Meet for Central Statutory Auditors of Banks

March 21, 2023

❄

Central Statutory Audit of PSBs
Challenges in Automation of IRAC and its certification

Organised & Hosted by
SIRC of ICAI

CA Dhananjay J. Gokhale

1

1

Disclaimers

- These are personal views of speakers and can not be construed to be the views of the ICAI.

- These views do not and shall not be considered as professional advice.

2

Coverage

Date	Circular
14.Sep.2020	Automation of Income Recognition, Asset Classification and Provisioning processes in banks
01.Apr.2022	Master Circular – Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
Annex II	RBI Certification requirements

CA Dhananjay J. Gokhale

3

3

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

A] Coverage

i)   All borrowal accounts, including TODs, irrespective of size, sector, type of limits
ii) Investments
iii) IRAC norms w.r.t.
  a) Asset classification
  b) Asset upgradation
  c) Provisioning
  d) Income reversal

CA Dhananjay J. Gokhale

4

4

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

B] Expectation

i)   STP: Straight Through Process

ii) Pre-set rules configured in the system

iii) Ongoing exercise of upgradation & downgradation

iv) Frequency: Part of EoD process

CA Dhananjay J. Gokhale   5

5

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

C] Exception

i)   Manual intervention only in exceptional circumstances

ii) Manual intervention over-riding system classification needs two level authorisation

iii) Delegation should be as per Board approved policy

iv) Preferably centralised & documented with adequate audit trails, subjected to concurrent & statutory audit

CA Dhananjay J. Gokhale   6

6

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

C] Exception

v.   Detailed report to be placed before Audit Committee

vi.   Logs to include
   a)   Date & time stamp
   b)   Purpose / reason
   c)   Account details
   d)   User-id & name of those making manual intervention

vii.   Logs to be stored for minimum 3 years

viii.   Logs to be system generated

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

D] System Requirements & System Audit

i.   If separate application outside CBS for NPA/NPI >>> access to required data in CBS to be provided

ii.   Banks shall keep business logic & other parameters / configurations of system updates to ensure compliance

iii.   Periodic system audit at least once in a year by internal / external auditors well versed with
   a)   System parameters
   b)   Compliance of IRAC

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

E] Baseline requirements for NPA classification solution

i.   Data Input
   a) Full capture and storage without truncation
   b) Validation checks (data type / limit check, etc.)
   c) Master data validation (margin, moratorium, security type, security valuation, repayment schedule, product mapping)
   d) Date inputs effected with due authentication / authorisation

CA Dhananjay J. Gokhale   **9**

9

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

E] Baseline requirements for NPA classification solution

ii.   User Access Management
   a) User-id to be linked with employee-ids to fix accountability
   b) Generic user-ids to be used only in exceptional circumstances
   c) Two factor or higher-level authentication
   d) Access to solution on 'need to have / least privilege' basis
   e) Maker / checker authorization / control for transactions

CA Dhananjay J. Gokhale   **10**

10

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

E] Baseline requirements for NPA classification solution

iii. Straight Through Process (STP)
   a) To include all facilities, exposures towards customer without manual interventions across multiple systems

   b) If NPA classification process is outside CBS, flow to CBS to be automatic

CA Dhananjay J. Gokhale   **11**

11

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

E] Baseline requirements for NPA classification solution

iv. Back-end Data Access Restrictions

   a) Back-end data access to be avoided
   b) Changes in data to be only through front-end with due authorization
   c) Audit Trail to be maintained along with user access
   d) Provision for MIS report to be available to auditors for complete list of back-end access and changes made

CA Dhananjay J. Gokhale   **12**

12

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

E] Baseline requirements for NPA classification solution

v.   Audit Logs

   a)   Provision for capturing audit trails of mandatory fields for future audit / forensic purpose of all financial / non-financial transactions

   b)   Logs w.r.t. changes in master data

   c)   Secure storage and retention of logs in encrypted format with access control in archival solution

CA Dhananjay J. Gokhale   **13**

13

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

E] Baseline requirements for NPA classification solution

vi.   System Generated NPAs

   a)   All parameters essential for NPA / NPI to be captured

   b)   Separate MIS Report capturing all parameters for NPA / NPI to be made available

CA Dhananjay J. Gokhale   **14**

14

Circular dated 14.Sep.2020

Automation of Income Recognition, Asset Classification and Provisioning processes in banks

E] Baseline requirements for NPA classification solution

vii. Test Environment

    a) Existing test-environment with dummy data and functional logic to be made available

    b) To enable to perform sample transactions review to verify adherence to NPA / NPI identification compliance

CA Dhananjay J. Gokhale   **15**

15

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

A] Term Loan
1. Specification of due date / repayment date
2. Concept of 'Overdue'
3. Accounting vis-à-vis treatment of advance installments
4. Reversal of Income

B] CC / OD (out of order)
1. EoD process for out of order
2. Effective date of stock statement
3. Reversal of Income

CA Dhananjay J. Gokhale   **16**

16

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

C] LCBD Exposures
1. Exposure on borrowers vis-à-vis on bank

D] Agricultural advances
1. Master Data updation and completeness
2. Interest calculation

E] Gold Loans
1. LTV
2. Loans closed and new loans opened on same date

CA Dhananjay J. Gokhale   **17**

17

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

F] Exemptions
1. Central Government Guaranteed Accounts - date validation & income recognition
2. Advance against FDR / IVP / KVP / LIP / NSC – income recognition

G] Fees / commission on renegotiation / reschedulement
1. Staggered over period covered under renegotiation

CA Dhananjay J. Gokhale   **18**

18

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
H] Reversal of Income 1. To be reversed if the same is not realised 2. Fees / commission accrued but uncollected to be reversed I] Appropriation of Recoveries (system driven) 1. Unform and consistent manner

19

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
J] Interest Application (Para 3.4) 1. *'banks may continue to record such accrued interest in a Memorandum account in their books'. 'Such interest would be excluded from calculation of Gross Advances'* K] Availability of security and valuation (realisability) 1. Mandatory valuation 2. Other assets (movable assets and others below mandatory threshold)

20

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
L] Accounts with temporary deficiency 1. Non-submission of stock statements (large borrower accounts) 2. Non-renewal / TODs / Adhocs / Short Reviews M] Upgradation of accounts 1. Entire arrears of all credit facilities to be repaid 2. Reversal of (unrealized) income to be restored

21

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
N] Devolvement of LCs / BGs 1. Parking in separate accounts O] M2M Derivatives receivable position (Trade Finance package linkage with CBS) P] Linkage of NPA and NPI Q] Inter-changeable limits

22

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

R] Straightaway classification norms
1. 50% erosion in value
2. Security value less than 10%

S] Advances to PACS / FSS

T] Loans with moratorium period for interest payment

U] Projects under implementation (DCCO) – Repeated restructuring

CA Dhananjay J. Gokhale   23

23

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

V] Provisioning norms
1. ECGC Guarantee / CGTMSE / CRGFTLIH

W] FITL

X] Realisation in cash / in kind

Y] Accounting of SRs – Para 77A (basis for automation and classification of investment as PI)

CA Dhananjay J. Gokhale   24

24

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

Z] Availability of granular data in CBS

AA] SMA classification

AB] Resolution Plan

AC] Linkage with Treasury / Trade Finance Modules / Packages

CA Dhananjay J. Gokhale   **25**

25

IRAC Master Circular dated April 01, 2022

Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

AD] Identification of restructuring / Additional Finance
1. Provisioning & asset classification
2. ~~Sacrifice calculation~~
3. Satisfactory performance and upgradation

AE] Willful defaulters (accelerated provision)

AF] Adverse balance in deposit accounts / outstanding assets other than advances

CA Dhananjay J. Gokhale   **26**

26

CA Dhananjay J. Gokhale   **27**

27

$\mathcal{T}hank\ you!$

Dhananjay J. Gokhale

9820047669 / 9322229740

dhan_gokhale@hotmail.com

28

28