

**Southern India Regional Council  
of  
Institute of Chartered Accountants of India**

**Critical issues in Bank Branch Audit**

**IRAC norms**

**Mar 22, 2023**

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# *Session Coverage*

1. Relevance of COVID-19- Regulatory Package & Concessions to MSME Sector.
2. RBI circular dated 12.11.2021 regarding important clarifications on IRAC norms.
3. Prudential Norms (Quick Refresher)
  1. a. NPA norms
  2. b. Restructuring of advances & project loans
  3. c. Asset Classification
  4. d. Provisioning norms



# *Relevance of COVID-19- Regulatory Package & Concessions to MSME Sector.*

## **MSME**

- 1) Circular DOR.No.BP.BC.34/21.04.048/2019-20 dated February 11, 2020
- 2) Circular DOR.No.BP.BC/4/21.04.048/2020-21 dated August 06, 2020

## **COVID 19 Circulars**

- a) Circular DOR.No.BP.BC.47/21.04.048 /2019-20 dated March 27, 2020. (Rescheduling of TL/WC facilities).
- b) Circular DOR.No.BP.BC.62/21.04.048 /2019-20 dated April 17, 2020. (Extension of timelines for resolution of SA)
- c) Circular DOR.No.BP.BC.63/21.04.048 /2019-20 dated April 17, 2020. (Asset classification & provisioning)
- d) Circular DOR.No.BP.BC.71/21.04.048 /2019-20 dated May 23, 2020. (Rescheduling of TL/WC facilities).

**The concessions granted by the above circulars are not applicable for accounts restructured during FY 2022-23**



# **Prudential norms on IRAC and Provisioning pertaining to Advances - Clarifications**

**RBI/2021-2022/125 DOR.STR.REC.68/21.04.048/2021-22 Nov12, 2021**

- **A. Specification of due date/repayment date**
- **B. Flagging of SMA & NPA**
- **C. Clarification regarding definition of ‘out of order’**
- **D. NPA classification in case of interest payments**
- **E. Upgradation of accounts classified as NPAs**
- **F. Income recognition policy for loans with moratorium on payment of interest**



# A. Specification of due date/repayment date

- ✿ The **exact due dates** for repayment of a loan, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. shall be clearly specified in the loan agreement.
- ✿ In cases of loan facilities with moratorium on payment of principal and/or interest, the exact date of commencement of repayment shall also be specified in the loan agreements.
- ✿ Compliance at the earliest, but not later than December 31, 2021, in respect of fresh loans.
- ✿ In case of existing loans, however, compliance to these instructions shall necessarily be ensured as and when such loans become due for renewal/review.



## B. Flagging of SMA & NPA

- ✿ 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.
- ✿ The **exact due dates** for repayment of a loan, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. shall be clearly specified in the loan agreement.
- ✿ 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. (Para 8.4)



## *C. Clarification regarding definition of 'out of order'*

- *Covering cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power*
- The balance o/s is within the limit/DP, but there are no credits continuously for 90 days ~~as on the date of the Balance sheet~~
- 
- 
- or the credits are inadequate to cover the interest debited during the ~~same period~~ previous 90 days period.



## ***D. NPA classification in case of interest payments***

✿ *In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days **from the end of the quarter**. (Para 2.1.3 of Master circular dated Oct 01, 2021)*

### **CHANGED TO**

✿ *In case of interest payments in respect of term loans, an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days.*



## ***E. Upgradation of accounts classified as NPAs***

- ✿ it is clarified that loan accounts classified as NPAs may be upgraded as ‘standard’ asset only if **entire arrears of interest and principal** are paid by the borrower.
- ✿ With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of date of commencement of commercial operations (DCCO), etc., the instructions as specified for such cases shall continue to be applicable.



## ***F. Income recognition policy for loans with moratorium on payment of interest***

- ✿ Loans where moratorium has been granted for repayment of interest, lending institutions may recognize interest income on accrual basis for accounts which continue to be classified as ‘standard’.
- ✿ However loans with moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest corresponding to the interest accrued during such moratorium period need not be reversed.



- **Prudential Norms**

- **a**

- **Quick Refresher**



## *NPA NORMS*

- Uniform norm of 90 days for all advances including Government guaranteed Accounts
- Agricultural loans – Continues to be based on crop seasons



# *NPA NORMS- Term Loans*

- Term Loan 1
- 
- Instalments of principal remain overdue for a period of more than 90 days in respect of a term loan.
- In case of interest payments in respect of term loans, an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days



# *NPA NORMS- Term Loans*

- Term Loan 2
- 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. (**Para 4.2.5 – RBI Master circular**).
- Upgradation is allowed only if the account reaches “no overdues” status. This should not be misunderstood with “overdues brought within 90 days”. (**ICAI GN – Para 11.136 Page 429**)



## *NPA NORMS- OD/CC*

- The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC).
- An account should be treated as '**out of order**' where
  - The balance o/s in the account remains continuously in excess of the limit/DP during a period of 90 days.
  - The balance o/s is within the limit/DP, but there are no credits continuously for 90 days ~~as on the date of the Balance sheet~~
  - or the credits are inadequate to cover the interest debited during the ~~same~~ ~~period~~ previous 90 days period.



# *NPA NORMS- OD/CC*

- CC 1
- CC 2



## *NPA NORMS - Bills*

- A bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.



# *Agricultural Advances- NPA*

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.
- “Long duration” crops would be crops with crop season longer than one year
- Crops, which are not “long duration” crops, would be treated as “short duration” crops.
- The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.



# *Agricultural Advances- Interest application*

Examples of Interest application according to crop seasons and for other activities:

<b>Crop Season</b>	<b>Kharif</b>	<b>Rabi</b>
Disbursement Period	April 01 to September 30	October 01 to March 31
Interest Application Date	Due date fixed for repayment	Due date fixed for repayment
Compounding from date	After due date	After due date
Penal Interest	From date the loan becomes overdue	From date the loan becomes overdue



# *Agricultural Advances- Interest application*

	<b>Allied Activities</b>	
	<b>Dairy, Poultry</b>	<b>Goat Rearing, Piggery</b>
Repayment	Quarterly	Half Yearly / Yearly
Interest Application	Quarterly	Half Yearly / Yearly
Interest application date	Quarter end	Half Year end / Year end
Compounding Frequency	Quarterly	Half Yearly / Yearly
Compounding from date	After Quarter end	After Half Year end / Year end
Penal Interest	If overdue, after Quarter end	If overdue after half year /year end.



## *Crop Season- RBI clarification recd by Maharashtra SLBC*

- Loan may be treated as NPA immediately on completion of two crop seasons / one crop season (as the case may be, depending on the duration of the crops) after the repayment due date.
- Two crop seasons after the due date should refer to only those two consecutive crop seasons in which the farmer usually undertakes crop production.



## *RBI clarification – Crop season*

The crop season for each crop, means the period up to harvesting of the crops raised. The asset classification norms assume that there is normal crop yield during the season for which credit is extended.

Hence, immediately after consecutive two harvest seasons (as per the cultivation pattern followed by the farmer borrower) from repayment due date, the account is to be identified as NPA.

In case of natural calamities as declared by the SG, the loan should be restructured/ rescheduled



# Agri loan NPA - Examples

S.No.	Particulars	Short Term Crops		Long Term Crops	
		Kharif	Rabi	Sugarcane	Banana
1	Sanction date	1 <sup>st</sup> April 2020 to 30 <sup>th</sup> September, 2020	1 <sup>st</sup> October 2020 to 31 <sup>st</sup> March, 2021	1 <sup>st</sup> October, 2019	1 <sup>st</sup> July, 2019
2	Harvesting time	September, 2020	March, 2021	December, 2020	September, 2020
3	Repayment due date	31 <sup>st</sup> December, 2020	30 <sup>th</sup> June, 2021	31 <sup>st</sup> March, 2021	31 <sup>st</sup> December, 2020
4	Interest subvention @ 3%	Available upto the date of repayment subject to maximum repayment due date.(subject to 1 year)	Available upto the date of repayment subject to maximum repayment due date. (subject to 1 year)		
5	Date of irregularity	31 <sup>st</sup> December, 2020	30 <sup>th</sup> June, 2021	31 <sup>st</sup> March, 2021	31 <sup>st</sup> December, 2020



# Agri loan NPA - Examples

<b><u>Multiple/ double cropping pattern</u></b>					
6	First crop season end date	30 <sup>th</sup> June, 2021	31 <sup>st</sup> December, 2021	NA	NA
7	Second crop season end date	31 <sup>st</sup> December, 2021	30 <sup>th</sup> June, 2022	NA	NA
8	Date of NPA	31 <sup>st</sup> December, 2021	30 <sup>th</sup> June, 2022	NA	NA
<b><u>Single/ mono cropping pattern</u></b>					
9	First crop season end date	31 <sup>st</sup> December, 2021	30 <sup>th</sup> June, 2021	31 <sup>st</sup> March 2023	31 <sup>st</sup> December 2022
10	Second crop season end date	31 <sup>st</sup> December 2022	30 <sup>th</sup> June, 2022	NA	NA
11	Date of NPA	31 <sup>st</sup> December 2022	30 <sup>th</sup> June, 2022	31 <sup>st</sup> March 2023	31 <sup>st</sup> December 2022



# *Agri – NPA Examples for allied activity*

<b>Allied Activity (Instalment)</b>				
<b>Type</b>	<b>Dairy</b> (equated quarterly instalment with moratorium period, first instalment is due on Sept 30, 2020)	<b>Goat Rearing</b> (equated half yearly / yearly instalment considering moratorium period of six months first instalment is due on June 30, 2021)	<b>Piggery</b> (equated half yearly / yearly instalment considering moratorium period of six months first instalment is due on June 30, 2021)	<b>Poultry</b> (equated quarterly instalment with moratorium period, first instalment is due on Sept 30, 2020)
<b>Loan Disbursed</b>	1-Jun-2022	1-Jul-2021	1-Jul-2021	1-Jun-2022
<b>Due Date</b>	30-Sep-2022	30-Jun-2022	30-Jun-2022	30-Sep-2022
<b>Overdue Date</b>	30-Sep-2022	30-Jun-2022	30-Jun-2022	30-Sep-2022
<b>Compounding</b>	30-Sep-2022	30-Jun-2022	30-Jun-2022	30-Sep-2022
<b>NPA turning date</b>	30-Dec-2022	29-Sep-2022	29-Sep-2022	30-Dec-2022
<b>Remarks</b>	NPA upon running day-end process on 90 days overdue	NPA upon running day-end process on 90 days overdue	NPA upon running day-end process on 90 days overdue	NPA upon running day-end process on 90 days overdue



# *Agricultural Advances*

- Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines contained in
- Master Direction – Reserve Bank of India (Relief Measures by Banks in Areas affected by Natural Calamities) Directions 2018 – SCBs dated October 17, 2018, as updated from time to time.



# **Significant factors for classifying an account as NPA in Working capital advances**

- Stock statements should not be more than 3 months old.
- Regular and ad hoc limits should not be left lapsed without renewal for a period of more than 180 days
- Solitary or very few credits in the account before the balance sheet date.



# Prudential Framework for Resolution of Stressed Assets

- **RBI has announced a revised framework for resolution of stressed assets on June 07, 2019. ( RBI/2018-19/203 DBR.No.BP.BC 45/21.04.048/2018-19**

**Framework aims at strengthening** the structure by:

- 1) Early identification and reporting of stress
  - 2) Implementation of resolution plan for defaulting accounts, supported by independent credit evaluation by credit rating agencies.
  - 3) Implementation conditions have been prescribed.
  - 4) Enable banks to take timely action for resolution of stressed accounts & provides for adequate disclosures by banks
  - 5) Additional provision if RP not implemented within prescribed timelines.
  - 6) Envisages higher provisioning, penal action & direction to file under IBC on banks in case of concealing of information.
- **The revised framework has discontinued with immediate effect Framework for Revitalising Distressed Assets, CDR, Flexible Structuring of Existing Long Term Project Loans, SDR, Change in Ownership outside SDR, and Scheme for Sustainable Structuring of Stressed Assets. Joint Lenders' Forum (JLF) as mandatory institutional mechanism for resolution of stressed accounts also stands discontinued**



# Prudential Framework for Resolution of Stressed Assets

Lenders shall identify incipient stress in loan accounts, immediately on default, by classifying stressed assets as special mention accounts (SMA) as following:

SMA sub-categories	Basis for classification – principal or interest payment or any other amount wholly or partly overdue between	For revolving credit facilities Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for a period of:
SMA-0	Upto 30 days	-
SMA-1	More than 30 days & upto 60 days	More than 30 days & upto 60 days
SMA-2	More than 60 days & upto 90 days	More than 60 days & upto 90 days

## Default

Non-payment of debt when whole or any part or instalment of debt amount has become due and payable and is not repaid by debtor.

For revolving facilities like cash credit, default would also mean, without prejudice to the above, the outstanding balance remaining continuously in excess of the sanctioned limit or drawing power, whichever is lower, for more than 30 days.



# *Meaning of Restructured Account*

- Reserve Bank of India has defined a restructured account as 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**



# *Meaning of Restructured Account*

- Restructuring means **modification** of terms of the advances including **alteration**
  - in repayment **period**, (including extension of moratorium period)
  - repayment **amount**,
  - amount of installments,
  - **rate of interest**.



## When is implementation complete?

- All related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are **completed by all lenders**; and
- The new capital structure and / or changes in the terms and conditions of the existing loans get duly reflected in the books of **all the lenders and the borrower.**



## *Restructured Accounts- Key points*

- **Specified Period** means a period of one year from the commencement of the first payment of interest or principal, **whichever is later**, on the credit facility with longest period of moratorium under the terms of restructuring package.
- Satisfactory performance during the specified period means adherence to the specified conditions during that period.



# *Restructured Accounts- Key points*

## Satisfactory performance

### Non-Agricultural Cash Credit Accounts

- In the case of non-agricultural cash credit accounts, the account should not be out of order any time during the specified period, for duration of more than 90 days and there should not be any overdues at the end of the specified period.

### Non-Agricultural Term Loan Accounts

- In the case of non-agricultural term loan accounts, no payment should remain overdue for a period of more than 90 days and there should not be any overdues at the end of the specified period.

### All Agricultural Accounts

- In the case of agricultural accounts, at the end of the specified period the account should be regular.



# *Project Loans*

- **Project loans** is the long-term finance of infrastructure and industrial projects based upon the projected cash flows of the project rather than just the balance sheets of its sponsors.
- the '**Date of Completion**' and the '**Date of Commencement of Commercial Operations**' (**DCCO**), of the project should be clearly spelt out at the time of financial closure of the project and the same should be formally documented.



# *Project Loans*

- In several instances, the completion of the projects is delayed due to extraneous reasons beyond the control of the promoters.
- The reasons for delay include legal disputes, delay in obtaining government approvals, etc.
- In such a situation Banks may restructure / reschedule
  - Project loans for infrastructure sector
  - Project loans for non infrastructure sector



# *Project Loans*

## **Deferment of DCCO not treated as restructuring and hence asset classified as Standard**

<b>Infrastructure Projects</b>	<b>Non Infrastructure Projects</b>	<b>Conditions</b>
The revised DCCO falls within a period of <b>two</b> years from the original DCCO stipulated at the time of financial closure	The revised DCCO falls within a period of <b>one</b> year from the original DCCO stipulated at the time of financial closure	The revised repayment period should be equal to or shorter than the original repayment term. <b>In other words if the repayment term is extended it will amount to restructuring</b>

**Standard Asset - Provision required 0.40%**



# *Project Loans*

## **Restructuring of Project loans by way of revision of DCCO for reasons beyond the control of the promoters**

<b>Infrastructure Projects</b>	<b>Non Infrastructure Projects</b>	<b>Conditions</b>
Up to another <b>one</b> year (total extension of <b>three</b> years from the date of original DCCO ).	Up to another <b>one</b> year (total extension of <b>two</b> years).  <b>Please note that this benefit is not available to Commercial Real Estate Exposures</b>	1. The application for restructuring should be received before the expiry of the deferred DCCO & the account must be standard as on the date of application for restructuring 2. In case of moratorium for payment of interest, banks should not book income on accrual basis beyond two years (for infrastructure loans) & one year (for non infrastructure loans) from the date of original DCCO

**Standard Asset - Provision required 5.00%**



## Restructuring of Infrastructure Projects involving court cases

Infrastructure Projects	Conditions
Up to another <b>two</b> years (total extension of <b>four</b> years from the date of original DCCO ), in case <b>the reason for extension of DCCO is arbitration proceedings or a court case.</b>	<ol style="list-style-type: none"><li>1. The application for restructuring should be received before the expiry of the deferred DCCO &amp; the account must be standard as on the date of application for restructuring</li><li>2. In case of moratorium for payment of interest, banks should not book income on accrual basis beyond two years (for infrastructure loans) &amp; one year (for non infrastructure loans) from the date of original DCCO</li></ol>

Standard Asset - Provision required 5.00%



# Income Recognition

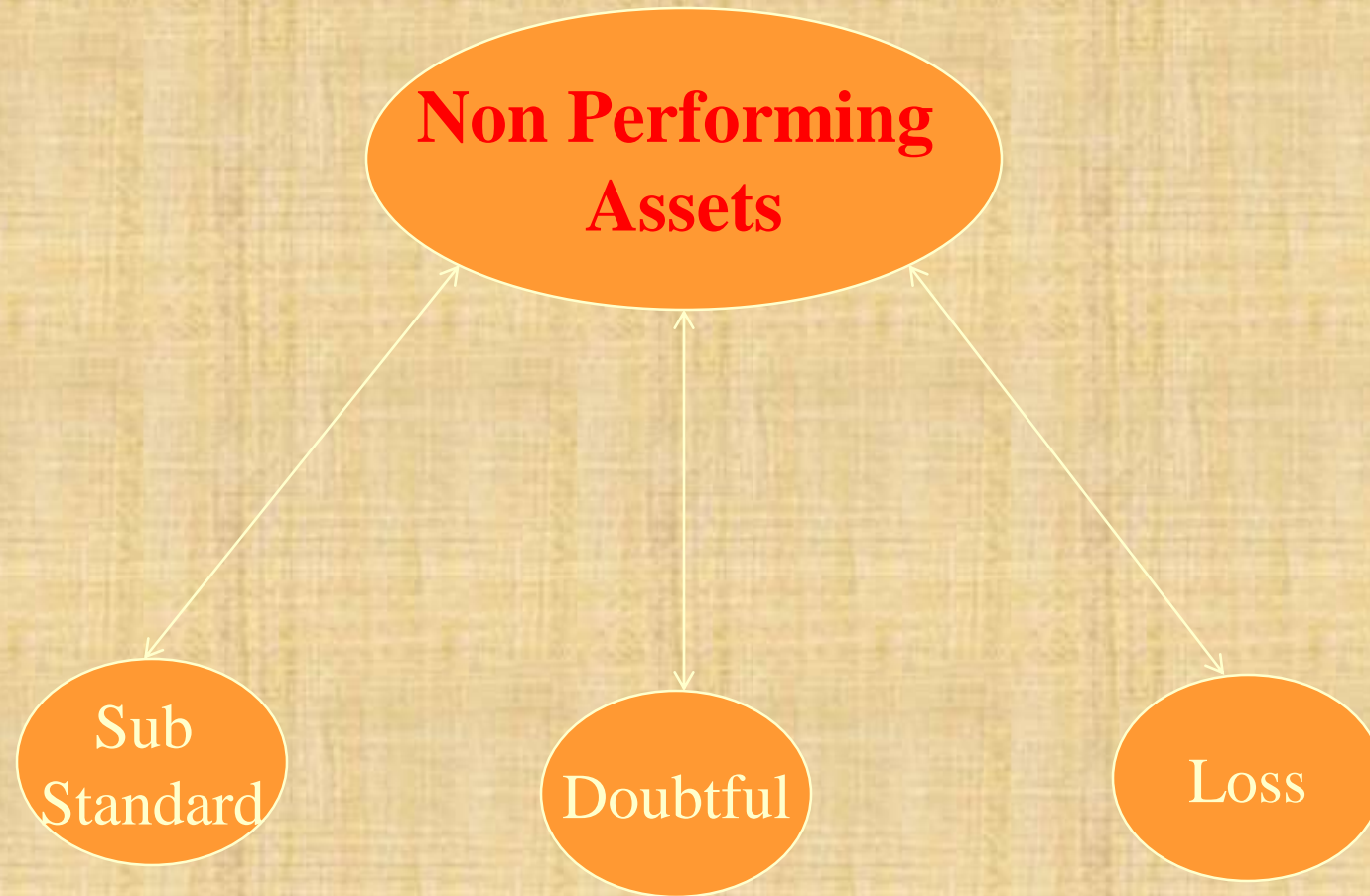
- Income is to be recognised based on recovery
- Not applicable to advances against Life Insurance Policies, NSCs, IVPs, KVPs etc, provided requisite margin is maintained.
- Critical area in respect of OD against deposits wherein Deposits with multiple Interest are taken as security
- Critical area in respect of loan against FD wherein interest is drawn periodically by the depositor but interest on loan is accumulated without payment



# Reversal of Interest

- In respect of accounts classified as NPA for the first time, interest debited in the current year (2022-2023) and **previous years** which has not been realised should be reversed or provided.
- This will apply to Government guaranteed accounts also.





# Sub Standard Assets & Doubtful assets

- An NPA which is less than 12 months old – SSA
- An NPA which is more than 12 months old - DA
- In case erosion in value of securities is more than 50%, classify as doubtful
- Critical point – Valuation has to be done once in three years for NPAs.



# Loss Assets

- An asset considered uncollectible
- An 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**
- An asset whose security value has been eroded by more than 90 % of the advance value

# Asset Classification

- Asset Classification to be borrower-wise and not facility-wise

## Exceptions

- Bills discounted under LC until default
- Mark to market value of derivatives contract
- Additional facility granted to a restructured NPA



# Asset Classification

- Asset classification of **accounts under consortium** should be based on the record of recovery of the individual member banks
- In case of multi branch financing – The classification by the branch where main limit is availed has to be considered by all branches.
- **CRITICAL** – Certificate from Main branch is compulsory since the operations may be good in the branch where sublimit is availed.
- A NPA need not go through the various stages of classification in cases of serious credit impairment



# Asset Classification

- **Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs.**
- Advances against gold ornaments, government securities and all other securities are not covered by the above exemption
- A sub-standard accounts which has been subjected to restructuring etc., would be eligible to be upgraded to the standard category only after the specified period of one year



# **Asset Classification**

## **Govt. Guaranteed Accounts**

Accounts to be classified as NPA if guaranteed by

- Central Govt. when the guarantee is repudiated.
- State Govts. When the guarantee is invoked and remains in default for more than 90 days.



## *Provisioning Whose responsibility*

- *The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and **the statutory auditors.***
- *The assessment made by the inspecting officer of the RBI is furnished to the bank to **assist the bank management and the statutory auditors** in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.*



# *Provisioning Norms*

Standard assets(other than Restructured accounts) – on global loan portfolio

- |   |              |
|---|--------------|
| a) Direct advances to agricultural and SME sectors                          | 0.25%        |
| b) Commercial Real Estate ( <b>CRE</b> ) <b>Exposures</b>                   | 1 %          |
| c) Commercial Real Estate – Residential Housing<br>Sector ( <b>CRE-RH</b> ) | <b>0.75%</b> |



# *Provisioning Norms*

- Standard assets (other than Restructured accounts) – on global loan portfolio
- d) Housing loans extended at teaser rates – 2%  
*(The provisioning on these assets would revert to 0.40per cent after 1 year from the date on which the rates are reset at higher rates if the accounts remain ‘standard’.)*
- e) All other Standard advances – 0.40%

Accounts Restructured during the current year classified as standard – 5 %



# Provisioning Norms

- Sub standard assets - 15 percent on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available

# Substandard Assets

- In case of Substandard accounts, where security available abinitio at the time of sanction is less than 10% of both funded and non funded limits put together, then the provision to be made is 25 % **(20% in case there is an escrow account in case of infrastructure lending, infrastructure loan accounts)** of the Outstanding Value
- It is different from erosion of security to be classified as loss asset.



# Provisioning Norms

- Doubtful assets – 100 % of the unsecured portion  
+  
25/40/100% (depending on age) of the secured portion
- Loss Asset – 100%

# PROVISIONING – 2022-2023

Sl. No.	NPA Date	Status of Asset	Unsecured Portions	Secured Portion
I	Before 1.4.2019	D3 – Current year	100% of Outstanding irrespective of the availability of security as reduced by ECGC cover	



II	1.4.2019- 31.3.2021	D2 – Current year	100% as reduced by ECGC Cover	40%
III	1.4.2021- 31.3.2022	D1 – Current year	100% as reduced by ECGC Cover	25%
IV	1.4.2022- 31.3.2023	Substandar d current year	15% of the outstanding irrespective of security or ECGC Cover **	

## *Master Circular Ref*

- RBI/2022-23/15 DOR.STR.REC.4/21.04.048/2022-23  
dated April 01, 2022- **Master circular for Prudential  
norms on IRAC and Provisioning relating to Advances**



**THANK YOU**



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