

# ***Seminar on Statutory Audit of Bank Branches***

IRAC Norms- Practical issues

**CA Pankaj Tiwari**  
**CNK & Associates LLP**



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# Changing Approach of RBI:

- ❑ Proactive vs. Reactive – Learnings from Past (ILFS, DHFL, SREI etc. )
- ❑ No tolerance by the RBI on the lapses by the Banks/NBFC/Other Financial Institution
- ❑ Going beyond the monetary penalty as done in the past to discontinuance or temporary halt of the business
- ❑ Change in inspection approach of RBI since last 2-3 years from process audit to business audit (beyond sanctioning process)
- ❑ Going beyond the adequacy of provisioning on loans or adequate capital adequacy of the banks to overall governance in banks
- ❑ “*Arjuna eye*” on the building up of the systematic risk in the certain credit portfolio or lending business of the banks/NBFC (PL, CC etc.)
- ❑ Interaction with SA now focusing more on the quality of the data, credit risk & quality of audit observations

# Challenges for Bank Audit -FY 2023-24:

- ❑ **Retail loan portfolio-** increase loan portfolio and due to interest rates leads to increase in the default risk which may lead to **possible evergreening**
- ❑ **IRAC Norms 2.0-** reporting on implementation issues in - daily NPA **classification through system** with minimum or no manual intervention, out of order in CC a/c etc. as per new norms- **stabilisation period**
- ❑ Ensuring **compliance of various RBI guidelines** relating to operational and other matters of consumer service- **LFAR reporting**
- ❑ **Increased RWA on “Consumer Credits”-** issues in classification of loans as consumer credits- wrong classification leads to wrong RWA- **impact on CRAR of banks** (LAP Loan, Top-up HL loan)
- ❑ **Reliance on effective functioning of automated systems in Banks-** interest rate re-set, interest paid on deposit account etc.- **independent testing by the auditor**

# *From Reserve Bank of India Desk*

# Relevant Circulars applicable for FY 2023-24:

## ❑ Important Circular/Notifications:

- Framework for Compromise Settlements and Technical Write-offs- June 8, 2023- **new NPA category**
- Reset of Floating Interest Rate on Equated Monthly Instalments (EMI) based Personal Loans- August 18, 2023- effective 1<sup>st</sup> January 2024- **LFAR reporting**
- Responsible Lending Conduct – Release of Movable / Immovable Property Documents on Repayment/ Settlement of Personal Loans- September 13, 2023- **LFAR reporting** (Rs.5,000 penalty per day)
- Display of information - Secured assets possessed under the SARFAESI Act, 2002- September 25, 2023 - **LFAR reporting (SCA)**
- Regulatory measures towards consumer credit and bank credit to NBFCs-November 16, 2023 – **classification for CRAR**

# Relevant Circulars applicable for FY 2023-24:

## ❑ Master Circular/Master Directions:

- Master Circular Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances 1<sup>st</sup> April 2023– **[Consolidated Circular]**
- Master Circular - Guarantees and Co-acceptances- 1<sup>st</sup> April 2023
- Master Directions on Frauds – Classification and Reporting by commercial banks and select FI- July 2017- **RFA & EWS mechanism**
- Master Direction-Priority Sector Lending-Targets and Classification (amended from time to time)- **Certificate from SBA's**
- Master Direction - Know Your Customer (KYC) Direction, 2016- **LFAR clauses**

# Relevant Circulars applicable for FY 2023-24:

## ❑ Other Circular/Notifications:

- Master Direction on Financial Statements - Presentation and Disclosures (amended time to time)- **mainly for SCAs**
- Master Direction – Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022- **effective from April 01, 2022**
- Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021- **mainly for SCAs**
- Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021- **mainly for SCAs**



# ICAI Materials:

## Guidance Note on Audit of Banks (2024 Edition)

### Attention

Members' attention is invited to relevant directions/circulars issued by the Reserve Bank of India up to January 31, 2024, available at ICAI website for ease of use and reference. Members are advised to keep track of legislative/regulatory developments, for example, circulars of the Reserve Bank of India, issued subsequent to the aforementioned date and having a bearing on the statutory audit of banks/bank branches for the year ended March 31, 2024.

Members are also advised to read this Guidance Note along with other two publications (Technical Guide on Audit of Internal Financial Controls in Case of Public Sector Banks and Technical Guide on Revised Formats of Long Form Audit Report) of AASB.



**The Institute of Chartered Accountants of India**  
(Set up by an Act of Parliament)  
New Delhi

## Technical Guide on Revised Formats of Long Form Audit Report



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(Set up by an Act of Parliament)

### Utility

for

### Bank Branch Audit - 2024 Edition

By



CENTRE FOR AUDIT QUALITY

# ICAI Utility::

Name of Firm	Name of Bank			Name of Branch				Zone/ Circle Code		Branch Code		Financial Year 2022-23	
Sheet	Total checks	Yet to be started		Not Applicable		Work in process		Query raised		Completed & no Adverse		Completed but with Adverse	
Cash	20	20	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Balances with RBI,SBI,OtherBank	14	14	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Money at call and short notice	7	7	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Investments	7	7	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Advances	118	118	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Other Assets	54	54	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Fixed Assets	47	47	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Borrowings & Deposits	18	18	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Other Liabilities	4	4	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Contingent Liabilities & Bills for Collection	47	47	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Interest Earned	9	9	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Commission Income	8	8	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Income on Account of Commitment Charges	3	3	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Interest Expended	10	10	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%
Other Expenses	13	13	100.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0.00%

## Advances

Sr. No.	Audit Procedures	Reference to G. Note /T. Guide	Work status	Working Paper Ref.	Comments/ Remarks (If any)	Date of Preparation	Prepared By	Date of Review	Reviewed By
	<b>Agriculture Advances</b>								
1	Obtain information in Format I and Format II submitted in respect of interest subvention by the branch to Head office/Bank to RBI and certify the correctness of the claim.	Guidance Note (10.28) (1)	Not Applicable						
2	Obtain and verify the working sheet of Interest subvention.	Guidance Note (10.28) (4)	Yet to be started						
3	Verify that the book credit entries are not passed only for the purpose of availing the interest subvention.	Guidance Note (10.28) (2)	Yet to be started						
4	Obtain a list of eligible borrowers and interest rate charged and ensure that the Rate of Interest Charged is as per Sanction, Circular and the ROI entered in the System.	Guidance Note (10.28) (3) & (5)	Not Applicable						
5	Verify that the Interest is credited to the accounts before reimbursing the claim for 3 % prompt repayment	Guidance Note (10.28) (6)	Query Raised						

# *IRAC Norms 2.0*

## NPA as per IRAC Norms:

Non-  
service  
of  
amount  
due  
(90days  
DPD  
norms)

Out of  
order  
criteria

DCCO  
beyond  
time  
limit

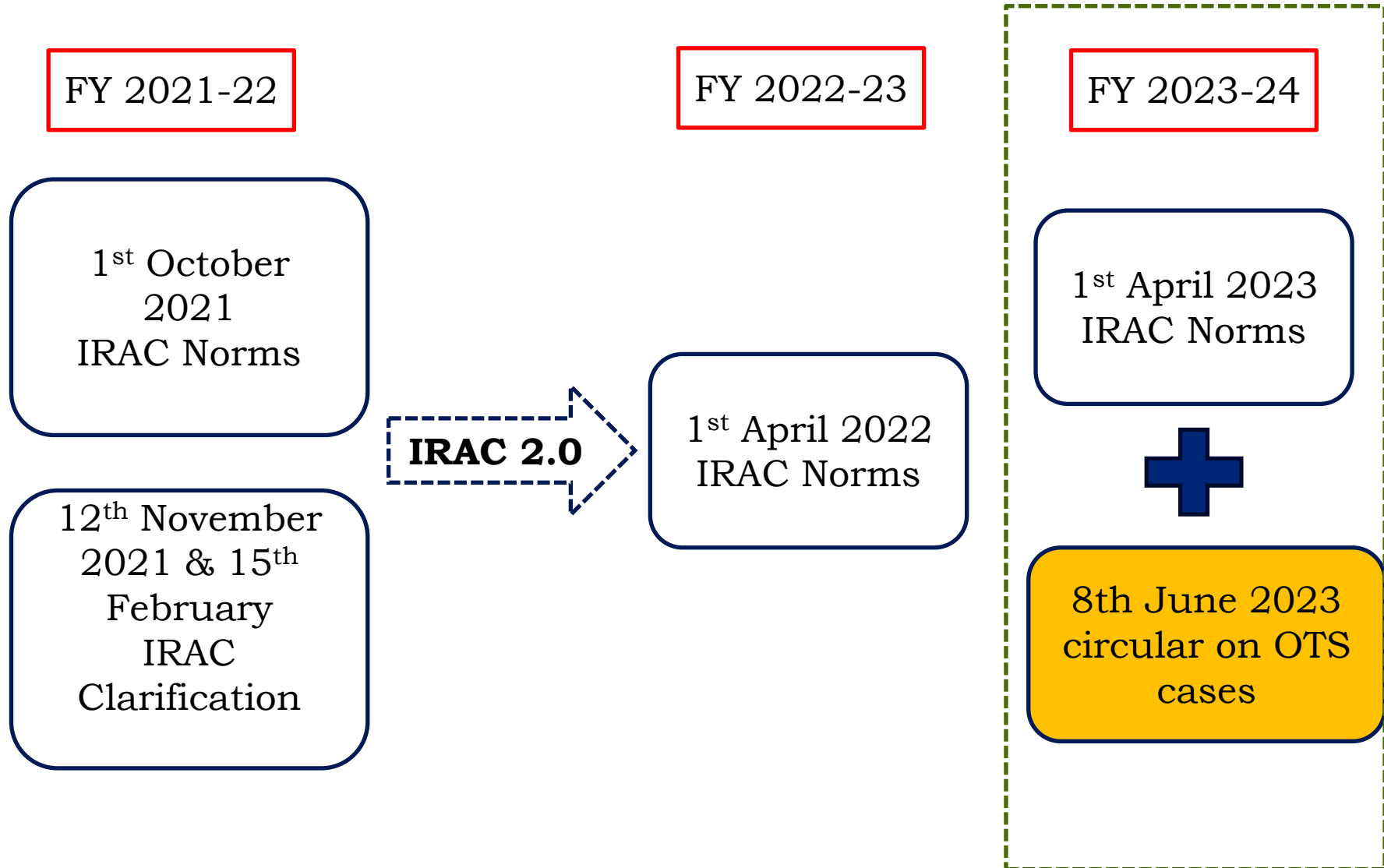
Due to  
value of  
security

Rest.  
Loan  
account

Non-  
renewal  
of limit  
within  
180  
days

Account  
Selected  
by the  
Bank or  
Auditor  
or RBI

# Journey of IRAC 2.0:



# IRAC Norms – Clarifications/changes for Banks:

## Major points of clarifications in 12<sup>th</sup> November 2021 circular:

- Specification of due date/repayment date in loan agreement
- **Classification of SMA & NPA –part of day-end process** (DPD on Same Day vs. Next Day)
- **Clarification regarding definition of ‘out of order’**
- NPA classification in case of interest payments
- ~~Upgradation to standard status –not relevant for banks~~
- Income recognition policy in case of loans with moratorium on interest
- Consumer education material

## **Relevant Circulars for Day End NPA :**

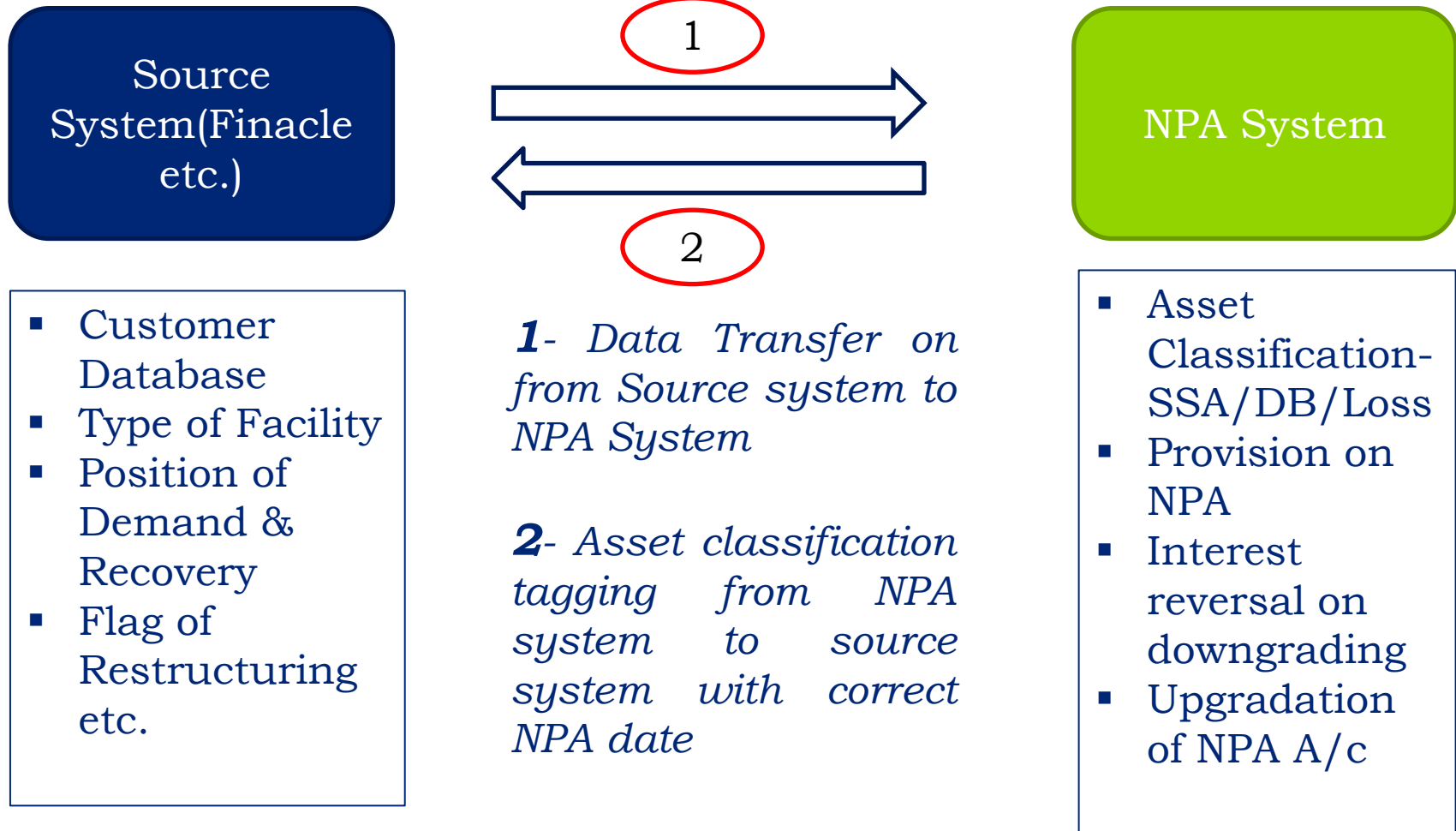
### **Classification of SMA & NPA –part of day-end process:**

4. In the above context, it is further clarified that borrower accounts shall be flagged as overdue by the lending institutions as part of their day-end processes for the due date, irrespective of the time of running such processes. Similarly, 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. In other words, the date of SMA/NPA shall reflect the asset classification status of an account at the day-end of that calendar date.



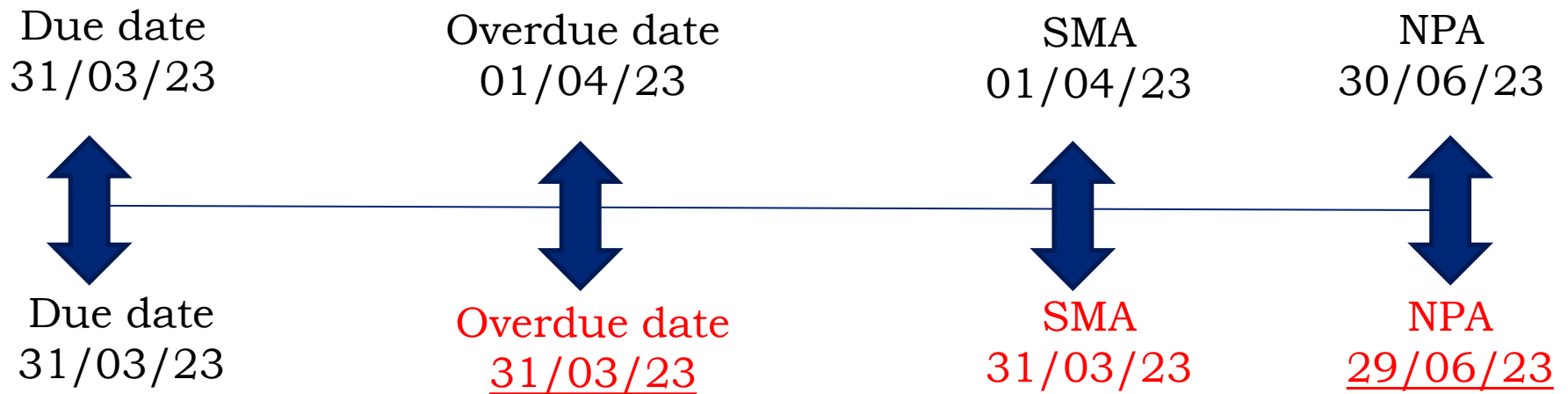
# IRAC Norms – Clarifications/changes for Banks:

Usual day-end process in case independent system used for NPA:



# IRAC Norms – Clarifications/changes for Banks:

## Classification of SMA & NPA –part of day-end process:



- ❑ Different banks were following different practice of identification of account as NPA- monthly/quarterly/daily/3EMI due
- ❑ September 2020 circular and November 2021 circulars now requires SCB to identify the NPA on daily basis through system- **June 2021**
- ❑ No exceptions are given for Saturday/Sunday/Holidays- NPA process need to run to identify any account as NPA- **LFAR point**
- ❑ Major impact- total overdue recovery for NPA vs. Partial recovery in Standard accounts

# NPA Automation Circular 2020:

## Coverage:

- 2.1 All borrowal accounts, including temporary overdrafts, irrespective of size, sector or types of limits, shall be covered in the automated IT based system (System) for asset classification, upgradation, and provisioning processes. Banks' investments shall also be covered under the System.
- 2.2 Asset classification rules shall be configured in the System, in compliance with the regulatory stipulations.
- 2.3 Calculation of provisioning requirement shall also be System based as per pre-set rules for various categories of assets, value of security as captured in the System and any other regulatory stipulations issued from time to time on provisioning requirements.
- 2.4 In addition, income recognition/derecognition in case of impaired assets (NPAs/NPIs) shall be system driven and amount required to be reversed from the income account should be obtained from the System without any manual intervention.
- 2.5 The System shall handle both down-grade and upgrade of accounts through Straight Through Process (STP) without manual intervention.

# IRAC Norms – Clarifications/changes for Banks:

## Clarification regarding definition of 'out of order':

*Changes in the wording of definition:*

An account should be treated as '**out of order**'

if the outstanding balance in the CC/OD accounts remains continuously in excess of the sanctioned limit/drawing power for 90 days or 1

~~In cases where~~ the outstanding balance in the CC/OD accounts ~~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 2

the outstanding balance in CC/OD account is less than the sanctioned limit/drawing power but credits are not enough to cover the interest debited during the same previous 90 days -period, ~~these accounts should be treated as 'out of order'~~. 3

# IRAC Norms – Clarifications/changes for Banks:

## Major points of clarifications – 15th February 2022 circular:

- Out of order- applicable to all loan products being offered as an overdraft facility
- Previous 90 days period- inclusive of the day for which the day-end process is being run- **IMP clarification**
- Upgradation of the facility-only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities- **IMP clarification**

# **IRAC Norms – Clarifications/changes for Banks:**

## **Major points of clarifications –Upgradation of loan account: 1<sup>st</sup> October 2021 IRAC norms:**

### 4.2.5 Upgradation of loan accounts classified as NPAs

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as nonperforming and may be classified as 'standard' accounts. With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of DCCO, etc., the instructions as specified for such cases shall be applicable.

## **1<sup>st</sup> April 2022- IRAC Norms: (added by 15/02 clarification)**

### 4.2.5 Upgradation of loan accounts classified as NPAs

The loan accounts classified as NPAs may be upgraded as 'standard' asset only if entire arrears of interest and principal are paid by the borrower. In case of borrowers having more than one credit facility from a bank, 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. With regard to upgradation of accounts classified as NPA due to

## Points for verification by SBA-on IRAC 2.0 :

- **Compliance of April 23 norms** to avoid any observations from RBI-impact in LFAR reporting- **same day vs. next day**
- Reporting on **different practice** followed by the banks- **CC/OD classification-** LFAR reporting – compliance of IRAC norms- **previous 90 days recovery & quality of credit**
- Linked account classification on recovery of dues- **zero DPD vs. recovery of dues in NPA account**
- Manual Intervention on asset classification-need to highlight the instances if any either in changing the date of NPA/class of assets- **should be rare instances**
- Extent of automation in NPA system- updation of security value & impact of **expired security valuation** (more than 3 years)

## New NPA in 2023-24- OTS cases :

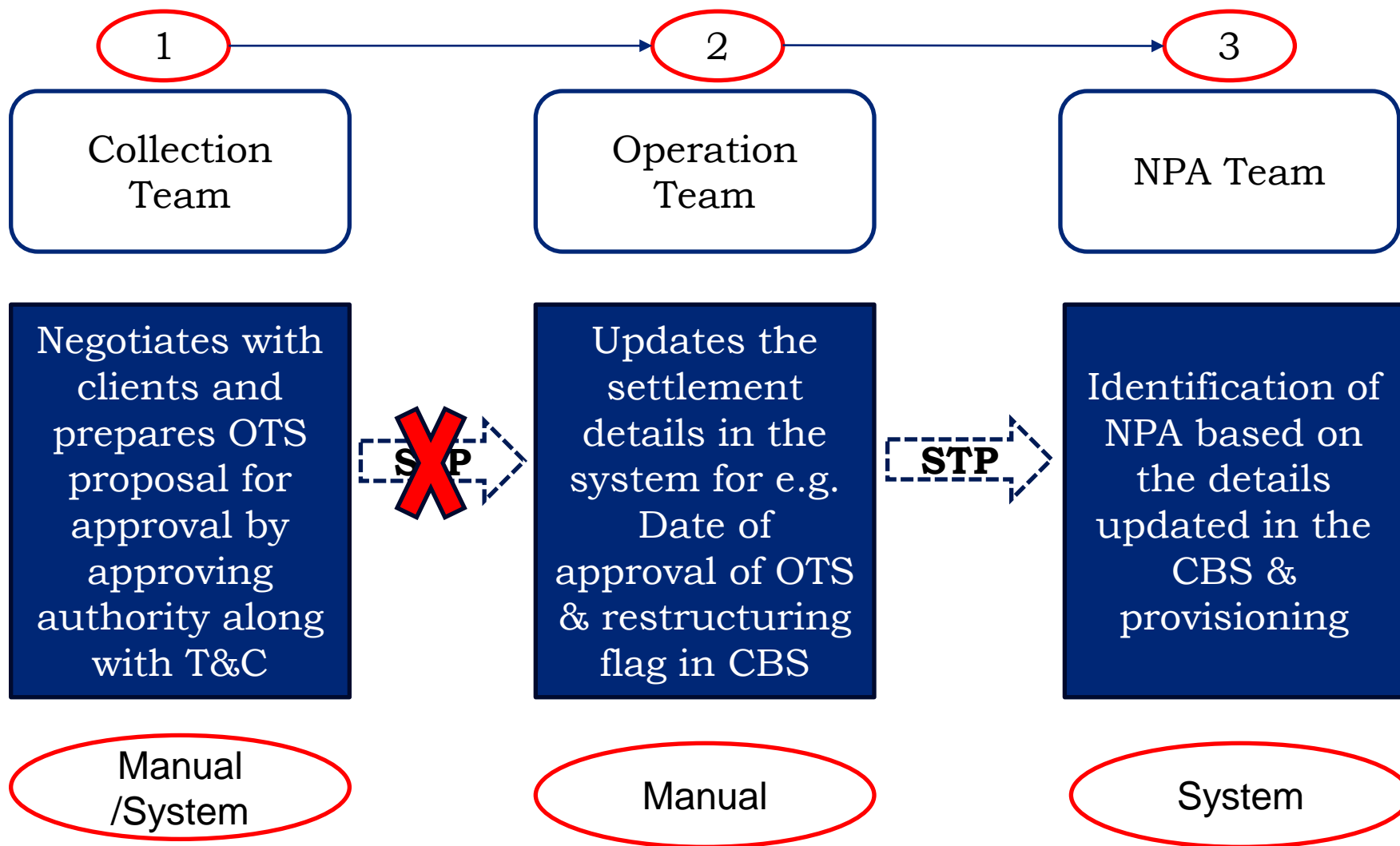
### Major points as per 8<sup>th</sup> June 2023 circular for SBAs:

- Board approved policy – on process to be followed for all compromise settlements and technical write-offs – permissible sacrifice etc.-  
**verification by SCAs**
- Time for payment of Agreed settlement amount exceeds three months- treated as restructuring and tagged as NPA – **important area** – subsequent changes in terms of repayment less than 3 months?
- Cooling period before giving fresh exposure to such borrowers- minimum 12 months as per RBI circular (except farm credit)-  
**important area for verification of new sanctions**
- Status of cases - settlement agreed between the bank and borrower on 29<sup>th</sup>/30<sup>th</sup> /31<sup>st</sup> March 2024? – **Potential NPA miss out cases- MOC-system delink**
- Annual Restructuring disclosure should include these accounts as well+ **LFAR reporting** on restructured accounts



# New NPA in 2023-24- OTS cases :

**Practical approach on 8<sup>th</sup> June 2023 circular by few Banks:**



## **New NPA in 2023-24- OTS cases :**

### **Checklist for verification of compliance of 8<sup>th</sup> June circular:**

<b>Sr. No.</b>	<b>Points of verification</b>	<b>Impact of Non-Compliance</b>
1.	Board Approved policy by the Bank on C&S	Modification in LFAR Reporting
2.	Process of OTS Accounts tagged as REST-handled centrally or is available at the branches	Modification in LFAR Reporting
2.	Process of Identification of account as NPA- for more than 3 months- Manual or through system?	IRAC Non-compliance +Reporting in LFAR-restructuring section
3.	Process of verification/check by the bank for not granting fresh facility to borrower with C&S	Reporting in LFAR
4.	Treatment of cases approved in few last days of month end (29 <sup>th</sup> /30 <sup>th</sup> /31 <sup>st</sup> )	MOC+ Reporting in LFAR & Main Report
5.	Accounts tagged as restructured accounts are part of REST disclosure	Incorrect Disclosures

## Relevant LFAR Clause- IRAC 2.0:

(f)	<i>Asset Classification, Provisioning of Advances and Resolution of Stressed Assets</i>		
(i)	<p>a) Has the branch identified and classified advances into standard / substandard / doubtful / loss assets through the computer system, without manual intervention?</p> <p>b) Is this identification &amp; classification in line with the norms prescribed by the Reserve Bank of India</p>	:	<p>f) Whether RBI guidelines on income recognition and provisioning have been followed.</p>
(iii)	<p>a) Whether the upgradations in non-performing advances is in line with the norms of Reserve Bank of India</p> <p>b) Where the auditor disagrees with upgradation of accounts? If yes, give reasons thereof.</p>	:	

# Identification of Account as “NPA”

## Recent RBI Divergence/observations:

- Non-implementation of RP-7<sup>th</sup> June 2019:
  - Defaults not rectified within the review period of 30 days or viable RP not implemented within 180 days
  - Additional provision made only on FB exposure portion and not on total o/s amount (FB+NFB)
- DP computed based on the expired stock statements- to be classified as NPA
- Wrongful upgradation of NPA accounts before implementation of restructuring plan
- Wrongful reversal of provision on change in ownership before expiry of monitoring period
- Realisable value of security less than 10% of o/s- not classified as Loss assets –only in NPA cases

## Probable Expectation of RBI from Bank Auditor :

- Identification of **probable evergreening of accounts** by the banks
- Reporting on **non-compliance of IRAC norms**- identification of account (e.g. restructured a/c) and provisioning (e.g. no security)
- Extra care or **additional audit procedure on restructured accounts**- MSME + Non-MSME
- **Basis compliance of IRAC norms** – upgradation of accounts from NPA to Standard
- **Assess increase in credit risk**- pervasive in nature- identify through QMR reports etc.
- Highlighting the areas of two different view/interpretation issues through LFAR

# Types of Assets:

## ❑ Standard Assets:

- The account/borrower is regular in paying the interest and the principal as and when due/demanded by the Bank.
- Normal risk and the provisioning on these advances depends on the category of the loans

## ❑ Non-Performing Assets:

- Para 2.1.1. *“An asset, including a leased asset, becomes non performing when it **ceases to generate income** for the bank”*
- Only recovery need to be seen to classify an account as NPA
- No distinction between Secured and Unsecured assets for the purpose of the classification of account

## Criteria for classification- NPA

Sr. No.	Type of Facility	Criteria –Para 2.1.2
(A)	Term Loans	“ <b><i>interest and/or instalment of principal</i></b> remain overdue for a period of more than 90 days in respect of a term loan”
(B)	Overdraft/Cash Credit	<p>“the account remains ‘out of order as indicated in the IRAC</p> <p><b><i>Out of Order- para 2.2</i></b></p> <ul style="list-style-type: none"> <li>▪ Outstanding Balance &gt; SL or DP continuously for 90 days</li> <li>▪ No credits in accounts continuously for 90 days <del>as on B/s date</del></li> <li>▪ Credits in the accounts are not sufficient to cover interest debited during <del>the same period</del> the previous 90 days period</li> </ul>



## Criteria for classification- NPA

Sr. No.	Type of Facility	Criteria –Para 2.1.2 & 4.2.21
(C)	Bills Purchased & Discounted	<p>“the bills remain overdue for a period of more than 90 days “</p> <p><b>Overdue</b> – any credit facility is overdue if it is not paid on the due date fixed by the bank (para 2.3)</p>
(D)	Credit Cards	<p>“if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the payment due date mentioned in the statement”</p>
(E)	Derivative Transactions	<p>“overdue receivable representing positive M-t-M value of derivative contract remains unpaid for more than 90 days”</p>

## Criteria for classification- NPA

Sr. No.	Type of Facility	Criteria –Para 2.1.2 & 4.2.21
(F)	Agricultural Advances	<ul style="list-style-type: none"><li>▪ <b>Short duration crop-</b> if the instalment of principal or interest thereon remains overdue for two crop season;</li><li>▪ Long duration crop- if the instalment of principal or interest thereon remains overdue for one crop season;</li><li>▪ Crop season is decided by State Level Banker's committee</li></ul>

# Classification of Co-borrower: [Industry Issue]

## ❑ Assessment of Joint Loans:

- Loans given after assessing and considering income of primary and co-borrower;
- Eligibility criteria tested considering the profile of both the borrowers;
- Borrower and Co-borrower – equal responsibility in regular service of EMI;
- Default in repayment by both would lead to account getting classified as overdue and then NPA.

## ❑ Current Industry practice:

- In absence of clear guidance- only Cust ID of primary borrower is classified/tagged as NPA- Co-borrower only CIBIL

Borrower	Housing Loan	Auto Loan	Credit Card
Primary	Rs.10 crore (Joint Loan)	Rs. 50 lakhs	
Co-borrower		-	Rs.5 lakhs
NPA Classification	Yes	Yes	???

## RBI directions on Negative amortisation: :

loan. However, in respect of EMI based floating rate personal loans, in the wake of rising interest rates, several consumer grievances related to elongation of loan tenor and/or increase in EMI amount, without proper communication with and/or consent of the borrowers have been received. In order to address these concerns, the REs are advised to put in place an appropriate policy framework meeting the following requirements for implementation and compliance:

- (v) REs shall ensure that the elongation of tenor in case of floating rate loan does not result in negative amortisation.

# Classification of NPA: Asset Classification

- **Sub-Standard Assets: (SSA)**

- ✓ Account has remained **NPA** for a period less than or equal to 12 months

- **Doubtful Assets:**

- ✓ Account has remained **SSA** category for a period of 12 months- **DB-1**
- ✓ Account has remained in **DB-1** for 1-3 years –**DB-2**
- ✓ Account has remained in **DB-2** for more than 3 years-**DB-3**

- **Loss Assets:**

- ✓ Identified by the bank or internal or external auditor or the RBI inspection

SA-SSA-DB1-DB2-DB-3



# Exemption from NPA Classification:

## ❑ Para 4.2.11 of IRAC Norms:

- 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.

## ❑ Para 4.2.14 of IRAC Norms:

- *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.*

## Provisioning Norms:

Sr. No.	Asset class (NPA)	Provisioning %
(A)	<b>Normal Category:</b> Sub-Standard Assets (Fully Secured) Sub-Standard Assets (Unsecured)  Unsecured exposure: <i>“Realisable value of security is not more than 10% of the outstanding exposure”</i>  <b>Infrastructure Category:</b> Sub-Standard Assets (Fully Secured) Sub-Standard Assets (Unsecured)	15% 25%        15% 20%
(B)	<b>Doubtful Assets:</b> DB-1 (Upto 1 Year) DB-2 (1 to 3 Year) DB-3 (More than 3 Year)	25% 40% 100%

## Provisioning Norms:

Sr. No.	Asset class (NPA)	Provisioning %
(C)	Loss Assets	100%
(D)	<b>Standard Assets:</b> <ul style="list-style-type: none"> <li>▪ Direct Advances to Agriculture and SME Sector</li> <li>▪ Advances to Commercial Real Estate (CRE)</li> <li>▪ Advances to CRE- Residential Housing (CRE-RH)</li> <li>▪ Housing Loan at Teaser rates (+ 1 Year)</li> <li>▪ Restructure Advances (Other than Provision for Dim. In Value)</li> <li>▪ All other loans not included in above</li> </ul>	0.25% 1.00% 0.75% 2.00% 5.00% 0.40%

### ***Accelerated provisioning:***

SMA status of accounts need to be reported to CRISIL-fails to report such status the bank will be subjected to accelerated provisioning (SSA- to the extent of 40% and DB to the extent of 100% in DB-2 category )



# Issues in Classification of advances as NPA:

## ❑ Erosion in value of security/Frauds by borrower:

- In Certain circumstances the NPA are classified directly to Doubtful/Loss assets
- Potential threat of recovery due to *erosion in value of security* or *non availability of security* and *existence of other factors (e.g. Frauds)*
- Following classification policy should be adopted:

Case	Situation – <i>Realisable value of Security</i>	Classification
(A)	Less than 50% (last assessed )	DB
(B)	Less than 10% (of balance o/s)	Loss

- New LFAR Clause- Substantial deterioration in Security Value

## Erosion in Value of Security Valuation:

Whether there is a substantial deterioration in value of security during financial year as per latest valuation report in comparison with earlier valuation report on record?

We have verified the security valuation report in case of material NPA accounts and there is no substantial deterioration in the value of security except in case of [REDACTED]

wherein the market value of the collateral has substantially reduced from Rs. 9.88 crores at the time of sanction (report date-27<sup>th</sup> March 2018) to Rs. 3.75 crores (as per the latest valuation report dated 5<sup>th</sup> January 2021).

Further, the valuation report obtained by the branch dated 5<sup>th</sup> January 2021 has several disclaimers such as (a) *Legal Report is not available;* (b) *at the time of visit said property is not traceable because no demarcation to identify the said property,* which has raised concerns over the appropriateness and completeness of such valuation report.

# RBI on Security Valuation:

## ❑ Para 4.2.9 of IRAC Norms:

- *In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification.*

## ❑ Para 5.3 of IRAC Norms:

- *100 percent of the extent to which the **advance 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 a realistic basis.*

## LFAR Clause of Security Valuation:

(vii)	In respect of non-performing assets, has the branch obtained valuation reports from approved valuers for the immovables charged to the bank, once in three years, unless the circumstances warrant a shorter duration?	:	
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# RBI on Security Valuation:

S N	Types of Advances	Types of Security available	Impact
1	Standard Advances	<ul style="list-style-type: none"> <li>Immovable and Movable Assets (P &amp; M, Inventories etc.);</li> <li>Shares and Securities;</li> <li>Fixed Deposits and other liquid security (LIC, KVP, NSC etc.)</li> <li>Guarantee by Govt./Promoter/Corporate</li> </ul>	<ul style="list-style-type: none"> <li>Schedule-9- Secured and Unsecured Loans;</li> <li>Para 4.2.9 of IRAC Norms;</li> <li>Para 4.2.11 of IRAC Norms;</li> <li>Para 4.2.14 of IRAC Norms</li> </ul>
2	Non-performing Assets (NPA)	<ul style="list-style-type: none"> <li>Immovable and Movable Assets (P &amp; M, Inventories etc.);</li> <li>Shares and Securities;</li> <li>Fixed Deposits and other liquid security (LIC, KVP, NSC etc.)</li> <li>Guarantee by Govt./Promoter/Corporate</li> </ul>	<ul style="list-style-type: none"> <li>Para 4.2.9 of IRAC Norms</li> <li>Para 5.3 of IRAC Norms;</li> </ul>

# Income Recognition & Reversal on NPA:

- ❑ Interest income on NPA **not** recognised on **accrual basis**- against the principal of certainty of collection as AS-9- Revenue Recognition
- ❑ Interest income on such accounts should be recognised on “Cash basis” or “Actual receipt” basis
- ❑ Exceptions:- Interest on advances against TD/KVP/NSC etc. subject to availability of Margin
- ❑ Advance, including bills purchased and discounted, becomes NPA, the entire interest accrued and credited to income in past period should be reversed if the same is **NOT REALISED**.
- ❑ 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**.

## Upgradation of NPA Account:

- ❑ If arrears of **interest and principal** are paid by the borrower in case of loan accounts classified as NPA, the account should no longer be treated as non-performing and may be classified as “Standard” accounts.
- ❑ Standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the bank should be upgraded only when **ALL the outstanding loan/facilities** in the account **perform satisfactorily** during the specified period i.e. principal and interest on all facilities in the account are serviced as per terms of payment during that period.
- ❑ Comparison of NPA accounts/ critical accounts over a period- may highlight some serious concern over Upgradation of NPA account during a particular period

# Recoveries in NPA Account:

## ❑ *Recoveries before Balance Sheet date:*

- **Interest realised on NPA's** may be taken to income account provided credits in the accounts towards interest are **not out of fresh/additional credit facilities** sanctioned to borrower by the bank.
- No formal guidelines/agreement between bank and borrower w.r.t. apportionment of recoveries made- bank should adopt an accounting principle and exercise the right of appropriation of recoveries in uniform and consistent manner.

## ❑ *Recoveries after Balance Sheet date:*

- No clear guidelines by the regulator- no objections as well in any Bank
- AS-4 Events occurring after the Balance Sheet date- Non adjusting event
- Temporary vs. Permanent deficiencies/weakness
- Best Judgement after review of facts and circumstances of each case



## LFAR Appropriation policy:

(f)	<i>Asset Classification, Provisioning of Advances and Resolution of Stressed Assets</i>		
(x)	Whether in the cases concluded the recoveries have been properly appropriated against the principal / interest as per the policy of the bank?	:	

## Practical Issues/Challenges:

- ❑ Divergence in NPA observed by RBI during the Inspections
- ❑ System based classified – sometime leads to incorrect classification (GIGO rule)
- ❑ Verification of parameters set in the system for classification of account as NPA (e.g. Repayment Schedule)
- ❑ Co-borrower classification – not implemented by the banks in system
- ❑ Non reversal of **total** interest in account classified as NPA (CY + PY unrealised)
- ❑ Recognition of interest income in NPA A/c's
- ❑ Non submission of Stock Statement by small borrowers.

## Practical Issues/Challenges:

- ❑ Carry forward of date of NPA (from earlier year to current year)
- ❑ Classification of accounts qua borrower would apply for agricultural and non agricultural loans?
- ❑ Classification of accounts transferred from other branches
- ❑ NPA regularised after balance sheet date but before signing the accounts
- ❑ Income Leakage- Rate of Interest fed in system is incorrect, DP is wrongly calculated, penal interest not recovered on late submission of Stock statements and Financials etc

## Audit Approach:

- ❑ Automated classification of NPA- verify system, parameters, controls on modification of parameters, control on categorisation of NPA
- ❑ CC/OD/WC facility- verify the computation of drawing power, fresh sanction to escape the NPA classification, stock statement submission with the latest Balance Sheet.
- ❑ Reversal of unrealised interest on first time classification and subsequent transfer to memorandum account
- ❑ Borrower wise classification, Upgradation, and subsequent down gradation of NPA accounts are as per IRAC Norms
- ❑ Valuation of Security of main NPA cases- above a certain threshold determined by the Bank.
- ❑ No debits allowed in the NPA Accounts (e.g. Legal Charges debit separately )

## Minimum Audit Procedures on NPA:

- ❑ Comparison of NPA of current year vs. Previous year [ Name of Customer, Date of NPA, O/s Balance etc.]
- ❑ Verification of the any changes in the above and reasons for the same along with relevant supporting documents
- ❑ Increase in the O/s Balances- due to recovery charges etc. should be debited to P & L A/c- CRIP Cost in case of IBC cases
- ❑ Verification of the recovery in the NPA accounts- apportionment as per the recovery policy of the bank- adjustment of recoveries done through suspense a/c rather than direct NEFT/RTGS
- ❑ Verification of the security valuation for the cases shifted to Doubtful category in the current year from the date of NPA
- ❑ Verification of Fraud accounts – comparison of the same with the last year and new accounts identified in the CY

## Key areas in NPA during Bank Audit-2023-24:

Area	Potential Issues	Potential Impact on Branch Audit
<b>Identification of account as NPA</b>	1. Time-gap between the approval and flagging OTS accounts in system	Non-identification of NPA- MOC and reporting in LFAR under Restructuring.
	2. Quality of credits in cash credits accounts	Non-identification of NPA- MOC and reporting in LFAR
	3. Classification of cases of Negative amortization	Non-identification of NPA- MOC and reporting in LFAR
	4. Classification of Co-Borrower as NPA	Non-identification of NPA- MOC and reporting in LFAR
	5. Possible evergreening through new facility	Non-identification of NPA- MOC and reporting in LFAR

## Key areas in NPA during Bank Audit-2023-24:

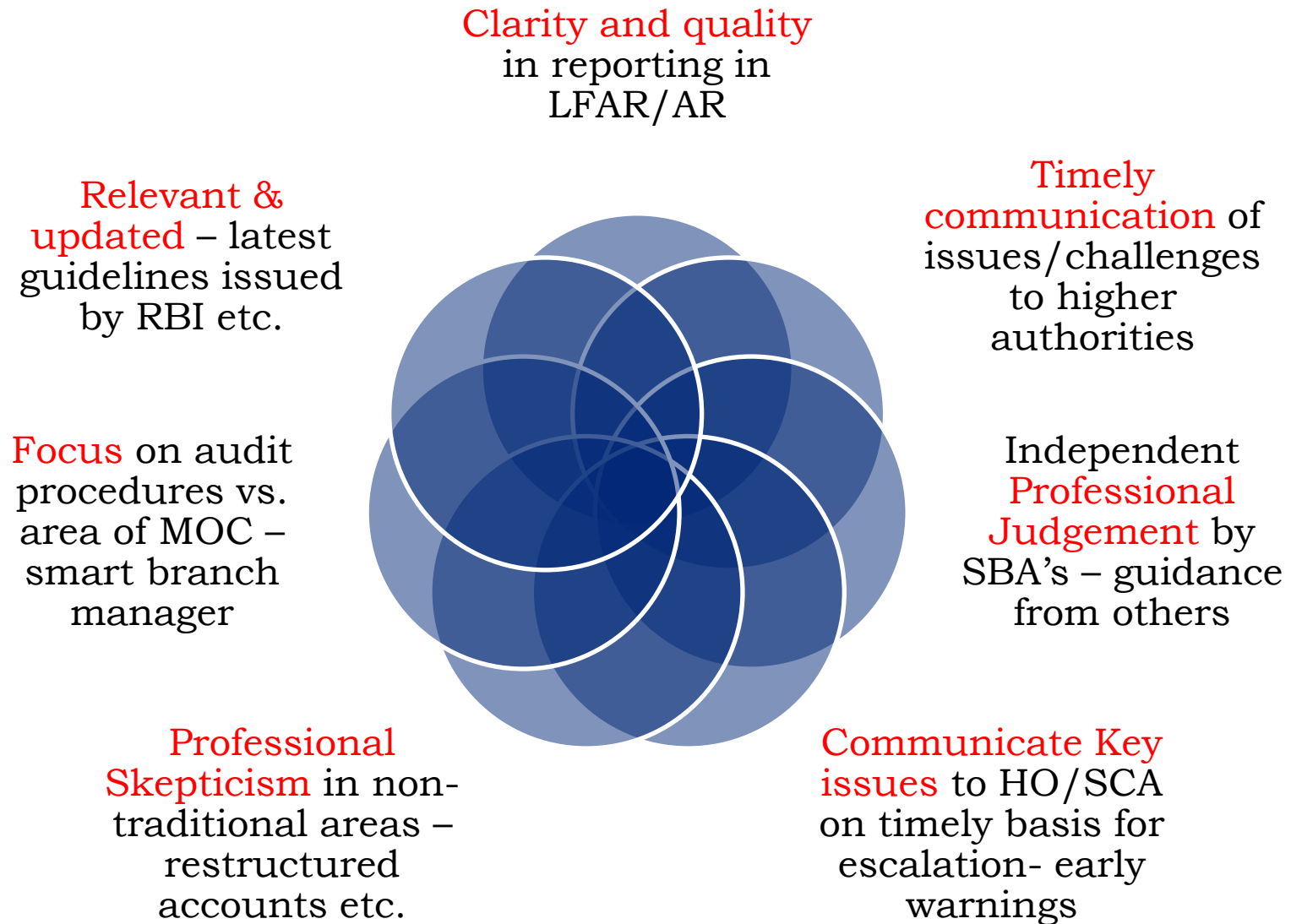
Area	Potential Issues	Potential Impact on Branch Audit
<b>Provision on NPA accounts</b>	6. Value of security post multiple auction failure	Under provisioning-MOC
	7. Existence of security in system but not in possession	Under provisioning-MOC
	8. Value of Plant & Machinery based on valuation report without any impact of subsequent depreciation	Under provisioning-MOC

## Key areas in NPA during Bank Audit-2023-24:

Area	Potential Issues	Potential Impact on Branch Audit
<b>Upgradation of NPA accounts</b>	9. Recoveries of guaranteed amount relating to ECLGS loans	Incorrect upgradation – MOC
	10.Upgradation with Linked facilities in overdue status	Incorrect upgradation – MOC
	11.Upgradation of written off accounts post recovery till date of w/off	Incorrect upgradation – MOC



# Do's in Bank Audit :



*Thank You*

*pankajtiwari@enkindia.com*