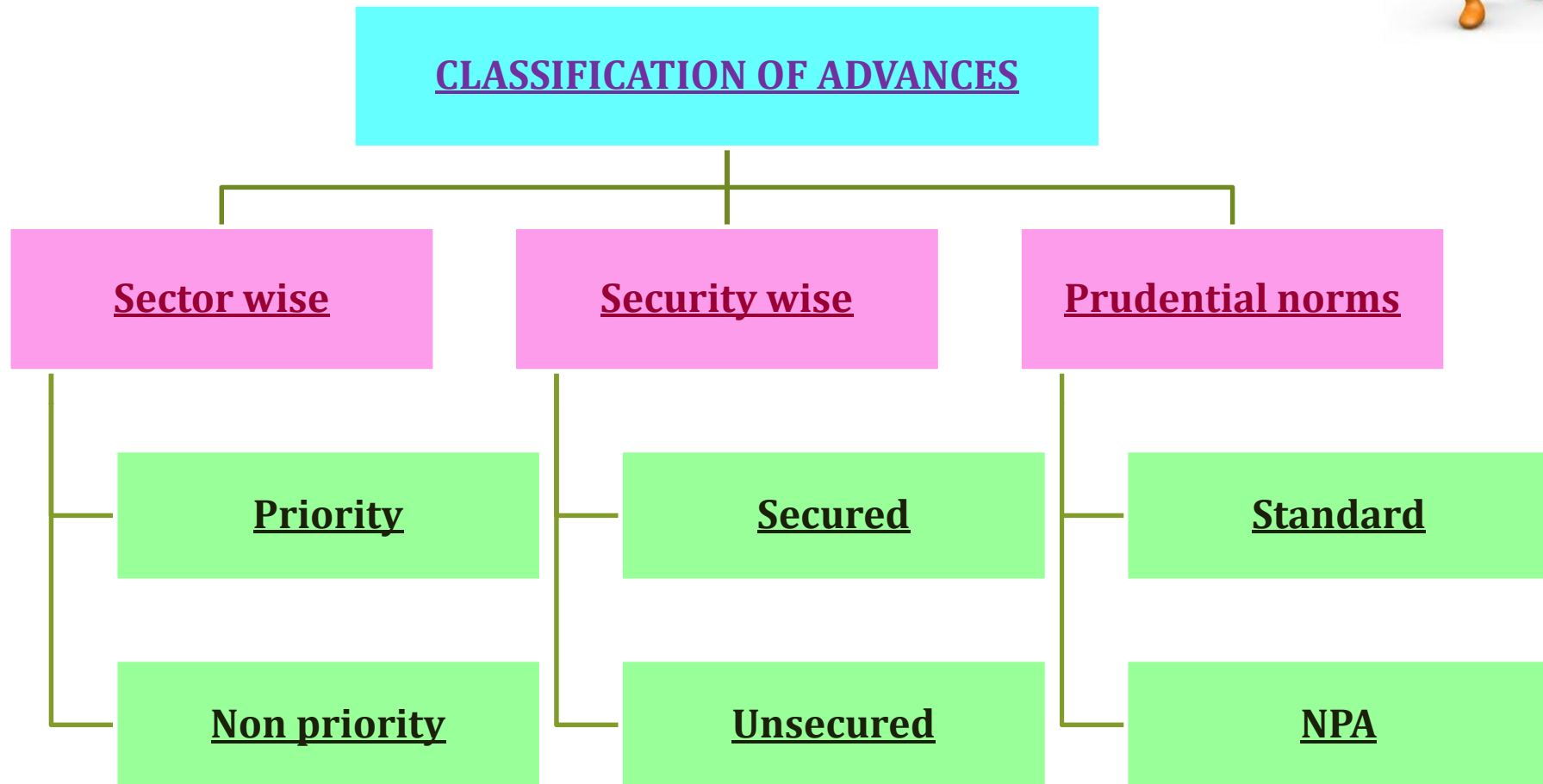


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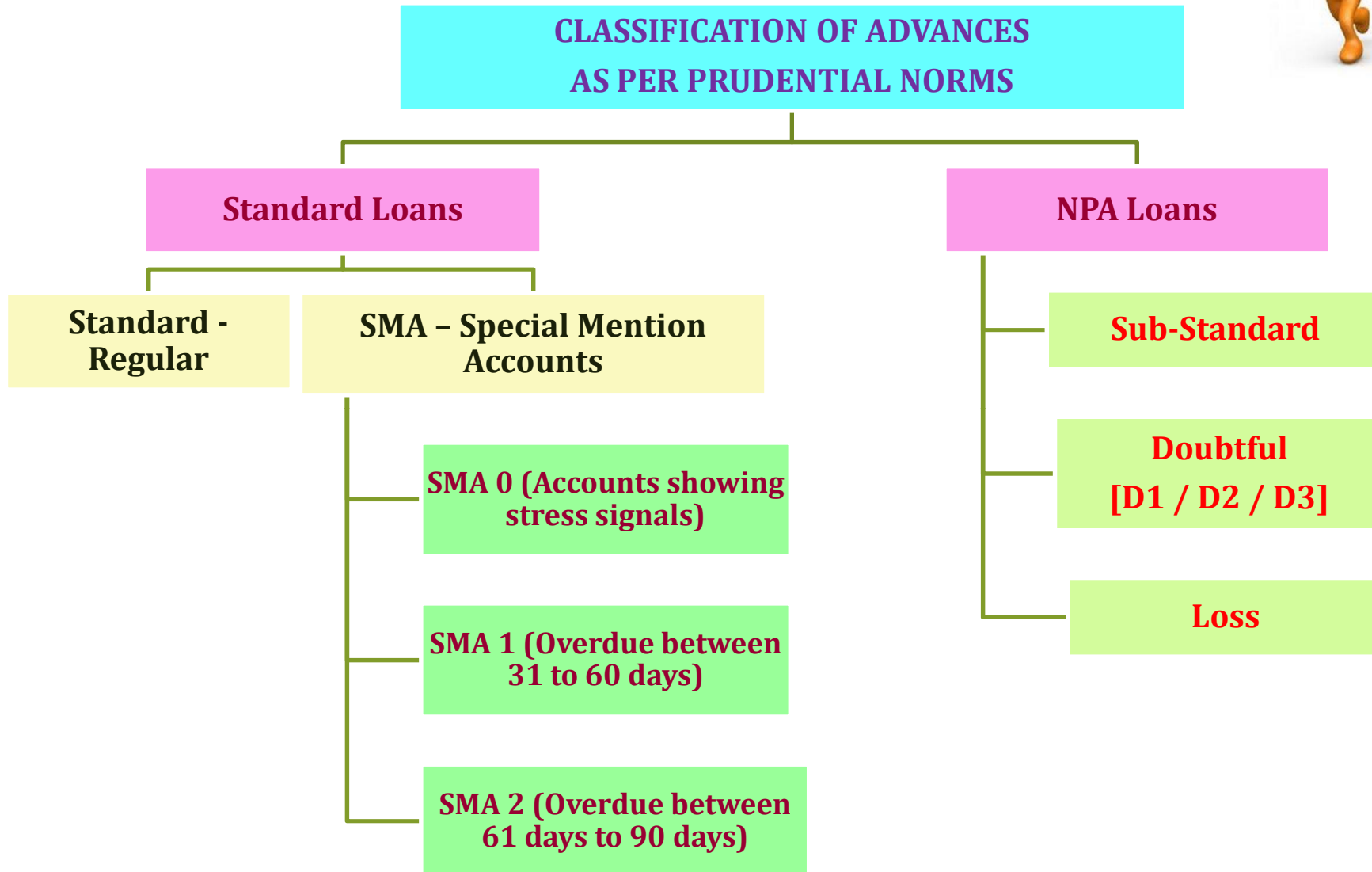
Advances:

Income Recognition
Provisioning
Asset Classification

Classification of Advances :



Classification of Advances :



ADVANCES Comprises of :



FUNDED AMOUNTS by way of :

- ❖ Term loans
- ❖ Cash credits, Overdrafts, Demand Loans
- ❖ Bills Discounted and Purchased
- ❖ Adverse balances in Deposit Accounts
- ❖ Participation on Risk Sharing basis
- ❖ Interest bearing Staff Loans

Advances :



Legal requirements of Disclosure in the Balance Sheet :

- A.
 - i) Bills purchased and discounted
 - ii) Cash credits, Overdrafts and loans repayable on demand
 - iii) Term Loans

- B.
 - i) Secured by tangible assets
 - ii) Covered by Bank/Government guarantees
 - iii) Unsecured

C. I. Advances in India:

- i) Priority sectors
- ii) Public sector
- iii) Banks
- iv) Others

C.II. Advances outside India:

- i) Due from Banks
- ii) Due from Others:
 - a) Bills Purchased and discounted
 - b) Syndicated loans
 - c) Others

Selection of Advances for Examination :



❖ **Large Advances**

Liability > Rs.2 Crores or 5% of the Branch Advances portfolio
[whichever is less]

❖ **Adversely commented accounts in latest reports of:**

- ❖ RBI (Accounts in which there is divergence with RBI)
- ❖ Statutory Auditors (including in LFAR)
- ❖ Latest Quarterly review
- ❖ Concurrent Auditors / Inspection by HO or RBI
- ❖ Stock audit reports
- ❖ Credit Audit and similar Reports
- ❖ Standard/sub standard Accounts in litigation/dispute
- ❖ Advances accounts in the list of published Wilful defaulters
- ❖ NPAs upgraded to standard
- ❖ Advances involving restructuring, rehabilitation, re phasing, renegotiation
- ❖ Advances identified but not treated as NPAs
- ❖ Accounts in which there are frequent irregularities or breach of norms and problem/Critical accounts as identified
- ❖ Special Mention Accounts with weaknesses and defaults within three slabs of 90 days.



Income Recognition,
Asset Classification and Provisioning
pertaining to Advances

Definition of Non-Performing Assets :



❖ **Non performing Assets:**

An asset becomes NPA when it ceases to generate income for the Bank

❖ **A non performing asset (NPA) is a loan or an advance where -:**

- ❖ interest and/ or installment of principal remain overdue for a period of more than 90 days 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,

❖ **Out of Order**

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

❖ **Overdue**

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Income Recognition :



- ❖ Policy has to be “**objective and based on the record of recovery**”.
- ❖ Income Recognition Policy
 - ❖ NPAs - on realisation basis
 - ❖ Interest on advances against Term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account provided adequate margin is available in the accounts.
 - ❖ Applicable for Government Guaranteed Advances as well.
- ❖ Reversal of Income
 - ❖ NPAs identified for the first time –Income to be reversed /not recognised.
 - ❖ Applicable for Government Guaranteed Advances as well.
- ❖ 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.

Suggested
though not
mandatory

1. Unrealised Expenses
2. Unrealised Interest
3. Principal Outstanding

Income Recognition :



❖ Interest Application

- ❖ On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books.
- ❖ For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

Categories of Non-Performing Assets :



❖ Substandard Assets:

Would be one, which has remained NPA for a period less than or equal to 12 months.

❖ Doubtful Assets

Would be one, which has remained in the substandard category for a period of 12 months.

❖ Loss Assets

Would be 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.

Also refer Relaxation (i.e. 60 / 90 days extra) due to "Demonetisation"

Matter for Attention :



❖ Para 2.1.3

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.

❖ Para 2.1.2 (i)

NPA is a loan or an advance where interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan,

ILLUSTRATION:

Repayment of Installment Originally Due on 'October 5 2016'
Status as on March 25, 2017 – 'UNPAID' Overdue by 200 days [Approx]

What would be Asset Classification

as on March 25, 2017 and as on March 31, 2017

Guidelines for classification of assets :



Classification as NPA Should be based on the record of recovery.

- ❖ Classification of assets should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realisation of dues.
- ❖ Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs
- ❖ Availability of security or net worth of borrower/guarantor not be taken into account for purpose of treating an advance as NPA or otherwise.
- ❖ **Non monetary defaults:**
Classification as NPA should be based on the record of recovery.
Not merely due to the existence of some deficiencies which are temporary.
Need consideration in case:
 - ❖ DP calculated from stock statements >3m
 - ❖ Regular/Ad-hoc limits not renewed within 90 days / 180 days. (i.e. not later than three months from the due date/date of ad-hoc sanction)
 - ❖ Multiple ad-hoc credit facilities extended to regular customers beyond permitted terms.

Guidelines for classification of assets :



Classification as NPA Should be based on the record of recovery.

- ❖ Up-gradation of NPAs
- ❖ Accounts regularized near about the Balance Sheet Date
- ❖ Asset Classification borrower wise and not facility wise
 - ❖ All facilities including investment in securities NPA/NPI
 - ❖ Devolvement of LCs and Guarantees
 - ❖ Bills discounted under LC
- ❖ Central Govt. guaranteed Advances, where the guarantee is not invoked/repudiated
 - ❖ Classified as Standard Assets.
 - ❖ but regarded as NPA for Income Recognition purpose.
- ❖ Additional Disbursement - BIFR approved packages, in respect of additional facilities sanctioned under the rehabilitation packages (to borrowers in NPA classification) the IRAC Norms will become applicable after a period of one year from the date of disbursement.

Guidelines for classification of assets :



Classification as NPA Should be based on the record of recovery.

❖ **Advances under consortium arrangements**

- ❖ Should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the advances.
- ❖ Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA.

❖ **DILIGENCE REPORT [By: CS / CA / CWA]**

to strengthen the information sharing system among banks

Guidelines for classification of assets :



Classification as NPA Should be based on the record of recovery.

- ❖ **Accounts where there is erosion in the value of security/frauds committed by borrowers**
 - ❖ Not prudent to follow stages of asset classification
 - ❖ It should be straightaway classified as doubtful or loss asset as appropriate:
 - i. 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 and provisioning should be made as applicable to doubtful assets.
 - ii. 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. It may be either written off or fully provided for by the bank.

Provisioning Norms :



Primary Responsibility is of the Bank Management and Auditors

❖ Standard Asset

Agricultural and SMEs Sectors	0.25%
Commercial Real Estate (CRE) Section	1.00%
CRE – Residential Housing Project	0.75%
Others	0.40%
Housing Loan during teaser rate period	2.00%

Provisioning Norms :



Primary Responsibility is of the Bank Management and Auditors

- ❖ **Sub-Standard Asset**
- ❖ **15% of total outstanding**
{general provision, without making any allowance for ECGC guarantee cover and securities available}
- ❖ **25% of total outstanding , if covered under 'unsecured exposures'**
- ❖ **20% of total outstanding if infrastructure loan [provided its backed by escrow facility with first charge]**

Unsecured exposure; 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.

'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.

Provisioning Norms :



Primary Responsibility is of the Bank Management and Auditors

❖ Doubtful Assets:

Period Provision	(Secured + Unsecured)	
Up to 1 year	25%	+ 100%
1 to 3 years	40%	+ 100%
More than 3 years	100%	+ 100%

*Provisions
to be made
to the
satisfaction
of the
auditors*

❖ Loss Assets:

Loss assets should be written off.

If permitted to remain in the books for any reason, 100% should be provided for.

* Intangible Security: Considered only if backed by legally enforceable and recoverable right over collection and rest of intangibles like rights, licenses, etc. are considered as 'Unsecured'

* Unsecured (For Doubtful): Advance which is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on realistic basis.

* Security Valuation in respect of collaterals **once in 3 years**

Agriculture Advances :



Definitions:

- ❖ Crop Season – ‘period up to harvesting of crops raised’ as determined by SLBC in each State depending upon the duration of crops raised by an agriculturist.
 - ❖ **‘Kharif’ Crop** - April – Dec - Due date of repayment may be fixed 31st March
 - ❖ **‘Rabi’ Crop** - Oct – April - Due date of repayment may be fixed 30th June
- ❖ Long duration crop & Short duration crop: - As per the extant RBI 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.

Agriculture Advances:

- ❖ Agricultural term Loan
- ❖ Kisan Credit Card (KCC)
 - * *Should be as per scale of finance applicable to the land under cultivation and the crop being cultivated.*
 - * *primary security is normally the standing crops under cultivation*

NPA Norms for Agriculture Advances:

- ❖ Short Duration Crops: 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**.
- ❖ Long Duration Crops : 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**.

Agriculture Advances :



Agricultural Advances Affected by Natural Calamities

- ❖ IRAC Master Circular dated July 1, 2015 deals elaborately with the classification and income recognition issues due to impairment caused by natural calamities.
- ❖ Banks may decide on their own relief measures, viz., conversion of the short term production loan into a term loan or re-schedulement of the repayment period and the sanctioning of fresh short-term loan, subject to the guidelines contained in RBI's latest Master Circular and directions contained in RBI Master Direction FIDD.No.FSD.BC.02/05.10.001/2016-17 dated July 1, 2016 on "Master Direction - Reserve Bank of India (Relief Measures by Banks in Areas Affected by Natural Calamities) Directions, 2016".
- ❖ In such cases the NPA classification would be governed by such rescheduled terms.
- ❖ In such cases of conversion or re-schedulement, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms & conditions and would be treated as NPA if interest and/or instalment of principal remain overdue for two crop seasons for short duration crops and for one crop season for long duration crops.
- ❖ 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" would be treated as "short duration" crops.

Agriculture Advances :



Agricultural Advances Affected by Natural Calamities

IMPORTANT RBI CIRCULARS

- ❖ Master Direction FIDD No.FSD.BC.2/05.10.001/2016-17 July 1, 2016 (Reserve Bank of India (Relief Measures by Banks in Areas Affected by Natural Calamities) Directions, 2016 ;
- ❖ FIDD.CO.FSD.BC.No 9/05.02.001/2016-17 August 4, 2016 (Union Budget – 2016-17 Interest Subvention Scheme);
- ❖ FIDD.No.FSD.BC. 19/05.04.02/2016-17 December 26, 2016 (Interest Subvention Scheme for Short Term Crop Loans during the year 2016-17- Grant of grace period of 60 days beyond due date)

Restructuring of Advances :



Key Features

- ❖ **An account where the bank, for economic or legal reasons grants concessions to the borrower that the bank would not otherwise consider.**
involve modification of terms / alteration of repayment period / repayable amount/ the amount of installments / rate of interest (due to reasons other than competitive reasons).
- ❖ Cannot reschedule / restructure accounts with retrospective effect
- ❖ Account to be Downgraded immediately upon restructuring
- ❖ Repeated Restructuring - Downgrade; No Benefits
- ❖ **UPGRADATION**
only on satisfactory performance during the 'specified period' [i.e. 1 Year].
- ❖ **INCOME RECOGNITION:** Standard – Accrual NPA – Cash Basis
- ❖ Parties indulging in frauds and malfeasance-**INELIGIBLE**.

Asset Classification Benefit available on restructuring on fulfilling the conditions have been withdrawn for all restructurings effective from April 1, 2015

Whether Restructuring???

- Extension in repayment tenor of a floating rate loan on reset of interest rate, to keep the EMI unchanged.
- Extension or deferment of EMIs to individual borrowers as against to an entire class
- Alteration of repayment period / repayable amount/ the amount of instalments / rate of interest (due to competitive reasons).

Restructuring of Advances :



Framework for Revitalising Distressed Assets

Master Circular IRAC Part C

Key Features

- ❖ **Part – C-1: Guidelines on JLF and Corrective Action Plan (CAP)**
 - ❖ Setting up of **CRILC** [Central Repository of Information on Large Credits]
 - ❖ Coverage for Fund and Non-Fund based exposures above Rs. 5 crores
 - ❖ Identifying **SMA-0** **SMA-1** **SMA-2**
 - ❖ **Formation of Joint Lender's Forum (JLF)**
Mandatory - If Exposure is above Rs. 100 crores
 - ❖ Reporting under SMA 0 for 3 quarters / year
 - ❖ Reporting under SMA 1 for 2 quarters / year
 - ❖ Reporting under SMA 2 at any time during the year
 - ❖ **Formulation of Corrective Action Plan (CAP)**
Step-1: Rectification → **Step-2: Restructuring** → **Step-3: Recovery**
 - ❖ **Accelerated Provision - for non-adherence of reporting / Ever-greening**

- ❖ **Part – C-2 : Refinancing of Project Loans, Sale of NPA and Other Regulatory Measures**

Restructuring of Advances :



Framework for Revitalising Distressed Assets

Master Circular IRAC Part C

Key Features

❖ Part - C-3 : Strategic Debt Restructuring Scheme

(to ensure more 'skin in the game' of promoters; Targeting change in management, in case of operational/ managerial inefficiencies)

- ❖ Initiative by JLF to change the ownership structure
- ❖ Needs to be agreed upon by creditors at least '75% in value' and '60% in number'
- ❖ Post-conversion (of debt to equity), all lenders under JLF to hold at least 51% or more of equity shares of the company.
- ❖ Can be divested in favor of new promoters subsequently.
- ❖ JLF must approve SDR package within 90 days from the date of deciding to undertake SDR
- ❖ **'STAND-STILL CLAUSE' IN ASSET CLASSIFICATION'** Existing asset classification norm as on reference date would be retained for a period of 18 months and then normal IRAC

❖ S4A - Scheme for Sustainable Structuring of Stressed Assets

Eligibility: Project commenced commercial operations; Aggregate exposure > Rs. 500 Crore; and account meeting 'sustainability test'

New Scheme by RBI w.e.f. **June 13, 2016**, to further strengthen the lenders' ability to deal with stressed assets" allows banks to bifurcate the debt of stressed borrowers into sustainable and unsustainable portion.

Outstanding shall be bifurcated into "**Part A - Sustainable Debt**" and "**Part B - Residual**"

Independent TEV study → Overseeing Committee Preparation of Resolution Plan



4

Other Critical Matters

Other Critical Matters :

- ❖ **Demonetisation**
- ❖ **Recent Frauds Reported - in Banking Industry.**
- ❖ **Secured /Unsecured classification into CBS**
- ❖ **MOCs vis-à-vis Main Audit Report vis-à-vis LFAR**
- ❖ **Ever-greening of Loan**
- ❖ **Cash Credit accounts -**
 - ❖ Stray credits just to keep the advance out of the ambit of NPA
 - ❖ Authenticity and regularity of stock statements
 - ❖ Drawing Power calculations vis-à-vis sanction terms
 - ❖ Ad-hoc Limits sanctioned (un-authorized).



Other Critical Matters :

- ❖ **Date of NPA (especially upon transfer to ARM Cell)**
- ❖ **Security at the time of classification as NPA**
- ❖ **Account operating on Manual Mode**
- ❖ **Moratorium Period**
 - ❖ Housing / Education / Agricultural
 - ❖ Unauthorised roll-over
- ❖ **Compliance of Conditions for SDR / CDR / Other restructuring**
 - ❖ Promoters' contribution - Invariably be brought upfront
 - ❖ Other performance related conditions
- ❖ **Quick Mortality Cases**
- ❖ **Non-fund Facilities, manually, outside the CBS.**



Computation of Drawing Power

ILLUSTRATION

Particulars of current assets

(A) Stocks:

Stocks at realizable value	1000	
Less: Unpaid stocks:		
- Sundry creditors	300	
- Acceptances/LCs etc.	<u>300</u>	<u>600</u>
Paid for stocks		400
Margin @ 25%		<u>100</u>

(B) Debtors:

Total Debtors		1000
Less: Ineligible debtors	<u>200</u>	
Eligible debtors		800
Margin @ 40%	<u>320</u>	

Total DP

DP

300

480

780

