

**J B Nagar CPE Study Circle (WIRC)**  
**Institute of Chartered Accountants of India (ICAI)**

# **Bank Branch Audit**

## **Loans and Advances**

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**29th March '20**

# Areas to be discussed

- ✓ What are advances ?
- ✓ Major Areas of Consideration : Pre-Sanction & Post Sanction
- ✓ Specific Areas for Verification – as per type of Advance
- ✓ Reading Material

# ADUIT PLANNING

- ✓ Go though RBI notifications, Circulars and Directions
- ✓ Internal Control mechanism
- ✓ Branch's dependence on limited number of Borrowers
  - Compromise (in procedure, in charges)
  - Accommodation (Overdrawing, Documentation defects)
- ✓ Problem of over familiarity
- ✓ Background review of major borrowers
- ✓ Type and nature of borrowers, like nature of industry, service, etc.

# Audit Standards – Critical ones for Bank Branch Audits

SA 210 – Terms of Audit Engagement

SA 310 – Knowledge of Business

SA 400 – Risk Assessment and Internal Control

SA 320 – Materiality

SA 530 – Audit sampling

SA 300 – Audit Planning

SA 220 – Quality Control for Audit Work

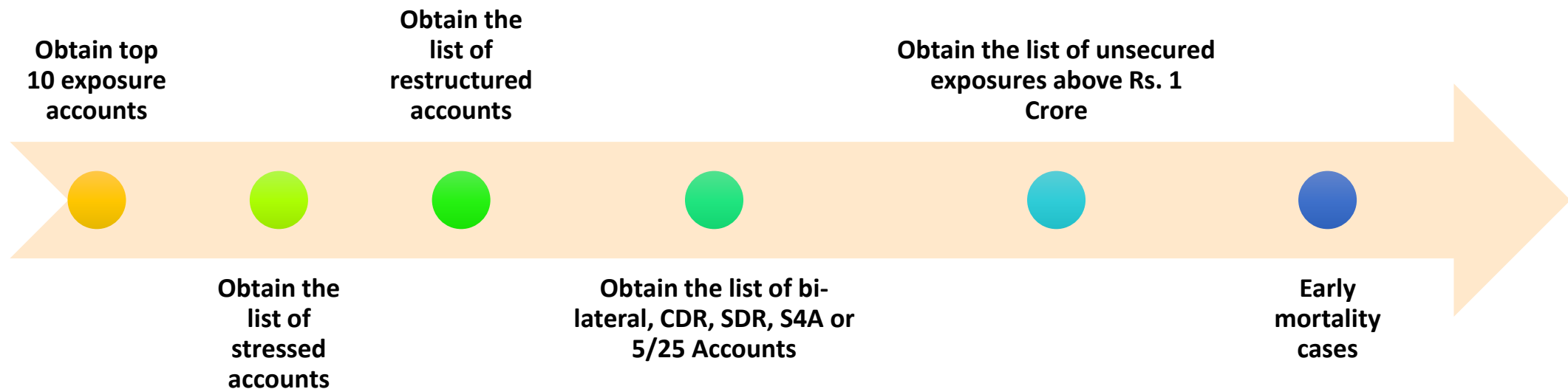
SA 230 – Audit Documentation

SA 500 – Audit Evidence

SA 580 – Representation by Management

# Loans & Advances – Key Information required

The auditor at branch may keep following in mind to plan comprehensive coverage of advances and for selection of sample.



# Funded / Non Funded Advances

**Funded Credit Facility** - Means Actual Transfer Of Funds from Bank to the Borrower.

**Non-Funded Credit Facilities** - Facilities which do not Involve Funds Transfer. However a non-funded facility may subsequently turn into funded facility i.e. where Bank makes Payment under Letter of Credits, BGs, etc. issued by it.



Funded	Non Funded
<ul style="list-style-type: none"><li>• Overdraft / Cash Credit</li><li>• Term Loans (Home Loans, Vehicle Loans, Mortgage Loans)</li><li>• Working Capital Demand Loans</li><li>• Bills Purchased/Discounted/Foreign Bills for Collection</li><li>• Packing Credit</li></ul>	<ul style="list-style-type: none"><li>• Guarantees</li><li>• Letter of Credit</li></ul>

# Major Areas of Consideration



## Pre Sanction / disbursement

- Application
- Credit Appraisal
- Sanction / Disbursement
- Documentation



## Post disbursement

- Review/Monitoring
- Asset Classification
- Provisioning Norms
- Income Recognition
- Restructuring

# Pre Sanction - Application

- ✓ Prescribed Application Form for fresh or renewal proposal
- ✓ KYC Compliance as Per RBI Requirements
- ✓ Evaluation of Latest Audited Financial Statements – Comparison with Industry standards
- ✓ Review of Project Report, Projected P&L, B/S & Cash Flow
- ✓ Board Resolution for the availment of the facility obtained
- ✓ Income Tax Records of Borrower and Guarantor – With supporting documents
- ✓ Various Registrations/Licenses/Permits



# Pre Sanction – Credit Appraisal

- ✓ Verify whether Appraisal Note of Bank is proper
- ✓ Whether Appraisal is done by Competent Authority
- ✓ Review whether Projections are realistic – Apply common sense, industry parameters and country parameters
- ✓ Net worth statement of the borrower and guarantor – With documentary evidence
- ✓ Confidential report and NOC from the existing banker
- ✓ Title Clearance Report. **Valuation Report from registered valuer – Review broadly**
- ✓ Nature of securities (Prime/ Collateral) offered and to confirm the adequacy of security cover
- ✓ Verify that important Financial ratios such as Debt Equity ratio & Debt service Coverage ratio and other ratios are satisfactory

# Pre Sanction – Credit Appraisal

- ✓ Creditworthiness of borrower
- ✓ Verify whether Exposure limit is within the limits fixed by Bank – Group wise, Industry wise & Policy of Bank
- ✓ Prospects of business, sources & periodicity of repayments, evaluation of financial statements, capacity utilization
- ✓ **Review of projected cash flows is most important while appraising the proposal**
- ✓ Whether the branch has a policy of maintaining Rejected Proposals
- ✓ Whether Branch is conducting credit rating of major advances accounts on periodic basis
- ✓ Project technically feasible, economically viable and commercially acceptable
- ✓ Register for date of receipt of proposal, approval / rejection date, TAT

# Pre Disbursement

- ✓ Whether Proposal routed through appropriate authority
- ✓ and recommendations are properly documented & noted
- ✓ Whether Limits sanctioned are within the discretionary powers of the sanctioning authority
- ✓ In case where the sanctions are beyond the discretionary powers, the same has been reported to appropriate authorities & ratified within specified period
- ✓ Whether any **change in the terms of sanction** is ratified by appropriate authority
- ✓ Whether Pre-disbursement unit inspection has been carried out & report held on record

# Pre Disbursement

- ✓ Adhoc limits (increase) given to borrower for temporary/seasonal/ peak periods  
– whether reported to controlling authorities and whether liquidated in time
- ✓ Verify that Disbursement done only after compliance of all terms & conditions of Sanction letter.
- ✓ Verify all Ad hoc sanction limits given
- ✓ Acceptance of the borrower confirming the terms & conditions of sanction is obtained
- ✓ Sanction letter/limit approval letter stating the terms and conditions is available
- ✓ Verify Margin Money of the borrower
- ✓ Verify **end use of funds**

# Pre Disbursement – Documentation

- ✓ All loan documents, as required by the sanction letter and loan policy have been executed (eg. DP Note, loan Agreement, Letter of guarantee, hypothecation Agreement, etc)
- ✓ Loan documents are approved by legal expert, if required and adequately stamped
- ✓ Documents must be exactly for Limit Sanctioned
- ✓ Fresh loan documents are obtained on change in limit, change in the constitution of the borrower
- ✓ Original agreement, share certificate, title deeds, title clearance certificate valuation report are held on record.
- ✓ In case of Third–party borrowing against Branch Fixed Deposits, normal lending rate of interest should be applied as against concessional rate.

# Pre Disbursement – Documentation

- ✓ Documents should not be blank or incomplete & there should be no overwriting, changes, different inks etc.
- ✓ Safe keeping of the documents under dual custody of officers
- ✓ Charge on securities offered must be registered with appropriate authority
- ✓ NOC of housing society
- ✓ Memorandum and Articles of Association or proof of constitution of the borrower
- ✓ Special Documentation for Consortium / Multiple Banking advances
- ✓ In case of advances against deposits, deposits must be lien marked
- ✓ Vetting of Documents

# Post Disbursement – Review Monitoring

- ✓ Review the Renewal facilities
- ✓ Verify Follow up of Accounts pending renewal
- ✓ LC issuance
- ✓ Security / Stock Inspection reports
- ✓ Regular Stock Statement Submissions. **Review of stock statements**
- ✓ Critically review Operations at month end, quarter end such as Turnover, **Excessive Cash transactions**, dormancy of account, balance exceeding limits, transfers from / to accounts, etc.
- ✓ In cases where borrower is availing Multiple banking Facility, obtain Outstanding Balance from each Bank and compare the limits availed with stocks held and DP applicable, in order to know whether the borrower is over– financed and any margin is to be introduced
- ✓ Adequacy of Insurance

# Post Disbursement – Review Monitoring

- ✓ Verify whether Fund disbursement utilized for the purpose for which limit was sanctioned and **not diverted to group companies or to pay off existing overdues**
- ✓ Periodic review of irregular / overdue / NPA accounts at appropriate level
- ✓ **Penal interest to be charged** if, DP limits breached, Stock Statements not submitted etc. Revenue Leakage
- ✓ Letter of Acknowledgement / Balance Confirmation
- ✓ Bills Discounted –a) whether accommodation bills b) whether ECGC Cover taken?



# Drawing Power Review

## Drawing Power Calculation

- ✓ Based on Stocks, Debtors and Creditors
- ✓ Critical review of stock/ Book Debts statement (Old debtors more than 180 days not to be considered)
- ✓ DP limits to be set as per latest statements. If stock statements is older than 3 months, account to be classified as “irregular”
- ✓ Verify **banks guidelines for DP calculation** specially for unpaid stocks
- ✓ Verify Inventory Valuation
- ✓ Verify annual audit report of the borrower with the monthly stock statement for the last month of the year
- ✓ Verify Stock audit report for NPA’s more than Rs 5 Crores

# Fraud Review

## **Fraud in Advances**

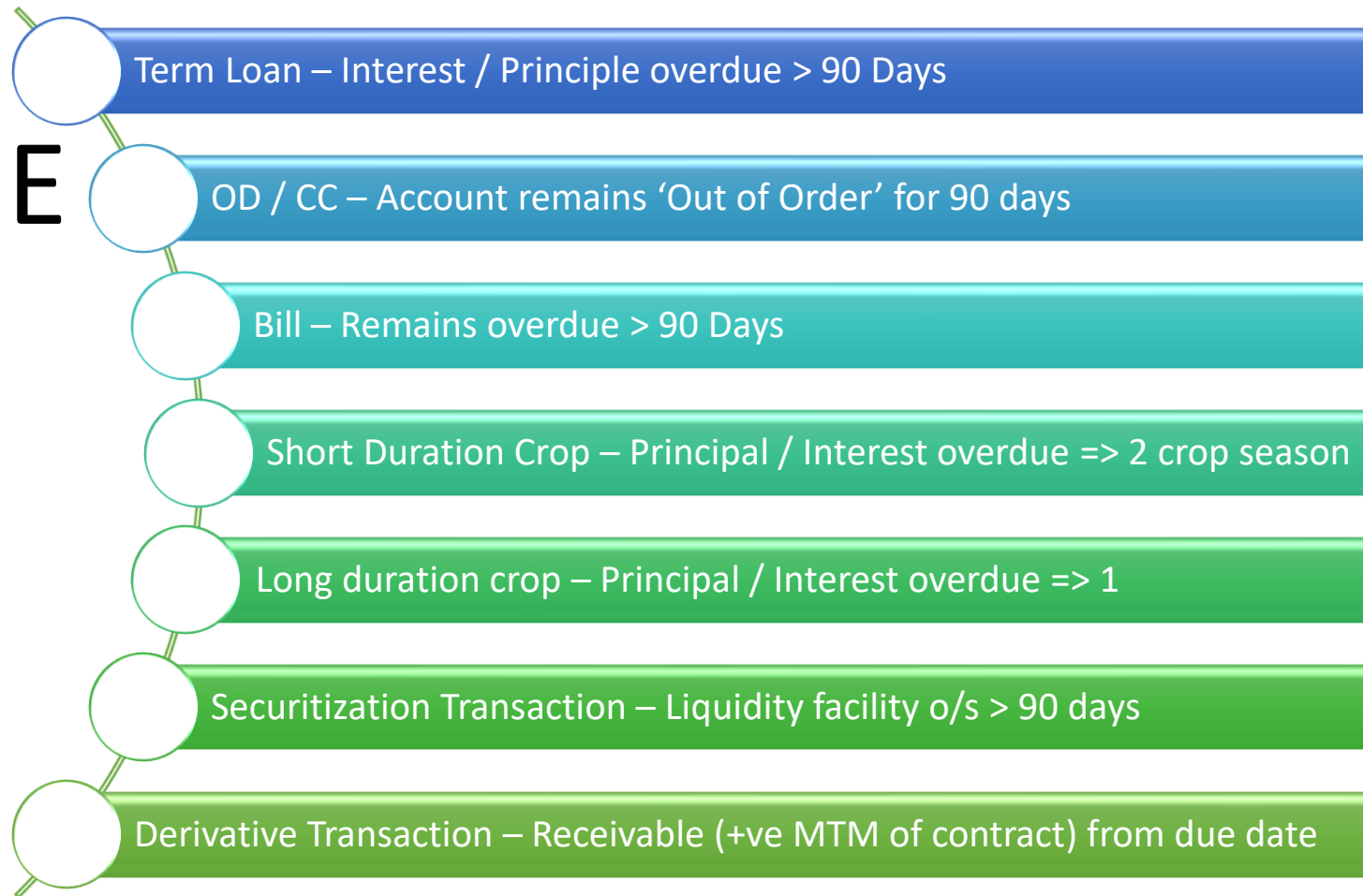
- ✓ Sanction without proper application and /or credit appraisal
- ✓ Sanction made beyond discretionary power and non reporting of the same to the appropriate authority
- ✓ Disbursement without taking proper securities or without compliance of sanction terms
- ✓ Unauthorized release of securities
- ✓ Security valuation (Especially NPA account e.g. Immovable Assets, Patents)
- ✓ Charging of same security to different Banks
- ✓ Diversion of funds
- ✓ Higher valuation of securities
- ✓ Submission of fake transport documents/ godown receipts
- ✓ Discounting of accommodation bills/ issuance/ LC
- ✓ Review CRICL report for declaration of fraud cases by other banks

# Asset Classification - NPA

OVERDUE

90

DAYS



## OUT of ORDER

O/S balance remains continuously in excess of the sanctioned limit / drawing power  
OR  
there are no credits continuously as on date or **credits are not enough to cover the interest debited during the same period**

# Asset Classification – Standard Assets

The guidelines require banks to classify their advances into four broad categories for the purpose of provisioning

Standard Asset	Sub-standard Asset
Doubtful Asset	Loss Asset

## Standard Asset

- ✓ Does not disclose any problems.
- ✓ Does not carry more than normal risk attached to business.

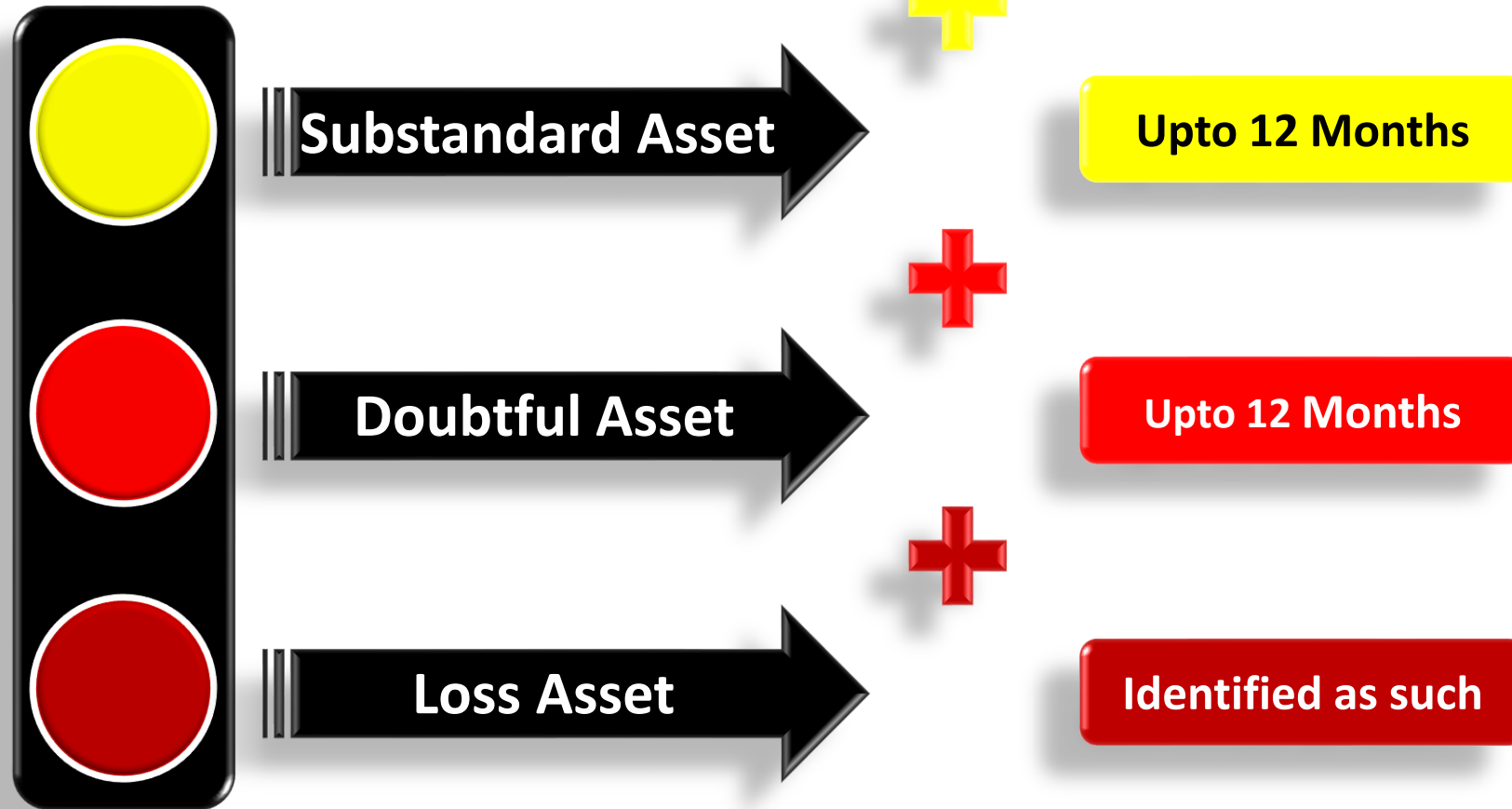


As per para 2.1 of Notification dated February 26, 2014, RBI has directed the banks to classify the standard accounts according to their overdue status under Special Monitoring Accounts popularly known as SMA

SMA Category	Basis of Classification
SMA-0	No overdue but sign of incipient stress
SMA-1	Overdue between 30 -60 days
SMA-2	Overdue between 60-90 days

**Classification is useful for audit perspective** to check the transactions & methods of keeping these standard at the balance sheet date.

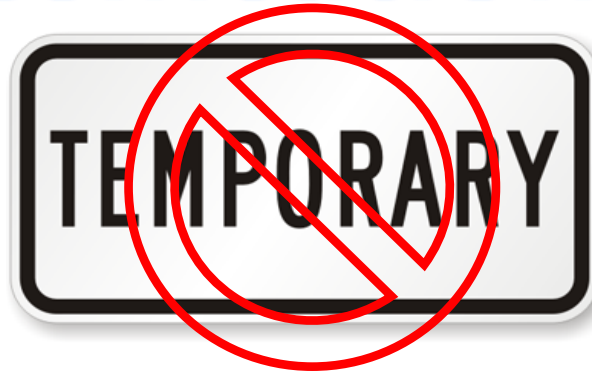
# Asset Classification - NPAs



- ✓ The availability of security or net worth of borrower / guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, **except erosion of security / fraud.**
- ✓ Asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.
- ✓ Has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.
- ✓ Asset 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 asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted

# Asset Classification – Specific Issues

## Accounts with Temporary Deficiency



✓ Classification should be based on record or recovery.

X Should not be based on temporary deficiency eg:

- X Non availability of adequate drawing power
- X O/s Balance > Limit (temporarily)
- X Non submission of stock statement (Should not be older than 3 months otherwise irregular)
- X Non renewal of Limits on due date etc. (Limit to be renewed / regularized within 90 days to 180 days otherwise NPA)

UP  
GRADE

If arrears of **interest and principal are paid fully** by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as NPA and may be classified as 'standard' accounts.

## Regularized near about Balance sheet date

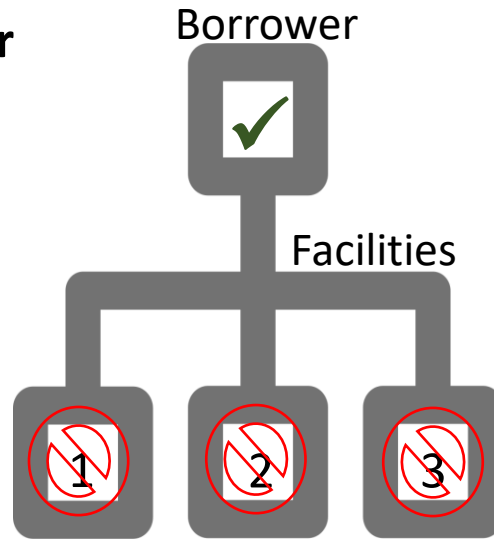
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- ✓ Case where **solitary or a few credits** are recorded before the balance sheet date should be **handled with care and without scope for subjectivity**.
- ✓ If inherent weakness – NPA.
- ✓ If genuine case - Satisfactory evidence to be seen about the manner of regularization of the account.

# Asset Classification – Specific Issues

## Classification to be borrower wise & not facility wise

All the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA / NPI and not facility wise.



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

- ✓ Need not be treated as NPA, provided adequate margin is available in the account.
- ✓ Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

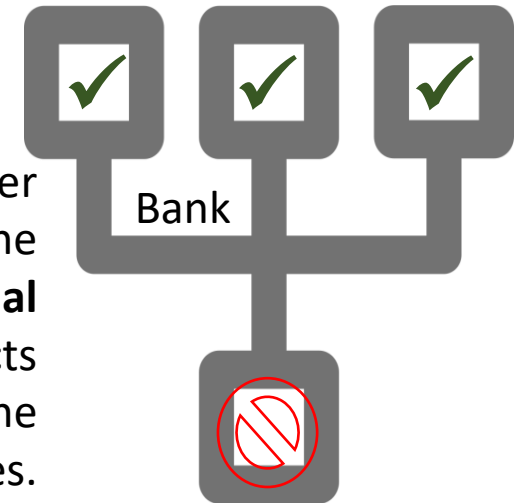
## Advances to Primary Agricultural Credit Societies (PACS) / Farmers' Service Societies (FSS) ceded to Banks

Advances granted by banks to PACS / FSS under the lending system only that particular credit facility granted to PACS/ FSS which is in default after it has become due (one / two crop season as applicable) will be classified as NPA and not all credit facilities sanctioned to PACS / FSS.

## Advances under Consortium Arrangement

Classification of accounts under consortium 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.

**However, check the asset Consortium Arrangement classification with other banks.**



# Asset Classification – Specific Issues

Accounts - Erosion in Security value / frauds committed by borrowers

VALUE  
EROSION

- ✓ Such accounts should **not** go through **various stages of asset classification.**

Particulars	Classification
RV < 50% of the last accessed value	Doubtful
RV < 10% of the last accessed value	Loss

- ✓ **Fraud – Entire amount due (irrespective of security held) is to be provided for over 4 quarters maximum.**



- ✓ **Fraud – If there is delay in reporting the same to RBI (beyond prescribed time), the entire provision to be made at once.**

## MORATORIUM

- ✓ Cases where moratorium is available for payment, due-date will be counted after completion of said period. Accordingly, NPA classification will be from due-date.

### Government Guaranteed Accounts

- ✓ Such accounts will be treated as NPA only when the Government repudiates its guarantee when invoked.
- X Exemption not available for income recognition.
- X Exemption not available on State Government guaranteed advances and investment.



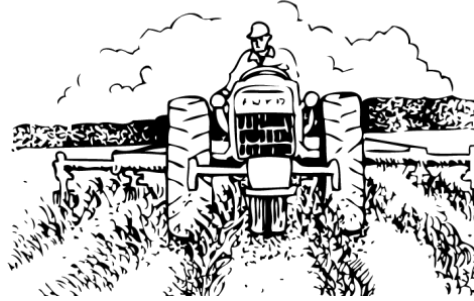


# Asset Classification – Specific Issues

## Agriculture Advances

**Long Duration Crop** - crop season longer than one year

**Short Duration Crop** – Other than above



- ✓ NPA classification based on crop season is applicable only to Farm Credit as listed in para III (1) of FIDD.CO-Plan.BC.54/04.09.01/ 2014-15 dated April 23, 2015.
- ✓ In case natural calamity hampers the repaying capacity, bank may decide a relief measure – conversion of short term to long term loan or reschedulement of repayment period or sanction of fresh loan as per FIDD.No.FSD.BC.52/ 05.10.001/2014-15 dated March 25, 2015. **NPA in such case will be based on revised terms. Such cases must be reported as rescheduled and provision be done accordingly. Compliance to RBI Guidelines must be checked before the account is not treated as NPA.**
- ✓ Coverage - Direct agricultural advances as given in the Master Direction on Lending to Priority Sector-Target and Classification dated July 7, 2016

## Takeout Finance

**Meaning** – The Institution / the Bank financing infrastructure projects will have an arrangement with any financial institution for transferring to the latter the outstanding in respect of such financing in their books on a predetermined basis.

- ✓ Asset classification to be followed by the entity in whose books the account stands on the relevant date .
- ✓ The taking over institution, on taking over such assets, should make provisions treating the account as **NPA** from **the actual date** of it becoming NPA even though the account was not in its books as on that date.



# Asset Classification – Specific Issues

## Post Shipment Suppliers Credit

Advances for which ECGC cover is available, **EXIM bank guarantees** the amount to be paid to the bank within 30 days of invocation, to the extent the payment has been received from the EXIM Bank, it may **not be** treated as **NPA** for asset classification and provisioning purposes.

## Export Project Finance

- ✓ The **actual importer** has **paid the dues** to the **bank abroad**.
- ✓ But the bank in turn is **unable to remit** the amount due to **political developments** such as war, strife, UN embargo, etc.
- ✓ **Established** that the importer has cleared the dues before it being NPA
- ✓ **Classification** may be made **after 1 Year** from the date the amount deposited by the importer.

## Advances under rehabilitation approved by Board for Industrial and Financial Reconstruction (BIFR)/Term Lending Institutions (TLIs)

- X **Not permitted to upgrade the classification in respect of which the terms have been renegotiated unless the package of renegotiated terms has worked satisfactorily for a period of one year.**

## Credit Cards Accounts

- ✓ A credit card account will be treated as NPA non-performing asset if the **minimum amount due**, as mentioned in the statement, is **not paid fully within 90 days** from the next statement date.

### Circular

**DBR.No.BP.BC.30/21.04.048/2**  
**015-16 dated July 16 2015**



# Asset Classification – Projects under Implementation

## Projects Under Implementation

- ✓ Clearly spelt out / documented – Date of Completion (DOC), Date of Commencement of Commercial Operation (DCCO).
- ✓ The below mentioned asset classification will apply to project before DCCO.

- ✓ Loan for a project may be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue).
- ✓ Deferment, reschedulement etc. due to factors beyond the control of promoter will not be treated as restructuring provided:

Particulars	Infra Loan	Non Infra Loan	Remarks	Class. & Prov.
DCCO (Revised – Original)	2 years	1 year	All other T & C are same.	Standard 0.40%
Court case	Additional 2 Years	NA	Serviced as per restructured terms. Appl. received when standard and before expiry of above timelines.	Standard 5.00% (Later of 2 Yrs. OR date of restructuring to revised DCCO.
Other Reason	Additional 1 Year	Additional 1 Year (Non CRE)		
If Moratorium of interest	Not beyond 2 Yrs.	Not beyond 1 Year.	Booking of accrual of Interest from org. DCCO	NA



# Asset Classification – projects under implementation

## Projects Under Implementation – Cont.

### Change of Ownership

Extension of **additional 2 year** or shift / extend repayment schedule (if req.) without change in asset classification if change of ownership takes place;

Before the period  
described in previous slide

OR

Before  
original DCCO

### Conditions:

- ✓ Intragroup or related party restructuring / merger / acquisition / takeover not covered under this. Viability of the project should be established.
- ✓ New management should have control over the project - more than 51% - If NR - investment ceiling limit – then higher of 26% or limit allowed.
- ✓ Repayment schedule - not beyond 85% of the economic life.
- ✓ Option available only once and not in subsequent change.
- ✓ Asset classification as on reference date

(date of execution on preliminary agreement) will continue during the extended period

New owners should bring in substantial capital to complete the project within extended time.



# Asset Classification – Projects under implementation

## Projects Under Implementation – Cont.

### Other Points

- ✓ Change in the repayment schedule – due to increase project outlay (changes in scope and size) – not to be treated restructuring if;
  - ✓ Change in Scope & size is before DCCO.
  - ✓ Rise in cost is 25% or more.
  - ✓ Re assess the viability of the project.
  - ✓ New rating is not below the prior rating by more than 1 notch.
- ✓ Multiple revision of DCCO (within time prescribed in previous slides) – consequential shift in repayment schedule – Treated as single event of restructuring provided all T & C remains same.

## Income Recognition

- ✓ Standard Asset – Income on Accrual basis.
- ✓ Other Classification – Realization basis.
- ✓ **Funded Interest** – Any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.
- ✓ **Conversion in Equity, debenture etc.** – Any conversion in respect of NPA, if recognised as income, should be fully provided. However, if converted instrument is quoted, Interest can be recognized at market value (max. upto original interest amount). If not quoted, then on redemption or realization.



# Interest Recognition - NPA

## Policy

**Interest – Not to charge and take to income account**  
(applicable to **Govt. guaranteed** a/c too)

**Fee & Commission – If Renegotiation or Rescheduling of Debt – Recognized over revised period of time**

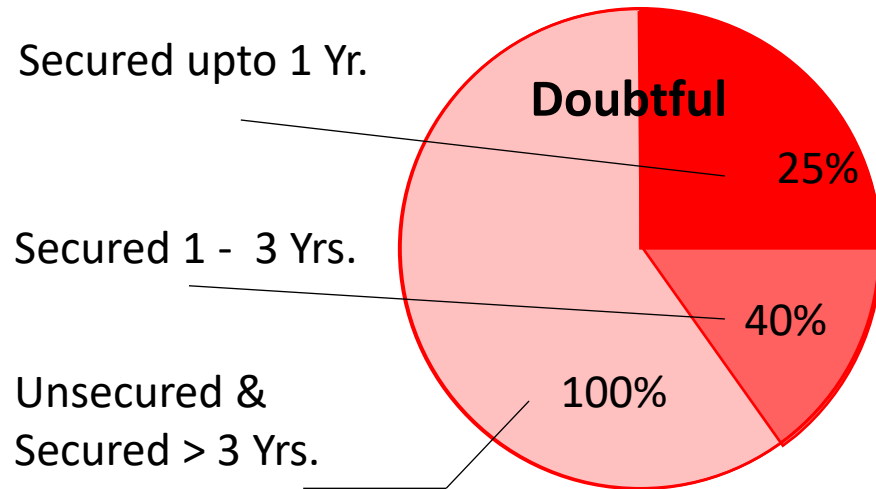
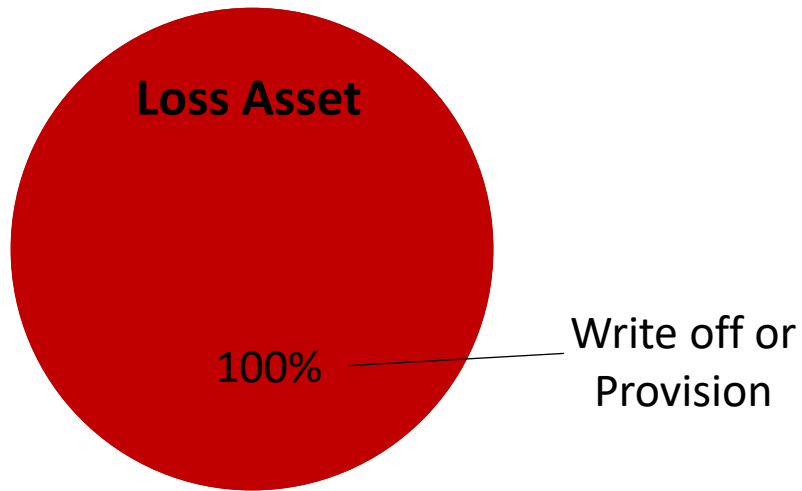
## If Income Recognized

**Interest - If credited or accrued and not realized then to be reversed**  
(applicable to **Govt. guaranteed** a/c too)

**Fee & Commission – if credited or accrued should be reversed if uncollected.**

- ✓ **Interest** – If advance is against TD, NSC, IVP, KVP and Life Policies – Income may be taken into account if adequate margin is available.
- X **Interest** – If **served from additional credit** allowed to the borrower, not to be considered as income.
- ✓ **The finance charge component of finance income on the leased asset** – accrued and credited to income account and remaining unrealised, should be reversed or provided for.

# Assets – Provisioning on NPAs

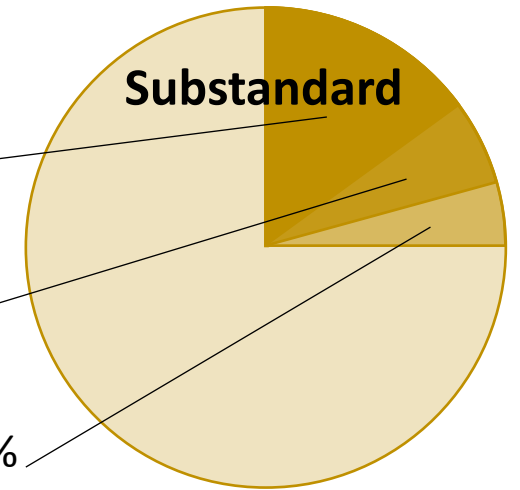


**Based on Classification**  
**Time Lag (NPA vs Recognition)**  
**Security (Erosion vs Realization)**

General Prov. w/o ECGC and securities 15%

Infra Escrow arrangement 20%

Unsecured 25% on total o/s



**Pointers**

- ✓ Unsecured Exposure = realisable value of the security is not more than 10 percent, ab-initio, of the outstanding exposure.
- ✓ Exposure = Funded + Non Funded
- ✓ Security = Tangible Security (discharged to bank). Do not include intangible security (eg. Guarantee etc.) except annuities under BOT model for roads etc.
- ✓ NPA balance 5Cr. Or more
  - ✓ Stock Audit at annual interval by external agency.
  - ✓ Collateral security eg. Immovable property – values once in 3 years.

# Provisioning – On Standard Assets



## Standard Asset

Micro, Small, Medium enterprise is defined in Master Circular **RPCD.SME&NFS.BC.No.3/06.02.31/2014-15** dated July 1, 2014

### General provision for funded o/s on global loan portfolio basis

Farm Credit to agricultural activities & SME	0.25%
Commercial Real Estate (CRE)	1.00%
CRE - Residential Housing Sector (RH)*	0.75%
Housing loan at Teaser rate #	2.00%
All other loan & advances	0.40%
Restructures A/c classified as standard	5.00%

\* Loan to builder / developer for RH project except for captive consumption. Ordinarily not include Commercial Real Estate. Integrated project can be classified CRE RH provided Commercial Space <=10% of total FSI.

# Higher provisioning will stop after one year of resetting the rates and will be provided as required.

## Unhedged Foreign Currency Exposure

Likely Loss / EBID %	Incremental Provision
Upto 15%	Nil
More than 15% and upto 30%	20 Bps
More than 30% and upto 50%	40 bps
More than 50% and upto 75%	60 bps
More than 75%	80 bps

Risk has to be ascertained as per the instructions in circular **DBOD.No.BP.BC.85/21.06.200/2013-14** dated January 15, 2014 & **DBOD.No.BP.BC.116/21.06.200/2013-14** dated June 3, 2014.





# Provisioning – Floating provisions

## CREATION

- ✓ Board of directors to lay down approved policy regarding the level to which the floating provisions can be created.
- ✓ Bank Should hold floating provisions for advances and investments separately.

## DISCLOSURE

- ✓ Comprehensive Disclosure in the 'notes to accounts' to balance sheet;

Opening Balance	XX
Add: Provision made in CY	XX
Less: Purpose and amount of draw-down	XX
Closing Balance	XX

## UTILIZATION

- X Not for making provision as per IRAC or regulatory provision.
  - ✓ Only for Contingencies, extraordinary circumstances.
  - ✓ Specific provision of Impaired Asset (approval of RBI & BOD required).
- General – Civil Unrest, Collapse of currency  
Market – General melt down in market etc.  
Credit – Exceptional credit loss etc.

## ACCOUNTING

- ✓ Cannot be reversed by credit to the profit and loss account.
- ✓ Until utilization these provisions can be netted off from gross NPAs to arrive at disclosure of net NPAs;  
OR
- ✓ Can be treated as part of Tier II capital within the overall ceiling of 1.25 % of total risk weighted assets.



# Provisioning – Other Matters

## Advances granted under rehabilitation packages approved by BIFR / term lending institutions

- ✓ The provision should continue to be made in respect of dues to the bank on the existing credit facilities as per their classification as substandard or doubtful asset.
- ✓ Additional credit facilities granted to sick SSI units (Section IV Para 4.6 of circular RPCD.SME&NFS.BC.No.3/06.02.31/2014-15 dated July 1, 2014) and rehabilitation package has been drawn by the banks, no provision need to be made for 1 Year).

- X For additional facility sanctioned, provision on additional facilities sanctioned need not be made for a period of one year from the date of disbursement.



## Advances against term deposit, NSC, IVPs, KVPs, Gold Ornaments, Govt. & Other Securities, Life Ins. Policy

- ✓ Attract provision as applicable to their asset classification.

## Interest Suspense A/c treatment (ISA)

- ✓ Deduct amt. in ISA from respective advance and provision to be made on net balance.
- X **Should not be reckoned as part of Provision.**

## Advance covered by ECGC guarantee

- ✓ Provision to be made only for balance in excess of the amount guaranteed by the Corporation.
- ✓ Doubtful Asset - realisable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by the Corporation

# Provisioning – Other Matters

**Advances covered by guarantees of Credit Guarantee Fund Trust For Micro And Small Enterprises (CGTMSE) or Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH)**

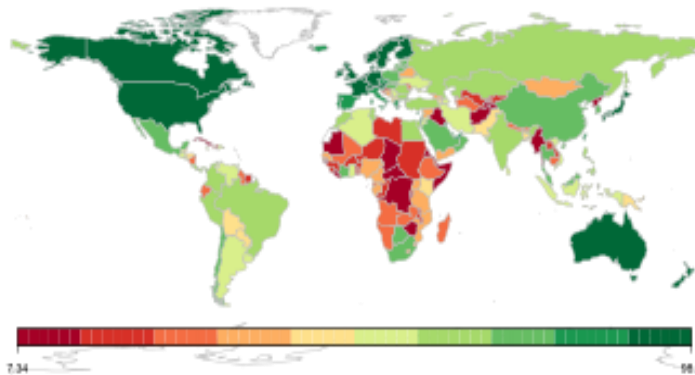
**X no provision need be made towards the guaranteed portion. Balance portion to be provided as required.**

**Provision for Diminution in Fair Value of restructured advance**

✓ Provision made on account of reduction in rate of interest and / or reschedulement of principal amount are permitted to be netted from the relative asset.

## PROVISION FOR COUNTRY RISK

Mean Country Risk, March 2000 - March 2011, Eurozone data



Risk Cat.	ECGC Class.	Provision
Insignificant	A1	0.25%
Low	A2	0.25%
Moderate	B1	5.00%
High	B2	20.00%
Very High	C1	25.00%
Restricted	C2	100.00%
Off-Credit	D	100.00%

### Pointers

- ✓ Provision required where its net funded exposure is one per cent or more of its total assets. (Country Wise).
- ✓ Additional Provision subject to max of 100%.
- ✓ Exposures of foreign branches of Indian banks to the host country should be included.
- ✓ Banks may make a lower level of provisioning wrt short term provision.

# Provisioning - PCR

$$\text{PCR} = \frac{\text{Provision}}{\text{Gross Non Performing Assets}}$$

## Pointers

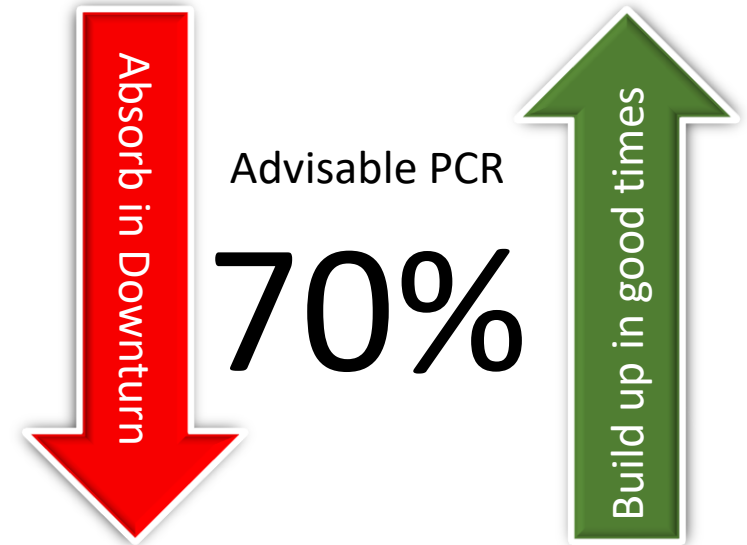
- ✓ the surplus provision under PCR vis-a-vis as required as per prudential norms should be segregated into an account styled as “countercyclical provisioning buffer.”
- ✓ PCR of the bank should be disclosed in the Notes to Accounts to the Balance Sheet.
- ✓ buffer will be allowed to be used by banks for making specific provisions for NPAs during periods of system wide downturn, with the prior approval of RBI (Bank were permitted to utilize upto 33% and 50% for making provision on NPA as on 31<sup>st</sup> March ‘13 and 31<sup>st</sup> December ‘14 respectively).

## Proposed Framework / Discussion Paper - Dynamic Loan Loss Provisioning Framework

Compute parameters such as probability of default, loss given default etc. to arrive at long term average annual expected loss.

OR

Use the standardized parameters prescribed by RBI towards computation of Dynamic Provisioning requirement.



COVERAGE  
RATIO



# Restructuring - Provisions

Restructuring is divided into 4 broad categories namely;

- I. Advances extended to industrial units
- II. Advances extended to industrial units under the Corporate Debt Restructuring (CDR) Mechanism
- III. Advances extended to Small and Medium Enterprises (SME)
- IV. All other advances.

## Eligibility criteria for restructuring of Advance

- ✓ Banks cannot reschedule / restructure / renegotiate borrowal accounts with retrospective effect. While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply.
- ✓ Alteration / changes in the original loan agreement are made with formal consent of debtors.
- ✓ Establishment of financials viability and reasonable certainty of repayment from the borrower.
- ✓ Borrowers indulging in frauds and malfeasance will continue to remain ineligible for restructuring.

- ✓ The accounts classified as 'standard assets' should be immediately re-classified as 'sub-standard assets' upon restructuring.
- ✓ The NPA, upon restructuring, would continue to have the same asset classification as prior to restructuring.
- ✓ Satisfactory performance after the specified period is not evidenced, the asset classification would be governed as per the IRAC norms with reference to the pre-restructuring payment schedule. Accounts where the pre-restructuring facilities were classified as 'sub-standard' and 'doubtful', interest income on cash basis only.
- ✓ If the restructured asset does not qualify for upgradation at the end of the above specified period, the additional finance shall be placed in the same asset classification category as the restructured debt.





- Non-fund based outstanding in NPA / Technical write off cases – Whether provision needs to be made as per IRAC norms or whether appropriate provision to be made as per AS 29.
- Frequent / continuous excess allowed in the account. Accounts being temporarily brought below limit for few days in a quarter. Whether to be treated as solitary credits as per RBI definition and hence the account to be downgraded. Receipt of money from group accounts overdrawn / other companies in the branch / other branch / other bank and then refunded.
- An account has become NPA for first time as on 1<sup>st</sup> September 2018. The outstanding in the loan account is Rs.50 Crores and the security value is Rs.15 Crores. What should be the category of loan account and what should be the provisioning.
- Granting more time for repayment of housing loan or reducing the EMI. Whether the account to be treated as restructured and whether to be downgraded.



- Non Charging of penal / overdue interest – On overdue installments / bills, TODs, delay in submission of stock statements/QIS/financial statements, non compliance to sanction terms, etc. If the amount would have been charged, the account would have been out of order / overdue beyond 90 days. Since when the overdue is to be considered. How to classify such accounts.
- Excess credit facility given to the borrower for which additional documents not executed. The amount of excess credit facility utilized to regularize the old dues. Impact on classification.
- An account was SS as on 31.03.2018. If the account is still NPA as on 31.03.2019, whether it may remain in SS or it has to mandatorily move to D1.
- A bill is discounted and payable after 90 days. In case of non-payment on due date, the banker, on the request of the borrower, extended the due dates by another 90 days. (i.e. 180 days). The charges for the extended period of 90 days are to be recovered upfront at the time of extension. Whether the account has to be declared NPA after 90 days from the date of extension of due date.



- Term Loan Installments paid by debiting overdrawn CC. However, the CC account was within the limits on various days during the quarter prior to the debit of term loan installments.
- A term loan has been downgraded on 28<sup>th</sup> February as NPA since three installments are overdue for more than 90 days. However, one of the installment has been paid on 25<sup>th</sup> March and hence the overdues are now for 60 days only. Whether the account can be upgraded based on the same.
- One of the CC account is having limit of Rs.60 Lac. The amount due during last 90 days in the account has never exceeded beyond Rs.50 Lac. However, there are no transactions or negligible transactions during last 90 days. Whether it has any impact on the classification of the account.
- The branch manager granted adhoc limits to a client and after execution of necessary documents, used the amount of adhoc limits towards the overdue of the client or of an associate company of the client. What shall be the treatment of the account.



# Reading Material

- ✓ Reports – Concurrent, Statutory, RBI Inspection, Stock & Debtors Inspection, System Audit, Special Audit, Manager hand over charge etc.
- ✓ RBI Circulars, Notifications and Master Directions
- ✓ Bank's Internal Circular
- ✓ Annual Closing Guidelines
- ✓ Guidance Note on Audit of Banks by ICAI
- ✓ Delegation of Authority

# Thank You!!

