ISSUES IN VERIFICATION OF ADVANCES

As reported in News India T.V. Channel on 1st January, 2014 – Bad loans upto 31st March, 2013 were around Rs.5 Lacs 75 Thousand Crores. It is estimated that by 31st March, 2014, the Banking Industry shall have more than 2 Lac 38 Thousand Crores of additional NPAs. Such alarming rise in fresh NPA has necessitated a very serious and indepth verification of Loans and Advances being given by the Banks.

As we know, the Core business of Banks is lending money. Such lending money is called Fund Based Advances. Besides the fund based advances, Banks also give guarantees, sureties and other commitments which are called non-fund based facilities. The Non-fund Based facilities when devolve on the Bank, the Bank being under obligation to honour its commitments pay the damages involved and thus these facilities also become the fund based advances. **Verification of Advances**, therefore, include both fund and non-fund based facilities extended to the customers/borrowers.

Generally, Banks are giving term loans for projects and expansion of the existing business for creation of long term assets such as land, buildings, plant & machinery etc. Banks also give money for carrying on day to day business activities by way of cash credit or overdraft facilities generally known as CC and OD limits. Banks facilitate smooth business of their customers by providing them funds against their receivables called Sundry Debtors by way of Bill Discounting facilities or book debts limits. Banks provide loans to farmers who are called agriculturist either on short term basis or on long term basis. Banks also provide financing against leased assets against the recoverable lease charges of the borrowers or against the future rent of the assets leased out by the borrowers. Banks open letters of Credit both inland and foreign, issues Guarantees on behalf of customers and make certain commitments. All above financial facilities are extended by Banks against tangible securities, however there is one Banking product in which Banks provide money for creation of assets without having clear, Marketable title of land – BOT advances to the franchisees of NHAI for construction of Roads and Bridges.

The verification of all kinds of Advances has to be conducted according to the nature of Advance, terms and conditions etc.

TERM LOAN ADVANCES :

The terms and conditions of the sanction letter of Term Loans must be thoroughly read and their proper compliance should be verified.

Banks are giving term loan advances against assets such as land, building, plant & machinery, housing loans, vehicles, consumer goods and infrastructure projects being undertaken by various customers on BOT System (Build, Operate & Transfer). The verification of land entails documentary evidence confirming clear and marketable title of land which has to be verified with regard to the original title deed which has to be seen very

cautiously since due to coloured photocopying, it has been possible to take out almost identical photocopy of any document in all its colour but the photocopy is a finer reproduction of the original document. The conditions attached to the acquisition of land by the borrowers is also to be verified e.g. the Delhi Development Authority and NOIDA, Greater NOIDA while allotting industrial plot, has invariably put the condition that 50% of the unearned increase of land in case of transfer shall have to be deposited with the DDA before effecting transfer. Very often the valuation of land as security against term loan is made on market value of the land without considering such clauses. There are many conditions on the lease hold lands which should be verified in order to arrive at the clear title of land. Similarly for buildings, the cost of construction as reduced by depreciation for the number of years, it has been put to use at the Income Tax rates (WDV rates) should be verified and for Plant & Machinery, the original cost less depreciation for the number of years, it has been put to use may be taken as the market value of the security against advance.

Very often it is seen that the term loan advances against land, building, plant & machinery are based upon valuation report of an approved valuer. Considering that value as the security available against term loans. Though the valuation being a technical matter is not within the domain of the auditor but in order to arrive at the **Realizable Market Value** of the security, the auditor may consider following parameters :-

A) <u>In case of Land</u> :

i) In case of free hold land with clear title, the auditor may accept valuation as per valuer's report considering the scheduled rate as notified by the Authority such as MCD, DDA, NOIDA etc.

ii) In case of lease hold land, auditor should verify the terms and conditions of the lease of land and thereafter may satisfy himself if the valuer has taken into account those conditions for arriving at the market value, most importantly whether lessee is entitled to mortgage the land and thereafter only the valuation of the land may be accepted otherwise the value of the land should be modified according to the terms of lease. Specific condition for deposition of "Unearned Increase" must be accounted for in case of Leased Land before transfer.

iii) Since land is scarce and demand is increasing every day, the increase in the value of land is generally not to be disputed unless there is a cogent reason for non increase or devaluation of land price. In most of the metropolitan towns, area-wise schedule of market price of land is available which is notified by the municipal corporation or authority for levy of stamp duty on registration or transfer of land. The audit may call for that list and rely on that valuation.

B) <u>In case of Building</u> :

i) If it is a new construction, then cost of construction may be taken provided that the interest during construction period is not material which happens in the case of project over run by 3 years or

more, when the element of interest during construction period becomes a material figure which is proportionately capitalized under Buildings.

ii) In case of building more than 3 years old, generally the depreciated value of the building should be taken as the **realizable market value** of the building. Exception to this general phenomena must have evidence of excellent maintenance/upkeep of the building where only the current cost of similar construction less depreciation for the number of years in use may be accepted. Therefore, if the valuer's report is based on the current cost of construction called substitution cost or substitution cost of construction less depreciation, the same need not be accepted as the **realizable market value** of the building.

iii) In the above 2 cases, no appreciation in the value of building is to considered since the appreciation in the value of land is more significant factor rather than the value of the building.

iv) However, if the building happens to be a flat either with or without non-divisible part of the land apertinent thereto the appreciation in the value of flat as per valuer's report may be accepted since the appreciation in the value of the land a-pertinent to the flat is not independent and hence it is the value of the flat which appreciates. While verifying the valuation of flat, the auditor may verify whether it is free hold or lease hold and if it is a lease hold flat then terms and conditions of the lease should be taken into account while arriving to the **realizable market value** of the flat.

C) <u>In case of Plant & Machinery</u> :

i) In case of new plant & machinery say upto 3 years, its cost of acquisition less depreciation may be accepted as its **realizable market value**. For all machines more than 3 years old, the **realizable market value** of the plant & machinery may be arrived at cost of acquisition less depreciation as per Income Tax Rules **and in no case** the substitution cost of plant & machinery less depreciation for the number of years it has been put to use should be accepted as the valuation if so considered by the approved valuer.

ii) In case, the plant & machinery which is more than 10 years old then irrespective of the valuer's valuation, only the scrap value i.e. 5% of the cost of acquisition may be considered as **realizable market value** of the plant & machinery. This phenomena is based on 2 factors. The first reason is that due to fast changing improvements in the technology, there are hardly any buyers for such old plant & machinery which generally becomes obsolete and **secondly** due to engineering innovations, old machines are no where required considering their lower production capacity and high man power and energy requirements. Hence **if the valuer has valued the old plant &**

machinery at substitution cost less depreciation, the same may not be accepted by the auditor.

Substantial number of accounts when become NPA and go for compromise under OTS, the last valuation just before OTS Agreement is found much lower than the valuation of Securities for the past long years. This sudden diminution in the value of Securities has never been explained by the Bank which have entertained OTS.

CASH CREDIT/OVERDRAFT ADVANCES :

i) A Cash Credit or Overdraft Advance is fund based limit to the borrower against its tangible bankable current assets such as raw material, goods in process, finished goods and receivables. In order to verify CC or OD facility, the auditor should verify whether the terms and conditions of the sanction letter have been adhered to specially the margins and age of current assets like raw materials, finished goods and sundry debtors. He should verify calculation of Drawing Power (DP) based on stock statement and other information such as QIS, Sundry Creditors and receivables etc. The DP should be calculated at regular intervals say monthly or maximum quarterly and should also be compared with CMA data furnished by the borrower wherever applicable. **Cash Credit (CC) limit based on more than 6 months old, DP calculation will make the account an NPA**. The reason for such old DP is undisputedly borne out of the fact that the borrower has not submitted its stock statement monthly and if the 90 days old stock statement are considered for DP for the next 90 days, then the account is out or order for 90 days which covers the required period to consider the account as NPA.

ii) In case of all CC/OD accounts having limits exceeding Rs.10.00 lacs, submission of audited accounts of the borrower is required generally as per terms and conditions of the sanction letter. The auditor should go through all the terms and conditions of the CC/OD limit and may verify whether these terms have been complied with or not. Very importantly, the auditor should verify the audited figures of **current assets, sundry debtors, sundry creditors and Bank Overdraft** with those given by the borrower as at the year end i.e. 31st of March. Invariably the figures of March are given for a date other than 31st March and auditor should request the auditee branch to work out or provide by forward calculation of current assets to arrive at the figures of 31st of March. In many account of large borrowers, if the auditor compares the current assets, sundry debtors, creditors and Bank Balance as per the audited accounts for 31st March, 2013 with the stock statements and other relevant information for 31st March, 2013, there could be a material decrease in the DP of the borrower as calculated/allowed by the Bank. If that is the case then auditor should compare similar figures of the earlier years i.e. 31st March, 2012, 31st March, 2011 and further to calculate the DP as per audited accounts. **Based on such reworked DP, the auditor may classify the CC or OD accounts not only as NPA but as sub-standard or doubtful**

category 1, 2 or 3 as the case may be as on 31st March, 2014. This qualification is based on the fact that the last audited documents available to the auditor is the Balance Sheet of the borrower as on 31st March, 2013 when he is conducting audit of the accounts for the financial year ending 31st March, 2014 and in no case the audited accounts of the borrower for the year ended 31st March, 2014 can be available at that time. Hence the comparison of earlier years figure **will reveal inefficiency in credit monitoring by the Bank. Such discrepancies over few years clearly represents inherent weaknesses in the borrower's performance, hence Auditor is fully justified to classify the account as sub-standard, D-1, D-2, D-3 and issue the MOC**.

iii) Auditor should glance through the main operating account i.e. CC or OD from Dec., 2013 to March, 2014. If he finds any **Credit** in the account by virtue of any **CONTRA** entry, he should verify the relevant voucher to confirm the source and nature of such credit. In case, it is transfer from any other account, whether the beneficiary of transferor of entry has **confirmed** this **"Contra"**. In case, this credit entry has been made by debiting any "suspense" account – its details be looked into. Bank adopts such practice to retain an NPA account as a "Standard Asset" as on 31st March. By valuedating such "Contra" entry(ies), the auditor may verify revised CC/OD statement and if satisfied should reclassify the account as NPA and issue the MOC.

iv) Verification of documents in case of CC or OD limits consists of verification of pronote, latest constitution of the borrower, enforceability of the personal guarantees of the borrowers (directors, partners or proprietors as the case may be), balance confirmation certificate which should be renewed atleast once within every 3 years, **insurance policies covering entire assets including current assets against which the CC/OD have been sanctioned and whether the insurance coverage is for maximum value of the current asset,** since in case if the insurance policy is for lower value than the current asset then in the case of loss, only proportionate claim is entertained by the insurance company. Sometimes, the raw material or finished goods of the borrower as shown in the stock statement are kept in 3rd party godowns. Wherever the current assets are stored in 3rd party godowns, then auditor should verify a certificate from the owner of 3rd party godown confirming description, quantity, condition of the stock and the age of the stocks. The Insurance Policy taken by the 3rd party for borrower's stock in their godowns should also be verified. The age of the goods stored in 3rd party godown is important to ascertain whether such goods are marketable or have become obsolete which is also to be verified through the conditions of the stocks as certified by the 3rd party.

<u>BILL DISCOUNTING AND BOOK DEBTS</u> :

i) In the case of Bill Discounting and Book Debts limit, the auditor should thoroughly ascertain the terms and conditions for such facility. It is important to note the validity of Bills for consideration as security

say bills for payment upto 60 days or 75 days or 90 days and he should then work out the value of bills on age-wise analysis and may verify that the DP has been calculated in accordance with the sanctioned terms or not.

ii) The auditor should call for the bills register and verify whether the bills of the same party are being realized in the chronological order or whether any bill in between have remained outstanding. If such a case comes to his notice, he should immediately verify the reasons for non payment of such bill since it could be only an accommodation bill and not for supply of goods.

iii) **Many times, the borrower substitutes long outstanding bills once considered for DP limits by submitting new bills to maintain the DP limit.** For example, a borrower has been allowed bill discounting or book debt limit of Rs.15.00 lacs for validity of 75 days, he submits as on 30th Sept., 2013, a list of 160 bills worth Rs.18.5 lacs. In Nov., 2013, 40 of those bills which remained unpaid for more than 75 days worth Rs.8.00 lacs were taken out of the list and substituted by new bills raised during Oct. and Nov., 2013. On 31st Jan., 2014, he submits another list where 20 bills as per list of 30th Sept., 2013 which remained unpaid for Rs.2.00 lacs were substituted by fresh bills to cover the DP. **In such case, the Bill Discounting or Book Debt limit shall be considered out of order in Oct., Nov, Dec. and January according to the details of the bills which completed 75 days** and were outstanding in those months. The account will be treated as NPA because **it is the concept of record of recovery which is main consideration for considering the accounts as standard rather than the availability of security** and an account is a non performing asset as defined being a credit facility. If a bill remains overdue for a period of more than 90 days in the case of Bills purchased and discounted, the same shall become as NPA and hence it is important to verify through the Bills register, the date of realization of the discounted bill.

iv) Generally in the Bill Discounting of Book Debt limits, a condition is stipulated regarding submission of Audited "Bills Outstanding" for the validity period. The Auditor should verify the "Bill Discounted Account" to verify if there is any credit by "CONTRA" entry. Most probably, such contra entry is made to delete the outstanding bill by creating a new bill. Wherever any "Contra" entry appears, the auditor should verify relevant voucher to ascertain facts and if any bill discounted remains overdue for more than 90 days, the account may be reclassified as NPA and MOC may be issued.

HOUSING LOANS :

Housing loans were considered as one of the best banking products being secured. However, in the last few years, almost 50% of fraud cases annually reported by banks are on account of Housing Loans alone. It is important for auditor to verify Housing Loans thoroughly and to properly classify the same under Term Loans.

Housing Loans are primarily of two types :-

A) Housing Loan against house/flat completed and purchased through the Conveyance Deed and

B) The house or flat under construction.

Verification of each loan falling under the above two categories entails :-

A) **Loan against completed house or flat :-**

If the house or flat has been constructed and a Term Loan is sanctioned for purchase of such property, the auditor should verify :-

i) Whether the house or flat has clear marketable title as per Legal Report.

ii) Whether Pre-sanction Inspection Report by an officer of the bank has been obtained on the prescribed format of the Bank covering all details of property under consideration

iii) Whether CIBIL Report has been obtained from the borrower and as per CIBIL Report, the borrower has no liability against any bank/financial institution.

iv) Whether the Conveyance Deed is original or a photocopy thereof. Since now a days, it is difficult to verify if the coloured photocopy of the Conveyance Deed is duplicate of the original Conveyance Deed.

v) Whether the periodic Post Sanction Inspection Report as per the format of the Bank is available on record.

vi) Whether bank has independently confirmed from the employer of the borrower (in case of salaried employees) regarding the employment details of the borrower and whether the EMI payments are being made by the employer of the borrower.

B) **Housing Loan against house or flat under construction :-**

The Auditor should ascertain and verify :-

i) The copy of the Sanctioned Plan of the house/flat and the builder's details as furnished by the borrower.

ii) Confirmation and undertaking by the employer of the borrower (in case of salaried employees) for payment of EMIs.

iii) Periodic Post Sanction Report as per bank's proforma confirming :-

a) Stage of progress of work.

b) Confirmation by the developer/builder that no conveyance deed has been executed and the same shall be handed over to the bank as and when the conveyance deed is executed.

c) That the developer/builder has submitted a 'No Objection Certificate' from the bank/financial institution which have extended any financial facility to the developer/builder or confirmation by the developer/builder that the proposed property is free from any encumbrance, lien or charge which should further confirmed by the Legal Report before sanction of the loan.

iv) Verify compliance of detailed terms of sanction regarding moratorium for repayment of interest and principal.

If moratorium for repayment of principal alone has been sanctioned then interest should be serviced monthly and if such interest is overdue from more than 3 months, then the account should be classified as NPA.

If there is moratorium for payment of interest and principal, then auditor should verify whether interest during moratorium has been clubbed with the principal loan and EMIs have been worked out on the aggregate amount of loan outstanding as on **due date.**

The verification of Housing Loans requires a thorough review of the sanction letter, compliance of the terms and conditions of loan and monitoring of the loan account since the borrower at any stage can defraud the bank and it is due to these reasons that considerable frauds in Housing Loans are being reported every year by Banks.

LOANS TO FARMERS :

As per Master Circular issued by RBI on 1st July, 2013 the direct finance to farmers is defined as short term loan for raising crops in addition upto Rs.10.00 lacs to farmers against pledge or hypothecation of agriculture produce (including warehouse receipts) for a period not exceeding 12 months where the farmer was given crop loans for raising the produce, **provided the borrowers draw credit from one bank.** For verifying Agricultural Advances, it is to be confirmed whether the advance is to an Agriculturist :

i) Whether the advance was for a short term or long term crop advance to the agriculturist or

A medium or long term loan provided directly to the farmer for purchase of agricultural implements and machinery as elaborated in Annexure – II in the Master Circular on lending to priority sector.

ii) An Agriculturist should either own or should have land on lease or be a co-cropper. For verification of crop advances, the title of cultivable agricultural land in the name of the borrower as per land revenue records or explicit permission by the competent authority to the borrower as lessee of the agricultural land belonging to competent authority has to be verified. Such authority is the Block Development Officer, Divisional Forest Officer, Defense Services Officer (for Defense lands) and State Government etc. who are competent to authorize any person to cultivate the land. NABARD constitutes a State level committee who at each district level decides the **"Level of Finance"** to farmers for crop loans and the Banks can advance crop loan upto maximum amount per cultivated land as fixed by this Committee. Then documentation of the agricultural advance will entail execution of promissory note pledge or hypothecation deed and whether the borrower has been given short duration crop or long duration crop. The crop season of each crop which means the period upto harvesting of the crop raised would be determined by the State level Bankers Committee in each State. Such certificate should also be a part of the documents. In case of long duration crop, the monitoring of the advance will differ. **In case of short duration crop, the account is to be considered as NPA if it remains out of order for 2 crop seasons, whereas a long term agricultural advance shall become NPA if it remains out of order for 1 crop seasons not more than a year from the due date of repayment,** exceptions to this, general conditions have been properly dealt with in the Master Circular in respect of areas which have suffered natural calamities for reschedulement or loss of production or draught.

iii) Med & Long Term Loan to Agriculturists include :-

i) Purchase of Agricultural Implements and machinery.
ii) Development of Irrigation Potential.
iii) Reclamation of Land Development Schemes.
iv) Construction of Farm Building and Structures.
v) Construction and running of Storage facilities.
vi) Production & Processing of Hybrid seeds.
vii) Other type of direct finance to farmers.

The debts of farmers who have suffered production and Income losses on account of successive natural calamities such as drought, floods or other calamities, such accounts may be rescheduled or restructured by the Banks provided State Government has declared such districts as calamity affected. In such account, interest

outstanding may be clubbed with principal outstanding and the amount so arrived shall be either waived or repayable over a period at reduced rate of interest including initial moratorium. In such rescheduled/restructured loans, the NPA norms would be applicable on expiry of **initial moratorium period** or as per repayment schedule as per RBI notification.

ADVANCES AGAINST TERM DEPOSITS :

Such advances should be verified confirming documents in the name of borrower and advance against term deposits. In case of advances against term deposits, a letter of pledge by the beneficiary or third party and proper discharge of the term deposit receipt is a must. If any one, of these two conditions, is not complied, then the advance can not be said as **secured**. No advance against FDR of another Branch is to be given unless 'lien' on such FDR is confirmed by the issuing Branch of the FDR directly to the lending Branch.

ADVANCES AGAINST NSCs, IVPs, KVPs and LIPs :

NSCs eligible for surrender, IVPs, KVPs and life policies should be verified by original certificates and their surrender value since interest on such advances can be accounted for on accrual basis only if there is sufficient margin in the surrender value vis-à-vis the loan outstanding as on 31st March, 2014. However, advances against gold ornaments are not to be treated in the same category and advances against gold ornaments, State Govt. Securities and all other securities are to be treated as loans where if interest remains out of order for more than 90 days from the due date, the same shall be classified as NPA and will attract provisioning as per RBI directions..

In case of Loan against NSCs to the Staff of Bank, Auditor should verify the date of Advance to the staff and the date of assignment of NSCs in favour of Bank. Sometimes, staff is given advance for purchase of NSCs which are later on, assigned to the Bank. Such practice is adopted by the staff to claim rebate U/S 80C of the Income Tax Act to reduce their Income Tax Liability. If such is a case then it is an "Advance for Purchase of NSCs" and not loan against – NSCs.

GOVERNMENT GUARANTEED ADVANCES :

Government Guaranteed Advances are of 2 types. The first being advances backed by Central Government Guarantee and the other backed by State Government Guarantees. In no case, a letter of comfort issued by the State Government or the Central Government or even a letter issued by the State or Central Government stating that the guarantee is under implementation should be considered as a Govt. guaranteed

account as on 31st March, 2014. The advance should be backed by clearly defined Govt. guarantee issued by the competent authority before 31st March, 2014 only is to be considered. The competent authority shall mean a Govt. notification to that effect in the Gazette Notification. In case of State Government guaranteed accounts, the advance and investments in State Govt. guaranteed securities is to be classified as NPA if interest and/or principal or any other amount due to the Bank remains overdue for a period of 90 days. In case of State Govt. guaranteed account which becomes NPA as on 31st March, 2014, **the entire unrealized interest on such guarantees for the financial year 2013-14 and earlier years shall have to be reversed.**

In case of the Central Govt. guaranteed accounts, the advance is to be treated as NPA only when the Central Govt. repudiates its guarantee when invoked. Hence the difference between State Govt. guaranteed accounts and Central Govt. guaranteed accounts is a fact that an advance becomes NPA when it remains in default for more than 90 days in the case of State Govt. guarantee whereas in case of Central Govt. guaranteed accounts, it becomes NPA only when invoked guarantee is repudiated by the Central Government.

The above conditions will also apply to Investments by Banks in Bonds and other Securities backed by State or Central Government guarantee issued by State PSUs or Central PSUs as the case may be.

With effect from 31st March, 2006, invocation of Guarantee on State Govt. Guaranteed advances and investments in securities has been done away with. However, **in case of Central Govt. Guaranteed Advances and Investments in Securities** – the account **shall not be classified as NPA until the guarantee is invoked and repudiated**.

RESTRUCTURED/RESCHEDULED LOANS :

The alarming expected increase in NPSs during 2013-14, as reported by RBI may be considered by Banks to retain such accounts as 'Standard' by invoking Restructuring/ Rescheduling of such loans. Auditor should verify whether all the conditions for 'Restructuring' as per Master Circular of RBI in this regard have been adhered to. No account can be restructured without determining the "Revised Financial Viability" of the loan. Hence if any loan is restructured without revised financial viability, the Auditor may reclassify the account as Substandard and issue MOC.

The restructured/rescheduled advances are classified into 3 categories which are advances where restructuring or rescheduling or renegotiation of the term of loan agreement took place :

a) Before commencement of commercial production.

b) After commencement of commercial production but before the asset has been classified as sub-standard and

c) After commencement of commercial production and after the asset has been classified as sub-standard.

In each case of the above 3 categories, the rescheduling etc. of the principal and/or of interest could take place with or without sacrifice as part of the restructuring package by the competent authority. **The auditor should verify the date when the decision of restructuring was taken by the Bank and the status of the advance on the date of restructuring and not on the date of commencement of restructuring proceedings**. Accordingly the advance shall be classified as a standard or sub-standard as per the date of decision and if the **advance becomes sub-standard then entire unrealized interest on the advance shall have to be reversed.**

Funding of the interest under restructuring of an advance which becomes sub-standard at the time of restructuring shall not be upgraded for a specified period i.e. a period of 1 year after the date when first part of interest or of principal whichever is earlier falls due, subject to satisfactory performance during the period.

Banks can not reschedule/restructure/renegotiate borrower accounts with retrospective effect. The Asset Classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring/ rescheduling/ renegotiation.

Banks are not expected to repeatedly restructure/reschedule the amounts due to them unless there are very strong and valid reasons for it. **Restructuring in all cases should be based on viability Parameters**. It is not appropriate to extend special asset classification status to such accounts where there are repeated restructuring/rescheduling.

Normally restructuring cannot take place without formal consent/ application by the debtor. However, Banks sue moto can start process of restructuring in deserving cases subject to customer agreeing to the terms and conditions.

Debts of Small and Medium Enterprises (SMEs) are also eligible for restructuring which are viable or potentially viable with following criteria :-

a) All Non Corporate SMEs irrespective of the level of dues.

b) All Corporate SMEs which are enjoying banking facilities from one Bank only.

c) All Corporate SMEs which are having outstanding funded and non funded facilities upto a limit under multiple/Consortium banking arrangements.

d) Accounts including willful defaults, fraud and malfeasance will not be eligible for restructuring.

e) "Loss Assets" will not be eligible for restructuring.

f) Banks should work out the restructuring package and implement the same within a maximum period of 90 days from the date of receipt of request.

g) Details of restructured accounts are to be disclosed in Notes to Accounts by the Bank.

CORPORATE DEBT RESTRUCTURING (CDR SYSTEM) :

For the revival of corporates as well as for the safety of the money lent by the Banks and Financial Institutions, timely support through restructuring is done under the CDR System. On the basis of review, the revised guidelines on CDR mechanism have been made which are as follows :-

1. Limit of outstanding exposure has been reduced to Rs.10 crores and above.
2. Consent of 75% of creditors by value and at least 60% of creditors by number are required for any account to be considered under CDR Scheme.
3. Allowing OTS as a part of CDR mechanism to make the exit option more flexible etc.

Accounts which are classified as standard and sub-standard in the books of the lenders will be restructured under the 1st category and accounts which are classified as doubtful would be restructured under the 2nd category. The CDR Standing Forum will be a self empowered body which will lay down policies and guidelines and monitor the progress of corporate debt restructuring.

The CDR system has a 3 Tier arrangements :-

a) CDR Cell

b) CDR Empowered Group

c) CDR Standing Forum and its Core Groups.

a) The CDR Cell entertains accounts where exposure of Banks/ Syndication/Consortium exposure is more than 10 crores. All references to CDR by lenders or borrowers are made to the CDR Cell which decides whether the rehabilitation is prima-facie feasible. If satisfied, then it prepares a details Rehabilitation Plan with the help of lenders and this plan is put upto CDR Empowered Group. For making reference to CDR Cell at least 75% by value of exposure of the Banks and Institutions and 60% of Creditors by number to the borrowers are required. **Auditor should call for the list of creditors, details of entire Bank/Institutional exposures and should verify**

whether CDR application has been moved by the required number of Banks/ Institutions and creditors.

b) The CDR Empowered Group decides individual cases of CDR with the help of participation of lender Banks and creditors , participation in the meetings and by their representations before the Empowered group. Empowered group considers preliminary report of all cases of request for restructuring submitted to it by CDR Cell. When it is satisfied that restructuring is feasible and the enterprise is potentially viable in terms of the policies and guidelines evolved by the Standing Forum, the detailed restructuring package is worked out by the CDR Cell in conjunction with the Lead Institution. It may approve the Rehabilitation package and the decision of the CDR Empowered group shall be final and the company is put on the restructuring mode.

c) The CDR Standing Forum is representative body of all Financial Institutions and Banks participating in CDR system. CDR Standing Forum will be a self empowered body which will lay down policies and guidelines and shall monitor the progress of Corporate Debt Restructuring. The CDR Standing Forum decides Policy in respect of each case on the merits of case hence there is no defined policy of the CDRs Standing Forum.

NON FUND BASED ADVANCES :

Generally Banks provide certain facilities to its borrowers to smoothen their business operations without deployment of all the funds required. Such facilities are called Non-fund Based and include :

1. Letter of Credit
2. Bank Guarantees :
   a) Performance Guarantee
   b) Deferred Payment or Usance Bills Guarantee
   c) Co-acceptance of Bills etc.

In the case of LC limits, the Bank evaluates credit facility for the borrower based on lead time or processing time or any other cogent reason and offers a guarantee to the Creditor that if the borrower does not fulfill its commitment then Bank will pay to the Creditor (supplier of goods or services). Such L.C. limit is allowed to the borrower on a low margin and if the borrower does not pay to the Creditor on due date then Bank has to pay to the Creditor and that is called **"Devolvement of LC".**

Similarly, Bank issues Bank Guarantee for and on behalf of its customer in favour of third parties which binds the Bank to honour such commitment if the borrower fails to honour his liability when due.

The Bank Guarantees are generally issued against :

a) Mobilization advance given to the contractors after award of work for completion of contract and such advance is adjusted against the running bills of the contractor. If the contractor does not complete work or abandons it, then the contractee can invoke the Bank guarantee and Bank has to compensate it by making payment upto the guaranteed amount.

b) Deferred Payment/Usance Bills are extended credit allowed by the supplier to his debtor for payment of considerations over agreed period in instalments. The supplier extends such credit through Bank Guarantee on behalf of his client.

c) Performance Guarantee is given for completed works/Uninterrupted smooth running at rated capacity of Plant & Machinery and/or for useful life of an asset. The Bank issues such guarantee on behalf of its customer as performer or supplier and is bound by the terms of such guarantee.

Auditor should call for LC and BG register and verify whether the borrower has honoured its LC or BG commitments on the due date or Bank has paid the money.

In case, the Bank has paid the money then, LC or BG has devolved on the Bank and the **amount so paid should be debited to the main operating account of the borrower**. Auditor should then verify the date and period when the borrower/party has paid such amount to the Bank.

In case, any LC/BG has remained unpaid for more than 90 days from its due date, then such LC/BG facility is called out of order over 90 days and all the accounts of the borrower are classified as NPA.

Many times, Banks park the devolved LC/BG in a separate account without effecting borrowers accounts. The auditor should verify the date of payment by party in the LC/BG Register and verify that the main operating account of the borrower i.e. CC or OD has been debited on that date or not. If there is "CONTRA" entry on that date, he should ask for the voucher from which it will be confirmed that the devolved LC/BG amount has been parked in some other account. He should ask bank to debit customer's account on that date and if the redrafted account shows irregularity exceeding 90 days then he should reclassify the Borrower's account as NPA.

It is suggested that if the Branch has issued any BG then Auditor may obtain a certificate from the Branch Manager that as on 31st March, 2014 there is no outstanding BG which has been invoked and is

unpaid. Since at times, the invoked BG is retained by the Branch Manager due to insufficiency of funds and such payment could reclassify the account as N.P.A.

The auditor should verify if all the terms of sanction of LC/BG limits have been complied with or not.

Verification of advances is a very deep subject since it is the base on which classification of advance depends. According to the classification of advance, the income of such advance is to be recognized and provisions are to be made for unrealized interest as well as for technical write off as per the classification of the advance being sub-standard, doubtful or loss asset.

CLASSIFICATION OF ADVANCES :

Advances are to be classified as :

(i) Standard Assets and
(ii) Sub Standard Assets

Substandard Assets are NPAs.

Non-performing assets

An asset including a leased asset becomes non-performing when it **ceases to generate income** for the bank. A 'non-performing asset' (NPA) was defined as a credit facility in respect of which the interest and/ or installment of principal has remained in arrears for more than 90 days

Accordingly, as from that date, a Non-performing Asset (NPA) is a loan or advance where :-

i. Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan
ii. The account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),
iii. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
iv. Interest and /or installment of principal remains overdue for two crop seasons in the case of short term crops.
v. For long term crops, if it remains overdue for 1 crop season from the date of

harvesting as fixed by the State Level Bankers Committee or the due date for direct agricultural advances. For details of agricultural advances referred to RBI Master Circular on lending to priority sector of 1st July, 2013 and

vi. Any amount of liquidity facility remains overdue for a period of more than 90 days in respect of a securitization transaction undertaken in terms of guidelines on securitization.

Out of Order status

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. Even in cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for three months as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Overdue'

Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Asset Classification

Categories of NPAs

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realizability of the dues is not ascertained :

a) Sub-standard Assets
b) Doubtful Assets
c) Loss Assets

Sub-standard Assets

With effect from 31 March 2010, a sub-standard asset is one, which has remained NPA for a period less than or equal to 12 months.

Doubtful Assets

A doubtful asset is one, which remains NPA for a period exceeding **12 months**.

Loss Assets

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection and the **realizable market value of security** is less than 10% of the loan outstanding but the amount

has not been written off wholly. In other words, such an asset is considered uncollectable and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

Accounts with temporary deficiencies

Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-review/renewal of the limits on the due date, etc. however when these temporary deficiencies persist, then in the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

Non submission of stock statement

Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets. Drawing power is required to be arrived at based on the stock statement, which is current. However, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as "irregular". A working capital borrowal account will become NPA if such "irregular" drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory. Hence in such cases where if the Drawing Power is calculated and allowed for more than 180 days then the Account will become NPA.

Non renewal of account

Regular and ad hoc credit limits need to be reviewed/ regularised not later than three months from the due date/date of ad hoc sanction. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 90 days from the due date/ date of ad hoc sanction will be treated as NPA.

Accounts regularized near about the balance sheet date

The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors about the manner of regularization of the account to eliminate doubts on their performing status. **Bills and cheques discounted to effect credit in such accounts at the year end should be verified by the Auditors.**

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

It is difficult to envisage a situation when only one facility to a borrower becomes a problem credit and not others. Therefore, all the facilities granted by a bank to a borrower will have to be treated as NPA and not the particular facility or part thereof which has become irregular.

If the debits arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

Advances under consortium arrangements

Asset 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. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA.

Accounts where there is erosion in the value of security

A NPA need not go through the various stages of classification in cases of serious credit impairment and such assets should be straightaway classified as doubtful or loss asset as appropriate. Erosion in the value of security can be reckoned as significant when the realizable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets – **failure to verify the Securities.**

If the realizable market value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank – **Loan against Corporate guarantee and that Company going into winding up**.

Availability of security / net worth of borrower/guarantor

The availability of security or net worth of borrower/ guarantor should not be taken into account for the propose of treating an advance as NPA or otherwise, **as income recognition is based on record of recovery.**

Advances under rehabilitation approved by BIFR/ Term Lending Institution

Banks are not permitted to upgrade the classification of any advance in respect of which the terms have been re-negotiated unless the package of re-negotiated terms has worked satisfactorily for a period of one year. While the existing credit facilities sanctioned to a unit under rehabilitation packages approved by BIFR/term lending

institutions will continue to be classified as sub-standard or doubtful as the case may be, in respect of additional facilities sanctioned under the rehabilitation packages, the Income Recognition, Asset Classification norms will become applicable after a period of one year from the date of disbursement.

Loans with moratorium for payment of interest

In the case of loan accounts where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if it remains uncollected for 90 days.

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates

Agricultural advances

In respect of agricultural loans, other than those specified above as crop loans, identification of NPAs would be done on the same basis as non-agricultural advances which, at present, is the 90 days delinquency norm.

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 various guidelines contained in RBI circulars from time to time.

In such cases of conversion or re-schedulement, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms & conditions and would be treated as NPA if interest and/or installment of principal remains unpaid, for two harvest seasons but for a period not exceeding two half years.

Government guaranteed advances

The credit facilities and investment in securities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Central Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition

of income. Advances sanctioned against State Government guarantees which should be classified as NPA in the normal course, if the advance remains in default for more than 90 days for the year ending 31st March, 2014 onwards.

Provisioning Norms

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 management's** and to the satisfaction of **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.

Standard Assets

Provisioning requirements for all types of standard assets stands as per RBI circular. Banks should make general provisions for standard assets for the **funded** outstanding on global loan portfolio basis :-

(a) direct advances to agricultural and Small and Micro Enterprises (SMEs) sector.

(b) Advances to Commercial Real Estates (CRE) Sector.

(c) Housing loans extended at teaser rates (initially lower rate of interest for some years, thereafter at Bank's normal lending rates) and Restructured Advances as indicated in **Para 5.9.13 and 5.9.14 respectively**.

(d) All other loans and advances not included in (a) (b) and (c) above as per RBI directions.

However, the provisions towards Standard Assets need not be netted from gross advances but shown separately as "**Contingent Provisions against Standard Assets" under "Other Liabilities and Provisions Others**" in Schedule 5 of the Balance Sheet.

It should also be noted that the Medium Enterprises will attract a percentage of **standard asset provisioning**. For definition of Medium Enterprises refer to Master Circular RPCD.SHE& NFS.BC.No.9/06.02.31/2010-11 dated 1st July, 2010 of RBI on Lending to Micro, Small and Medium Enterprises (MSME) Sector.

Sub-standard assets

A general provision of **15 percent** on total outstanding should be made without making any allowance for ECGC guarantee cover and **Securities Available**.

The "unsecured exposures " which are identified as 'substandard' would attract additional provision of **10 percent** i.e. a total provision of **25 percent** on the outstanding balance. However, in respect of Infrastructure lending, infrastructure loan accounts which are classified as substandard, a separate provision shall be made if such advances comply with the requisite conditions of lending norms. The provisioning requirement for unsecured 'Doubtful' assets would remain unchanged at 100%. The Unsecured exposure is defined as an exposure **where the realizable value of security**, as assessed by the Bank/approved valuers/RBI's inspecting officers is not more than 10% ab-initio, of the outstanding exposure. 'Exposure' shall include all funded and non funded exposures (including under writing and similar commitments). Securities will mean tangible securities properly discharged to the bank and will not include intangible securities like guarantees, comfort letters etc.

Doubtful Assets

i) 100 percent of the extent to which the advance is not covered by the realizable value of the security to which the Bank has a valid recourse and the realizable value is estimated on a realistic basis.

ii) In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful and classified as DI, D-II or D-III.

In case of NPAs with balance of Rs.5.00 crores and above, stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board is mandatory in order to enhance the reliability on stock valuation. Collaterally such as immovable properties charged in favour of the Bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.

iii) In case, it is observed that there is inherent weakness/shortfall in the securities offered to the Bank in Working Capital facilities by comparison of audited accounts with the stock statements as on the reporting date i.e. 31st March in previous years continuously, the Drawing Power should be recalculated on the basis of audited accounts and if Bank has allowed substantial excess DP then such account needs to be classified as substandard and such NPA account will attract the requisite provision under doubtful category whereby the provisions ranging from 25% to 100% shall be made. Auditor should not change the Schedule of Advances and the Balance Sheet of the Branch if in his opinion, classification needs a change and accordingly the provisions are also enhanced. He should issue a Memorandum of Changes (MOC) and the same may be appended alongwith his report on the Branch Balance Sheet and forward to consolidating auditor (Central Auditor) and H.O. separately. Since at H.O. level, the consolidating auditor has only the Branch Audit Report and LFAR while the Bank may try to convince the Central Auditor by various explanations and

documents which could not have been shown/appreciated by the Branch auditor. Hence for the Statutory Auditor / Consolidating Auditor to properly understand the observations of the Branch auditor, it is necessary that the Branch auditor should furnish a detailed note in support of the MOC, he has issued in respect of the Branch accounts.

Loss Assets

The entire asset should be written off and if for any reason, an asset is allowed to remain in books, 100% of the sum of the net investment in the lease and the unrealized portion of finance income, net of finance charge component should be provided for. **For more details in regard to provisioning norms in respect of various kind of advances, Master Circular of RBI dated 1.07.2014 regarding Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to advances may be considered in depth.**

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

In respect of advances under rehabilitation package 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 sub-standard or doubtful asset.

As regards the additional facilities sanctioned as per package finalised by BIFR and/or term lending institutions, provision on additional facilities sanctioned need not be made for a period of **one year** from the date of disbursement.

In respect of additional credit facilities granted to SSI units which are identified as sick and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements, no provision need be made for a period of one year.

Advances against Term Deposits, NSCs, LICs, KVP/IVP, etc

Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs as long as realizable value of Security is more than loan outstanding. **Advances against gold ornaments, State government securities and all other securities are not covered by this exemption.**

Treatment of interest suspense account

Amounts held in Interest Suspense Account should not be reckoned as part of provisions. Amounts lying in the Interest Suspense Account should be deducted from the relative advances and thereafter, provisioning as per the norms, should be made on the balances after such deduction.

Advances covered by ECGC guarantee

In the case of advances guaranteed by ECGC, provision should be made only for the balance in excess of the amount guaranteed by these Corporations. Further, while arriving at the provision required to be made for doubtful assets, **realisable market value of the securities** should first be deducted from the outstanding balance in respect of the amount guaranteed by ECGC

Valuation of Security for provisioning purposes

With a view to bringing down divergence arising out of difference in assessment of the value of security, in cases of NPAs with balance of Rs. 5 crore and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board would be mandatory in order to enhance the reliability on stock valuation. Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.

Restructuring/ Rescheduling of Loans

In the context of restructuring of the accounts, the following stages at which the restructuring / rescheduling / renegotiations of the terms of loan agreement could take place, can be identified:

a) before commencement of commercial production;

b) after commencement of commercial production but before the asset has been classified as sub standard,

c) after commencement of commercial production and after the asset has been classified as sub standard.

In each of the foregoing three stages, the rescheduling, etc., of principal and/or of interest could take place, with or without sacrifice, as part of the restructuring package evolved.

Treatment of Restructured Standard Accounts

a) A rescheduling of the installments of **principal alone**, at any of the aforesaid first two stages would not cause a standard asset to be classified in the sub standard category provided the loan/credit facility is **fully secured**.

b) A rescheduling of **interest element** at any of the foregoing first two stages would not cause an asset to be downgraded to sub standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, **measured in present value terms**, is either written off or provision is made to the extent of the sacrifice involved.

Treatment of restructured sub-standard accounts

a) A rescheduling of the installments of principal alone, would render a sub-standard asset eligible to be **continued** in the sub-standard category for the specified period, **provided** the loan/credit facility is **fully secured**.

b) A rescheduling of interest element would render a sub-standard asset eligible to be **continued** to be classified in **sub standard** category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, **measured in present value terms**, is either written off or provision is made to the extent of the sacrifice involved.

c) In case there is a **sacrifice involved in the amount of interest** in present value terms, as at (b) above, **the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved**. Even in cases where the sacrifice is by way of write off of the **past** interest dues, the asset should continue to be treated as sub-standard.

Up-gradation of restructured accounts

The sub-standard accounts which have been subjected to restructuring etc., whether in respect of principal installment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after the specified period i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period.

(a) These instructions would be applicable to all type of credit facilities including working capital limits, extended to industrial units, provided they are fully covered by tangible securities.

(b) As trading involves only buying and selling of commodities and the problems associated with manufacturing units such as bottleneck in commercial production, time and cost escalation etc. are not applicable to them, these guidelines should not be applied to restructuring/ rescheduling of credit facilities extended to traders.

(c) While assessing the extent of security cover available to the credit facilities, which are being restructured/ rescheduled, collateral security would also be reckoned, provided such collateral is a tangible security properly charged to the bank and is not in the intangible form like guarantee etc. of the promoter/ others.

INCOME RECOGNITION

The policy of income recognition has to be objective and based on the record of recovery. Internationally income from non-performing assets (NPA) is not recognized on accrual basis but is booked as income only when

it is actually received. Therefore, **the banks should not charge and take to income account interest on any NPA until realized**.

Interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date on accrual method, provided adequate margin is available in the accounts.

If State Government guaranteed advances become NPA, the interest on such advances should **not** be taken to income account unless the interest has been realized. However, in the case of Central Govt. guaranteed Advance, **account will not be classified as NPA but no income is to be recognized unless received.**

Reversal of income

If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, interest accrued and credited to income account in the corresponding previous year, should be reversed or provided for if the same is not realized. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

In respect of Leased Assets, the finance charge component of finance income [as defined in AS-19 (Leases, issued by ICAI)] on the leased assets which has accrued and credited to income account before the asset become NPA and remaining unrealized, should be reversed or provided for in the current accounting period.

<u>POINTS TO BE CONSIDERED BY AUDITOR :</u>

NPA Norms

1. While classifying fresh NPA account, unrealized income of previous year sometimes is not reversed. In NPA worksheet lot of fresh NPA accounts are identified without any income reversal, Branches have a habit of ignoring March interest for reversal
2. Credits in accounts are not matched with interest debit considering CONTRA entries so as to ascertain the correct amount of income reversal in the accounts.
3. Accounts with insufficient security are continued in Substandard/Doubtful category. RBI directions in this regard are very clear.

   A NPA need not go through the various stages of classification in cases of serious credit impairment and such assets should be straightaway classified as doubtful or loss asset as appropriate. Erosion in the value of security can be reckoned as significant when the realisable market value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

If the realizable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank.

4. Plant and Machinery are not depreciated while determining **realizable value of security**. Sometimes, even in the Audited Balance sheets, No depreciation is charged on Plant & Machinery. Auditor should consider all Notes to Accounts and qualifications in Audited Accounts.
5. Revaluation of leasehold lands should be discouraged. In valuation report mention of free / lease hold land should be verified and such conditions of lease like payment of percent of "unearned increase" in case of transfer of Lease.
6. Building should not be revalued, it should be depreciated. In case where we have the second charge, at times the outstanding of 1st charge holders is not reduced to ascertain the correct realizable market value for the 2nd charge holding Bank.
7. Right of crown is first thus while ascertaining realizable market value of security, govt. dues and statutory dues should be reduced first i.e. ESI and PF liability.
8. Date of NPA is being changed on the basis of recovery, though the account continues to be irregular for example if as on 31.03.2012 an EMI account is classified as NPA on 4 installments being in arrears and four installments continues in arrears, than the said account has to be classified as Doubtful in March 2014. Date of NPA is 31.03.2012 and down grading has to be done according to age. Date of NPA is not a moving date it has to be correctly given irrespective of the fact that it is generally identified on half yearly basis.
9. We should never consider the book value of assets but **realizable market value** only is to be considered.
10. Branches as well as Circle/Zonal offices are generally taking restructuring of NPA A/c and the same is classified as standard in closing returns. Technically when a NPA account is restructured it should continued in NPA category for one year.
11. NPA classification on Account of non-receipt of Stock statement is ignored by branches.
12. NPA classification on account of non-renewal of limits is also ignored by branches.

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