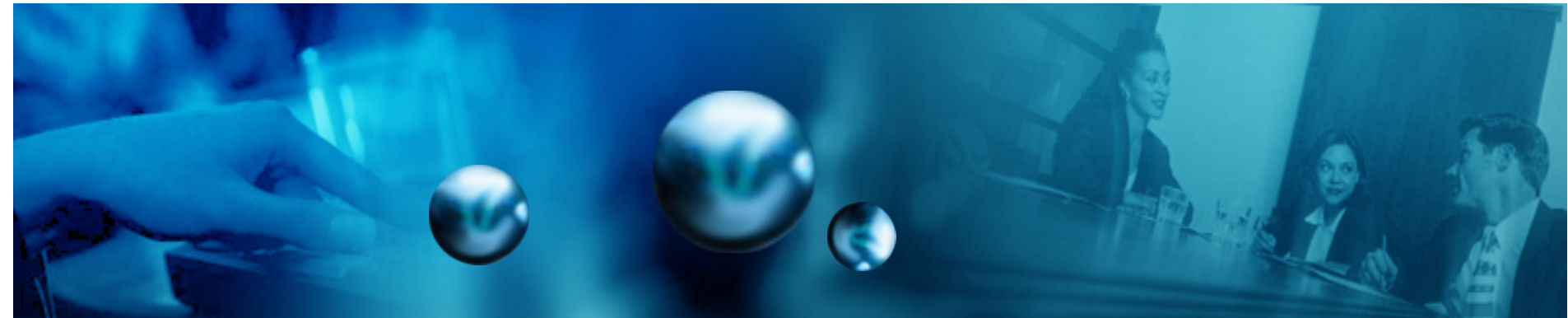


# Bank Branch Statutory Audit Prudential Norms on Income Recognition, Asset Classification and Provisioning



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# Agenda

- Objective
- Identification of Account as NPA
- Exceptions / Clarifications
- Income Recognition
- Asset Classification and Provisioning
- Early recognition of financial distress
- Revitalization of distressed assets
- Points to ponder
- Case Studies



# Objective

- The classification of assets of banks has to be done on the basis of objective criteria, which would ensure a uniform and consistent application of the norms.
- The provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realizable value thereof.



# Important RBI Circulars

- Master Circular No. RBI 2015-16/101DBR. No.BP.BC.2/21.04.048/2015-16 dated July 01, 2015 on IRAC Norms
  - Part A – General Guidelines
  - Part B – Prudential Guidelines on Restructuring
  - Part C – Early recognition of financial distress
- Master Circular dated July 01, 2015 on Disclosure in Financial Statements – Notes to Accounts
- Circulars dated November 21, 2016 & December 28, 2016



# Asset Types

- **Standard Assets:**
- Performing Assets (PA)
- Do not carry risk more than normal banking risk
  
- **Non-Performing Assets (NPAs)**
- Not Performing
- Cease to generate income for the Bank
- Higher risk than normal banking risk
- NPA as per various criteria defined



# Criteria for NPA

- **Loans or Advance:**

- Interest and/or installment remains overdue for a period of more than 90 days in respect of a term loan.

- **Exceptions:**

- Loans with moratorium for payment of interest
- Housing Loan or similar advance to staff
- Education Loans with moratorium



# Criteria for NPA

## Bills Purchased and discounted

Bill remains overdue for a Discounted period of more than 90 days.

## Agricultural Advances

Interest or installment remains overdue for two crop seasons for short duration crop, one crop season for long duration crop.

### *\*Definitions*

*crop season – ‘period up to harvesting of crops raised’ as determined by SLBC (State Level Bankers’ Committee)*

*Long duration crop – Crops wherein crop season is more than 12 months*



# Criteria for NPA

## Agricultural Advances

Banks have discretion of rescheduling the agricultural advances in case of natural calamities, which impair repaying capacity

## Reference Circulars of Reserve Bank of India

FIDD.CO.Plan.BC.54/04.09.01/ 2014-15 dated April 23, 2015

FIDD.No.FSD.BC.52/ 05.10.001/2014-15 dated March 25, 2015

## FIDD.CO.Plan.BC.54/04.09.01/2014-15 dated April 23, 2015

Defines 'Farm Credit'.





# Criteria for NPA

Guidelines for relief measures by banks in areas affected by natural calamity

- A s s e t** - Restructured portion to be considered as current dues
- Classification**
- Un-restructured portion to be governed by original terms and conditions
  - Additional finance to be treated as 'Standard Asset'
  - Second restructuring would not be considered as 'repeated restructuring'

**I n s u r a n c e** To be adjusted against restructured loans wherein fresh loans are granted

**Proceeds**



# Criteria for NPA

- Derivative Transaction** Overdue receivables representing positive mark to market value of a derivative contract remaining unpaid for a period of 90 days from specified due date.
- Liquidity facility** Remains outstanding for more than 90 days in respect of Securitization transaction.
- Credit Card dues** The minimum amount payable is not paid within 90 days from the payment due date mentioned in the statement



# Criteria for NPA

## Cash Credit Accounts If the account is 'out of order'

### Conditions for out of order status

- Outstanding Balance remains continuously in excess of sanctioned limit / drawing power for more than 90 days
- No credit continuously for 90 days as on the date of Balance Sheet
- Credits in the account are not sufficient to cover interest debited during the same period



# Criteria for NPA

What is 'Overdue'?

If an amount due to bank under any credit facility is not paid on the due date fixed by the bank.



# Criteria for NPA

## Accounts with Temporary Deficiencies

- Outstanding Balance in account based on the drawing power calculated from stock statements older than 3 months would be deemed as irregular & if such irregular drawing are permitted for a period of 90 days, account needs to be classified as NPA.
- In case of consortium accounts, the drawing power calculation and allocation is made by the Lead Bank and is binding on the Member Banks (***circular no. No. C&I/ Circular/2014-15/689 dated 29 September 2014 issued by the Indian Banks Association***).

Non-renewal/ Non-regularization of ***regular / adhoc limit*** within 180 days from the due date



# Criteria for NPA

## Exceptions / Clarifications

- Advances against term deposits, NSCs, IVPs, KVPs and Life Insurance Policies need not be treated as NPAs, till security cover is sufficient to cover outstanding balance.
- Income to be recognised subject to availability of margin
- ECGC guaranteed accounts to the extent payment has been received from Exim Bank.
- Advance against gold ornaments / Government securities not exempt.
- Central Government guaranteed advance to be classified as NPA only if Government repudiates the guarantee when invoked. (income to be recognized only on cash basis)



# Criteria for NPA

## Exceptions / Clarifications

### Classification Qua Borrower

All facilities granted to a borrower shall be treated as NPA & not only that facility which has become irregular.

- Special emphasis for duplicate Customer ID of the Borrower
- Case of devolved LCs and invoked BGs

### Exception

- (i) Credit facility to Primary Agricultural Credit Society (PACS) and Farmers Service Societies (FSS) under on lending arrangement;



# Criteria for NPA

## Exceptions / Clarifications

### (ii) Bill Discounted against accepted LC

- Unless not honored by the LC issuing Bank on the due date.
- Not made good by the borrower immediately.
- Account to be immediately classified as NPA with effect from the date when the other facilities had been classified as NPA (with retrospective effect).





# Criteria for NPA

## Exceptions / Clarifications

### Consortium Advances

- Member banks shall classify the accounts according to their own record of recovery.
- Bank needs to arrange to get their share of recovery or obtain an express consent from the Lead Bank otherwise the account in such deprived banks might be treated as NPA for non-servicing.



# Criteria for NPA

## Exceptions / Clarifications

### Straightaway Classification (Potential threat of recovery)

- Erosion in Value ..... Where realizable value of security is less than 50% of the value assessed (*by bank or value accepted in last RBI Inspection*), account to be straightaway classified as **Doubtful Asset**..
- Where realizable value (*as assessed by Bank / Valuator / RBI Inspector*) of security is less than 10% of outstanding balance, account to be straightaway classified as **Loss Asset**.



# Criteria for NPA

## Exceptions / Clarifications

### Straightaway Classification (Potential threat of recovery)

- Fraud .....
- 100% to be provided irrespective of security spread over 4 quarters commencing from the quarter in which fraud has been detected.
- If not reported to RBI, 100% to be provided instantly

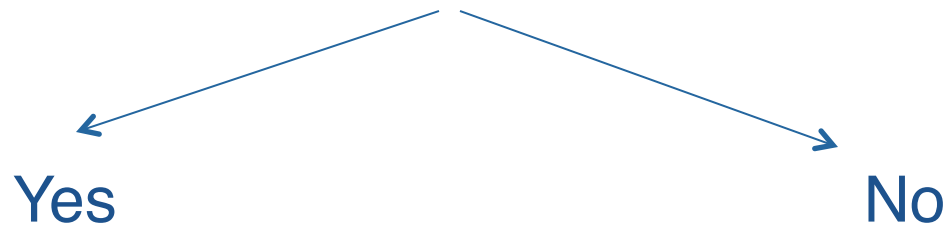


# Criteria for NPA

## Exceptions / Clarifications

Solitary or few credit entries recorded before Balance Sheet to regularize the account

Whether the account is having inherent weakness?



Mark the account as NPA

The bank to evidence the auditors about manner of regularization of account



# Criteria for NPA

## Mandatory Valuation of Securities

Applicable only if balance in NPA is Rs. 5 crores & above

- Annual Stock Audit by external agencies
- Immovable Properties – Valuation to be carried out once in three years by approve valuer



# Criteria for NPA

## Quick Reference to Para 4.2.5

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 non-performing and may be classified as 'standard' accounts.

## Quick Reference to Para 4.2.2

The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines



# Deferment for SSA Recognition

Circular dated November 21, 2016

## Eligibility:

- i) Running working capital finance (CC/OD), Crop loans with sanctioned limits upto Rs. 1 crore
- ii) Term Loans with original sanctioned limit upto Rs. 1 crore
- iii) Loans to NBFC / Housing Finance Companies, PACs
- iv) Loans by State Co-op. Bank to DCCBs

## Conditions:

- i) Dues are payable between 01.Nov.16 to 31.Dec.16
- ii) Deferment restricted to the above period for further 60 days
- iii) Applies only to PAs and not to existing NPAs



# Deferment for SSA Recognition

Circular dated December 28, 2016

## Eligibility:

- i) Running working capital finance (CC/OD), Crop loans with sanctioned limits upto Rs. 1 crore
- ii) **Business (including Agriculture)** Term Loans with original sanctioned limit upto Rs. 1 crore  
*(both limits are mutually exclusive)*

## Conditions:

- i) Dues are payable between 01.Nov.16 to 31.Dec.16
- ii) Deferment restricted to the above period for further 30 days (i.e., in all  $60 + 30 = 90$  days)
- iii) Applies only to PAs and not to existing NPAs





# Deferment for SSA Recognition

## Illustrations

- CC account continuously overdrawn and becoming NPA on 1 November, 2016 will be given benefit of 90 days more and will now become NPA on 30 January, 2017.
- TL installment due on 30 August, 2016 becoming NPA on 29 November, 2016 will now become NPA on 28 February, 2017.
- Standard account becoming NPA – defer the NPA date by 90 days.



# Income Recognition

- For NPA accounts income should be recognised on realisation basis.
- When an account becomes non-performing, unrealised interest / fees / commission of the previous periods should be reversed or provided.
- UIPY – unrealized interest of previous year
- INCA – interest not collected account
- Interest income on additional finance in NPA account should be recognised on cash basis.



# Income Recognition

- In project loan, funding of interest in respect of NPA if recognised as income, should be fully provided.
- If interest due is converted into (unlisted) equity or any other instrument, income recognised should be fully provided (if listed, income recognised to the extent of MV)
- Fees & Commissions earned on renegotiation/ rescheduling of debts to be recognized over the period of time covered by the renegotiated or rescheduled extension of credit.



# Income Recognition

## Order of Recovery

Suggested though not mandatory

- Unrealised Expenses
- Unrealised Interest
- Principal Outstanding

Clarification vide Master Circular - in the absence of clear agreement between the Bank and the Borrower, an appropriate policy to be followed in uniform and consistent manner.



# Classification Norms

- Standard Asset

The account is not non-performing.

- Sub-Standard Asset

A sub standard Asset is one which has remained NPA for a period of less than or equal to 12 months.

- Loss Assets

These are accounts, identified by the bank or internal or external auditors or by RBI Inspectors as wholly irrecoverable but the amount for which has not been written off.



# Classification Norms

- Doubtful Asset - Three Categories

Category

Period

Doubtful - I

Up to One Year

Doubtful – II

One to Three Years

Doubtful - III

More than Three Years



# 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%
▪Restructured accounts (First 2 years from the date of restructuring).	5.00%



# Provisioning Norms

## Sub-standard Asset

- 15% of total outstanding
- 25% of total outstanding if loan is unsecured
- 20% of total outstanding if infrastructure loan provided is backed by escrow facility with first charge

## Definition of Un Secured Loan:

If security is less than 10% of exposure (funded & non-funded) ab initio







# Provisioning Norms

## Provisions under Special Circumstances

Advances under rehabilitation program (BIFR)

- i. Provision to be continued
- ii. Eligible for up gradation if renegotiated terms have worked satisfactorily for one year

For Additional facilities, no provision required for one year

Advances guaranteed by CGTSI/ECGC, Provision should be made only for balance in excess of the amount guaranteed by these corporations



# Reiteration of Points

## Some important references to RBI Circular

Para 4.2.2 : Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs, especially in respect of high value accounts.

Para 4.2.5 : 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 non-performing and may be classified as 'standard' accounts

Annex 5 : A restructured account is one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider.



# MOC

- For any classification and income leakage/ reversals issue MOC.
- Don't just mention in LFAR.
- Can be issued even if BM disagrees.
- Disagreement with BM – issue with relevant supporting with detailed note/ annexure to CSA.
- Discretion of the auditor.



# Subsequent Recoveries

- Fully closed accounts.
- AS-5 Events occurring after the Balance Sheet date.
- Source of recoveries
- Recovery of all arrears.
- Best judgment of the auditor based on the full knowledge of the account.
- No window dressing or ever greening of the account.



# GREENING ISSUES

- Sanction/extension of Additional facility/Adhoc facility.
- Enhancement of Limit.
- Conversion of Overdue Limits.
- Frequent Reschedulement of Term Loans.
- Adjusting Loan of one borrower against other Borrower.
- Debiting Suspense and crediting Borrower.
- Purchasing Cheques from Party.



# LFAR – Reporting

- Advances :
- Has the Branch identified and classified advances into Standard / Sub.....
  - Categorical statement
  - Disagreement – if material – mention in main report and report in MOC
  - Do not comment in LFAR for material deviations and not report in main report
- P&L:
  - Complied with the IRAC norms



# Non –Agricultural Gold Loans – Bullet Payment

- Quantum – as per Banks policy
  - Tenor shall not exceed 12 months
  - Interest charged at monthly rests for Standard a/cs
  - Normal IRAC shall apply once principal & interest become overdue
  - LTV of 75 % shall be maintained throughout
  - Rate is based on previous 30 days average

(RBI/2014-15/142 ; DBOD. No. BP. BC 27/ 21. 04. 048/ 2014-5 July 22,2014)





## Points to Ponder

Divergences in NPA observed by RBI AFI

Verification Parameters in CBS vis-à-vis RBI Circular

Purity of Master Data in CBS

Reversal of un-serviced Interest of NPA

Availability of valuation of security for advances below 5 crores

Authenticity and regularity of stock statements

Date of NPA – current and prior year of newly identified NPAs

Unique Customer-id of borrower accounts

Accounts upgraded during the year-whether all arrears recovered

Regularisation of account subsequent to balance sheet date



# Points to Ponder

Accounts other than Advances accounts including Sundries / Suspense Accounts

Demonetization – role of concurrent auditor

Accounts transferred to other branches – control over identification / classification of accounts

Income leakages identified and resulting in overdrawing of accounts

Recalculation of Drawing Power

LCs and BGs o/s in case of NPA accounts

Early Mortality Cases

Ever-greening of accounts

MOCs vis-à-vis Main Audit Report vis-à-vis LFAR



# Case Studies

1. S Ltd was having CC limit of Rs.182 crores and three term loan accounts aggregating to Rs.200 crores. Cash credit was above the limit in the last quarter from 26/02/17 till 31/03/17. The interest and installments in Term Loans were always paid with delay. The installments and interest on term loans due 31/12/16 was debited to CC a/c from 29/02/17 to 31/03/17 amounting to Rs.6 crores when the CC balance was already above DP. The interest on CC account was Rs. 4.60 crores during the quarter. The total credits in CC account for the quarter was Rs.6.20 crores of which Rs. 3.50 crores was credited on 29/03 and debited on 31/03/17. Can we classify this borrower as NPA



## Case Studies

When CC account exceeded the limit on the date of debit of term loan recovery, it amounts to fresh sanction of limit and when one account is regularized by sanction of another facility , it is to be treated as NPA. The total credits in CC account was effectively only Rs. 2.70 crores as against interest debit of Rs. 4.60 cores for the same period. On that count also to be classified. Even granting the total credit is Rs.6.20 crores the critical amount to be collected is Rs.10.60 crores (6+4.60) leaving a shortfall of Rs.4.40 crores. ***Hence the account to be classified as NPA***



# Case Studies

2. Two PC a/cs of AB Exports Ltd were overdue as on 31/12/2016. These accounts were closed in Mar 2017 and hence not appearing in the advances list as on 31/03/2017. The CC account of the party was to the brim as on 31/03/2017. In the loan list under unsecured personal Loan, Mr A Personal Loan(clean Loan) was outstanding as on 31/03/2017.

On analyzing the a/c, it was found that the credits in PC a/cs were transfer from CC a/c of same party. The CC a/c was generally operated to the brim and only credit on the date of transfer came from current a/c of the company. The credit in current a/c was transfer from SB a/c of Mr. A, director of the company. The credit in SB a/c was from loan a/c of Mr. A. The loan a/c of Mr.A was a fresh personal loan (clean loan) sanctioned on that day.



## Case Studies

PC account should be closed only from export proceeds. It is a “made to perform” transaction by transfer from one account to other and out of fresh limits sanctioned.

***Hence the account needs to be classified as NPA as on 31/03/2017.***



# Case Studies

3. Bank has given two loans To DCCB, a Primary Agricultural Credit Society for onward lending of which one loan has become NPA as on March. The bank has classified that loan alone as NPA and the other loan was treated as Standard. Is the bank right ?
- 4.2.10 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



# Thank you

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