SIRC of ICAI

Reporting Excellence – LFAR, MOC & Top Issues in Bank Branch Audit

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Session Coverage

1. **Reporting Excellence – LFAR and MOC**
   a) **Importance**
   b) **Critical Clauses**
   c) **Manner of Reporting**
   d) **Areas of important Coverage**
   e) **Relevance to MOC**

2. **Top Issues in Bank Branch Audit**
   a) **Directions substituting Master Circulars**
   b) **Restructuring & Rehabilitation**
   c) **Asset Classification & criticality thereon**

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Top Issues in Bank Branch Audit

1. Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated April 01, 2025.

WITHDRAWN

REPLACED

Reserve Bank of India (Commercial Banks – Income Recognition, Asset Classification and Provisioning) Directions, 2025 dated Nov 28, 2025

2. Provisioning of advances for restructured accounts as prescribed in the Reserve Bank of India (Commercial Banks – Resolution of Stressed Assets) Directions, 2025

3. Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises (MSMEs)

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Reserve Bank of India (Commercial Banks – Income Recognition, Asset Classification and Provisioning) Directions 2025

Contains 6 chapters and 2 Annexures

Each chapter has sub-divisions ranging from 3 to 9

Sub- divisions total to 31

Annexures deal with disclosure formats

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What is NEW in RBI (CB – IRAC) Directions 2025

- Substance of IRAC norms largely unchanged; improvements relate mainly to clarity, structure and governance.
- Directions aligned with other RBI prudential regulations and supervisory expectations
- New Directions reorganise the framework and include formal definitions for key regulatory terms.

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What is NEW in RBI (CB – IRAC) Directions 2025

- Banks required to implement system-driven NPA classification with minimal manual intervention.
- Provisioning norms largely retained but structured more clearly for regulatory clarity.
- Exposure, Security, Unsecured Exposure, PCR and crop duration definitions formally added.

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Concept / Term	Definition in IRACP Directions 2025	Position in Old IRAC Master Circular	Key Change / Observation
Non-Performing Asset (NPA)	Asset which has ceased to generate income for the bank.	Concept explained in asset classification section stating that an asset becomes non-performing when it ceases to generate income.	Concept unchanged; definition formally codified in 2025 Directions.
Out of Order (OD/CC)	OD/CC account treated as out of order if outstanding exceeds limit/DP for 90 days, or there are no credits for 90 days, or credits insufficient to cover interest debited.	Same three conditions explained within OD/CC classification paragraph.	No conceptual change; wording formalised.
Overdue	Any amount due to the bank not paid on the due date fixed by the bank.	Explained in repayment default paragraph rather than in a definitions section.	Same concept; now formally defined.
Sub-standard Asset	Asset which has remained NPA for ≤12 months.	Same explanation provided under asset classification section.	No change.

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Concept / Term	Definition in IRACP Directions 2025	Position in Old IRAC Master Circular	Key Change / Observation
Doubtful Asset	Asset which has remained in sub-standard category for >12 months.	Same concept described in the classification section.	No change.
Loss Asset	Asset where loss has been identified by bank / auditors / RBI inspection but not fully written off.	Identical explanation provided under loss asset classification.	No change.
Security	Tangible security properly charged to the bank; excludes guarantees and comfort letters.	Concept used implicitly while discussing secured exposure and provisioning.	Now formally defined.
Unsecured Exposure	Exposure where realisable value of security is ≤10% of outstanding.	Similar concept used for provisioning but without formal definition.	Formal definition introduced.

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Concept / Term	Definition in IRACP Directions 2025	Position in Old IRAC Master Circular	Key Change / Observation
Provisioning Coverage Ratio (PCR)	Ratio of provisions held to Gross NPAs.	PCR referenced in supervisory guidance but not defined in the circular.	Explicit definition introduced.
Exposure	Includes funded and non-funded credit exposure of a borrower.	Term used in regulatory discussions but not defined.	Formal definition introduced.
Short Duration Crop / Long Duration Crop	Defined based on crop season duration for agricultural advances.	Earlier explained only within agricultural loan classification guidance.	Now codified as formal definitions.

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Concept / Term	Definition in IRACP Directions 2025	Position in Old IRAC Master Circular	Key Change / Observation
Crop Season	'crop season' for each crop, shall mean the period up to harvesting of the crops raised, as determined by the State Level Bankers' Committee (SLBC) in each State;	Earlier explained only within agricultural advances.	Now codified as formal definitions.
Wiful Defaulter	'wilful defaulter' shall mean the same as defined under the Reserve Bank of India (Commercial Banks – Treatment of Wilful Defaulters and Large Defaulters) Directions, 2025.	Referenced earlier under para 28 - wilful Defaulters	Now codified as formal definitions.

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Critical issues in Prudential Norms

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Sanction Terms

Term Loan sanctioned - 06-06 -2020

Amount sanctioned - 1.20 Crores

Tenor – 5 Years

Repayment : 60 monthly instalment of Rs 2,00,000 each commencing from July 2020

Interest 10.15 % - To be paid as & when debited.

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TL sanctioned on	06-06-2020								
Amount sanctioned	1.2	crores							
Tenor	5	Years							
Repayment	60 monthy instalments of Rs		2,00,000	each commencing from					Jul-20
Monthly due date	15th								
Interest	10.15	%	To be paid as and when debited						

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Chapter III Para A31 – Cassification of SMA/NPA

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.

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Flagging of SMA & NPA(Chapter III ParaA 31)

- 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.

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Specification of due /repayment date (Chapter II Para B13)

A bank shall comply with the following instructions in respect of all loans sanctioned on or after December 31, 2021:

- 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.
- In case of loans sanctioned prior to Dec 31, 2021, compliance to these instructions shall be ensured as and when such loans become due for renewal/review.

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Definition of 'Out of order' (Chapter 1 Para C7)

'out of order status' **– a cash credit / overdraft (CC / OD) account shall be treated as 'out of order' if any of the following conditions are satisfied:**

(i) the outstanding balance remains continuously in excess of the sanctioned limit / drawing power for 90 days;

- **(ii) the outstanding balance is less than the sanctioned limit / drawing power but there are no credits continuously for 90 days;**
- **(iii) the outstanding balance is less than the sanctioned limit / drawing power but credits are not enough to cover the interest debited during the previous 90 days period.**

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Explanation to Out of Order Definition

Explanation 1: 'Previous 90 days period' referred above shall be inclusive of the day for which the day-end process is being run.

Explanation 2: The definition of 'out of order' shall be applicable to all credit products being offered as an overdraft facility, including those not meant for business purpose and / or which entail interest repayments as the only credits.

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Facility	TL	Repayment to commence	Jan-22	
Instalment due by		10th of every month		
Loan	48,00,000	Last Instalment	Dec-25	
RoI	12	Instalment	1,00,000	Per month

Statement of account from 01.04.2023 to 31.03.2024

Date	Particulars	Debit	Credit	Balance
01-04-2023	Bal B/f	35,00,000		35,00,000
20-04-2023			50,000	34,50,000
28-04-2023	Int	34,200		34,84,200
10-05-2023			90,000	33,94,200
28-05-2023	Int	34,500		34,28,700
15-06-2023	NPA 15-06-2023	0		34,28,700
15-02-2024	int	3,08,583		37,37,283
	Inst repayment		13,37,283	24,00,000
	Upgraded to STD			24,00,000
28-02-2024	int	24,000		24,24,000
15-03-2024	Inst repayment		1,00,000	23,24,000
28-03-2024	int	23,740		23,47,740

[redacted]

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Facility	TL	Repayment to commence	Jan-22	
Instalment due by		10th of every month		
Loan	48,00,000	Last Instalment	Dec-25	
RoI	12	Instalment	1,00,000	Per month

Statement of account from 01.04.2023 to 31.03.2024

Date	Particulars	Debit	Credit	Balance	DP as on 15th		overdue
01-04-2023	Bal B/f	35,00,000		35,00,000	32,00,000	Apr-23	3,00,000
20-04-2023			50,000	34,50,000	31,00,000	May-23	2,94,200
28-04-2023	Int	34,200		34,84,200	30,00,000	Jun-23	4,28,700
10-05-2023			90,000	33,94,200	29,00,000	Jul-23	
28-05-2023	Int	34,500		34,28,700	28,00,000	Aug-23	
15-06-2023	NPA 15-06-2023	0		34,28,700	27,00,000	Sep-23	
15-02-2024	int	3,08,583		37,37,283	26,00,000	Oct-23	
	Inst repayment		13,37,283	24,00,000	25,00,000	Nov-23	
	Upgraded to STD			24,00,000	24,00,000	Dec-23	
28-02-2024	int	24,000		24,24,000	23,00,000	Jan-24	
15-03-2024	Inst repayment		1,00,000	23,24,000	22,00,000	Feb-24	2,00,000
28-03-2024	int	23,740		23,47,740	21,00,000	Mar-24	

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Upgradation of accounts classified as NPAs

- Loan accounts classified as NPAs may be upgraded as 'standard' asset only if **entire arrears of interest and principal** are paid by the borrower. (**Chapter III Para G 69**)

- 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. (Refer Reserve Bank of India (Commercial Banks – Resolution of Stressed Assets) Directions, 2025 (**Chapter III Para G 70**)

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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'. (Chapter V Para E 139)
- 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. (Chapter V Para B129)

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Agricultural Advances- NPA
(Chapter III Para C 42(6)&(7))

- 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.

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Agri loan NPA - Examples

S.No.	Particulars	Short Term Crops		Long Term Crops	
		Kharif	Rabi	Sugarcane	Banana
1	Sanction date	1st April 2020 to 30th September, 2020	1st October 2020 to 31st March, 2021	1st October, 2019	1st July, 2019
2	Harvesting time	September, 2020	March, 2021	December, 2020	September, 2020
3	Repayment due date	31st December, 2020	30th June, 2021	31st March, 2021	31st 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	31st December, 2020	30th June, 2021	31st March, 2021	31st December, 2020

Refer page 422-424 of ICAI GN

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Agri loan NPA - Examples

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

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Agri – NPA Examples for allied activity

Allied Activity (Instalment)				
Type	**Dairy**	**Goat Rearing**	**Piggery**	**Poultry**
	(equated quarterly instalment with moratorium period, first instalment is due on Sept 30, 2020)	(equated half yearly / yearly instalment considering moratorium period of six months first instalment is due on June 302021)	(equated half yearly / yearly instalment considering moratorium period of six months first instalment is due on June 30, 2021)	(equated quarterly instalment with moratorium period, first instalment is due on Sept 30, 2020)
Loan Disbursed	1-Jun-2022	1-Jul-2021	1-Jul-2021	1-Jun-2022
Due Date	30-Sep-2022	30-Jun-2022	30-Jun-2022	30-Sep-2022
Overdue Date	30-Sep-2022	30-Jun-2022	30-Jun-2022	30-Sep-2022
Compounding	30-Sep-2022	30-Jun-2022	30-Jun-2022	30-Sep-2022
NPA turning date	30-Dec-2022	29-Sep-2022	29-Sep-2022	30-Dec-2022
Remarks	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

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Reserve Bank of India (Commercial Banks – Resolution of Stressed Assets) Directions, 2025

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Meaning of Restructured Account

- Restructuring would normally involve **modification** of terms of the advances / securities, which would generally include, among others, alteration of
- payment period
- payable amount / the amount of instalments
- rate of interest;
- roll over of credit facilities; sanction of additional credit facility/ release of additional funds for an account in default to aid curing of default / enhancement of existing credit limits; compromise settlements where time for payment of settlement amount exceeds three months.

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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.
- Borrower is not in default with any of the specified lender.

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Restructured Accounts- Key points

- ***specified period*'** shall mean the period from the date of implementation of RP up to the date by which **at least 20 per cent of the sum** of outstanding principal debt as per the resolution plan and interest capitalisation sanctioned as part of the restructuring, if any, **is repaid.**
- *Provided that* for accounts **restructured under IBC**, the specified period shall be deemed to commence from the **date of implementation** of the resolution plan as approved by the Adjudicating Authority.
- *Provided further that* in the case of restructuring of **MSME accounts where aggregate exposure of commercial banks (including SFBs, but excluding PBs, LABs and RRBs) is less than ₹25 crore**, specified period shall mean 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 for a particular bank.

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Restructured Accounts- Key points

Satisfactory performance shall mean that the borrower **entity is not in default** with any specified lender **at any point of time during the period** concerned;

Provided that in the case of restructuring of **MSME accounts** where aggregate exposure of Commercial Banks (including SFBs, but excluding PBs, LABs and RRBs) is **less than ₹25 crore**, **satisfactory performance** shall mean:

(i) **no payment (interest and / or principal) remain outstanding for a period of more than 30 days;**

(ii) in the case of **cash credit / overdraft** account, the **outstanding** in the account is **not more than the sanctioned limit or drawing power**, whichever is lower, for a period of **more than 30 continuous days.**

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Reversal of Interest

- **B. Reversal of income upon classification as NPA**

a) If any advance, including bills purchased and discounted as well as a Government guaranteed account, becomes NPA, the entire interest accrued and credited to income account in the **past periods**, shall be reversed if the same is not realised.

- b) If 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, if any, corresponding to the interest accrued during such moratorium period need not be reversed.
- c) In respect of NPAs, fees, commission and similar income that have accrued shall cease to accrue in the current period and shall be reversed with respect to past periods, if uncollected.

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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.***

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Reporting Excellence – LFAR & MOC

- ***Importance :***
  - ***A comprehensive Questionairre***
  - ***All activities of bank is covered – Cash, advances, liaiblities, etc.***
  - ***Early warning signals are reportable***
  - ***Supplementary and not a substitute***
  - ***Acts as a significant tool to :***
    - ***Branch Auditors***
    - ***Central Statutory Auditors***
    - ***Controlling office***
    - ***Regulators***

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Reporting Excellence – LFAR & MOC – contd.

- ***Critical Clauses :***
- ***Clause V – Very critical on advances***
  - ***Credit Appraisal***
  - ***Sanctioning and documentation (incl RACPC held docs)***
  - ***Disbursement***
  - ***Review and Monitoring***
  - ***Assets classification, Provisioning & stressed assets resolution***
  - ***NPA & Suit Filed cases monitoring***
  - ***Non Funded exposures and compliances therein***

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Reporting Excellence – LFAR & MOC – contd.

- ***Critical Clauses : OTHER THAN ADVANCES***
  - ***Suspense – Expeditious clearance & reporting unusual items***
  - ***Liabilities – Deposits – KYC compliances & FCNR (B) deposits***
  - ***Bills Payable, Sundry Deposits – Ageing & reporting unusual items***
  - ***Contingent Liabilities – If any (other than LC/BG)***
  - ***Test Check of Income earned and expenses incurred & reporting of material items***
  - ***IRAC norms compliances and reporting thereon***
  - ***Divergent Trends in income & expenditure to report***

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Reporting Excellence – LFAR & MOC – contd.

- ***Critical Clauses : OTHER THAN ADVANCES***
  - ***Internal Control of gold/bullion/security items***
  - ***Books & Records maintenance & reports generation***
  - ***Manual intervention & data integrity***
  - ***Inter branch accounts***
  - ***Frauds***
  - ***KYC/AML guidelines***
  - ***MIS reporting***
  - ***Other audits conducted at the branch & pending issues***
  - ***Any other information to the Central Statutory Auditors attention***

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Reporting Excellence – LFAR & MOC – contd.

- ***Manner of Reporting :***
  - ***Yes/No/Not applicable – Not sufficient***
  - ***Specific statistics is required in respect of verified advances***
  - ***Top 5 standard advances are to be listed***
  - ***Wherever MOC is given relevant clauses has to be reported***
  - ***Avoid vague and general comments***
  - ***Have the points focused and specific***
  - ***Discuss with the management and take their inputs***
  - ***Summarise the points with detailed statistics***

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Reporting Excellence – LFAR & MOC – contd.

- ***Areas of important coverage :***
- ***All Large advances***
- ***Few other advances – But all categories are to be covered***
- ***Non Fund Based Advances***
- ***Suspense & Sundry Deposits***
- ***Income, Expenditure & divergent trends***
- ***Frauds – verification & reporting***
- ***Last year Audit reports***
- ***Redflagged Accounts***
- ***KYC / AML guidelines***

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Reporting Excellence – LFAR & MOC – contd.

- ***Relevance to MOC :***
- ***Triggers reporting for every entry in MOC***
  - ***Revenue items requiring adjustment – Clause 2 (ii)***
  - ***Reclassification of Advances***
    - ***Performance – Clause V (f) (i) (a) & (d)***
    - ***Security & Priority – Not part of LFAR***
  - ***Interest/discount/commission short / excess credit – Clause III (a)***
  - ***Reversal of Interest on account of performance – Clause III (b)***
  - ***Interest on deposits short/over debit – Clause III (c)***

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Reporting Excellence – LFAR & MOC – contd.

- ***Relevance to MOC : - continued***
  - ***Upgradation / Downgradation of asset – Clause V (f) (iii)***
  - ***Suspense Account :***
    - ***Long outstanding and irrecoverable – Clause 6 (a) (i)***
    - ***Unrecognised assets & expenses – Clause 6(a) (i)***

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Key Takeaways – LFAR & MOC

- ***Document your work appropriately***
- ***Have the circulars & detailed working papers***
- ***Discuss with the Branch management***
- ***Review the report***
- ***Summarise the Final Report with Detailed statistics***
- ***Wherever MOC is there – LFAR should have corresponding report***
- ***MRL alone not sufficient***
- ***Preserve the records for 7 years from the date of signing***

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THANK YOU



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