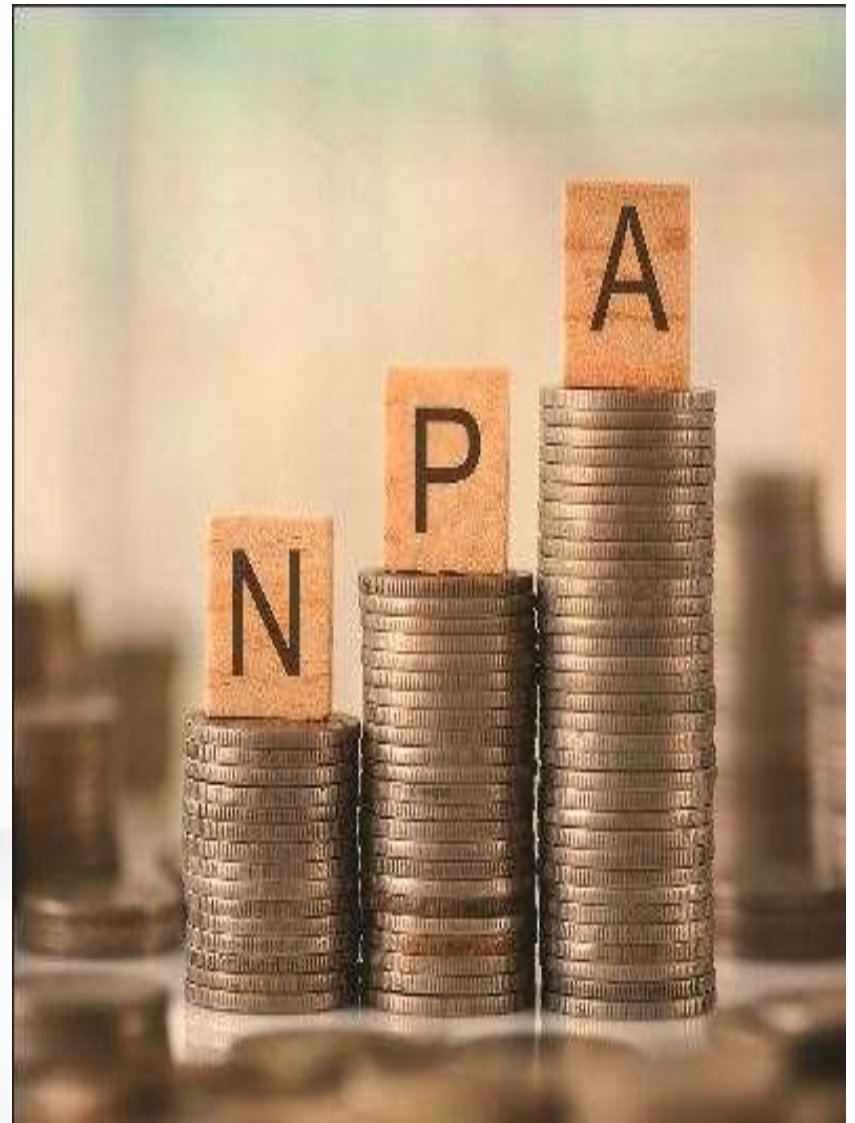




**BANK AUDIT SEMINAR
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VERIFICATION OF NON PERFORMING ASSETS OF BANKS

-CA (Dr.) V Venugopalan



RBI has asked banks to introduce technology enabled process for proper and timely identification of NPA's. In spite of RBI guidelines, their might remain some accounts which, though required to be classified as NPA, are shown as 'standard' by the branch.

To improve the record of recovery in advances, RBI has advised banks to ensure that while granting loans and advances, realistic repayment schedule to be fixed based on cash flows with borrowers.

In order to ascertain correct identification and clarification of NPA accounts, auditor has to verify the following reports and accounts;

1. Concurrent Audit/ Internal Audit Report which gives a fair idea of problems/irregular accounts.
2. RBI Inspection Report (latest) if available to verify all commented accounts
3. Restructured/ Rescheduled accounts without executing proper documents and ascertaining viability.
4. Suit filed major accounts.
5. Accounts pending review renewal.

6. Accounts having erosion in the value of primary security.
7. Debit and Credit entries with same value in cash credit/overdraft accounts with a gap of few days.
8. TOD in current account at year end and transferring the funds to overdue loan accounts.
9. Year-end credit in overdue accounts.

10. Educational loan/Housing loan which are restructured without proper approval and documentation.
11. Accounts regularized near about Balance sheet date without satisfactory evidence about the manner of regularization of accounts.
12. Advance under consortium arrangements
13. Standard accounts with lower credit rating

Study all accounts in “Watch List” and “Stressed Accounts”. Collect the system generated report of probable NPA accounts. Get the list of such accounts as on 01st March or 15th March, 2023. Verify the list and ensure that NPA accounts are correctly identified and classified, as of March 31st, 2023.

Collect and verify software reports showing installment arrears and amount overdue reports.

Last years audited Balance sheet copy to be collected and stock value ascertained and compared with the last years stock statement and wide variation in stock enquired and if required the shortage in stock to be reduced from the latest stock statement to find out correct stock.

Definition of Non- Performing Assets

NPA is a loan where;

- i. Interest or/and installment of principal remains “overdue” for a period of more than 90 days in respect of term loan.

ii. An overdue/cash credit amount remains “out of order”. OD/CC account will be treated as ‘out of order’, if outstanding balance remains continuously in excess of sanctioned limit/drawing power for 90 days; or, If the outstanding balance in CC/OD account is less than the drawing power but there are no credits continuously for 90 days, or credits are not enough to cover the interest debited during the previous 90 days period, the CC/OD account should be treated as “out of order” and NPA.

- iii. Bills remains “overdue” for a period of more than 90 days in the case of bills purchased and discounted.
- iv. In respect of Agricultural advances, installment of principal or interest remains “overdue” for a two crop season for short duration crop and one crop season for long duration crop.

Special Mention Account (SMA)

- SMA 1. Principal or interest overdue more than 30 days and up to 60 days.
- SMA 2. Principle or interest overdue more than 60 and up to 90 days

Income Recognition Policy

- Bank should not charge and take to income account interest on NPA. This will apply to Government Guaranteed account also.
- However, interest on advance against Term Deposit, NSC, Indira Vikas Patra, Kissan Vikas Patra and Life Policies may be taken to income account on due date, provided adequate margin is available.

- Fees and commission earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognized on accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit.

Reversal of income

If any advances including bills purchased and discounted and leased assets becomes NPA, the entire interest accrued and credited to income account in the past periods, should be reversed if the same is not realized. These will apply to Government Guaranteed accounts also.

Appropriation of recovery of NPA

- Interest realized on NPA may be taken to income account provided the credits in the accounts towards interest are not out of fresh/additional credit facilities sanctioned to the borrower.

- In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPA, banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

Asset Classification

- Sub Standard:

A substandard asset would be one, which has remained NPA for a period less than or equal to 12 months

- Doubtful Assets:

An asset would be classified as doubtful if it has remained in the substandard category for a period of 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, but the amount has not been written off wholly.

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 purpose of treating an advance as NPA or otherwise.

Accounts with temporary deficiencies

Classification of asset as NPA should be based on record of recovery. Banks should not classify an advance 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 statements, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date.

Non-submission of stock statements and renewal pending

Outstanding in the working capital based on drawing power calculated from stocks statement older than three months(90 days), would be deemed as “irregular”. Such irregular drawings if permitted in the account for a continuous period of 90 days the account will become NPA, even though the unit may be working.

An account where the credit limit has not been reviewed/renewed within 180 days from the due date/date of ad-hoc sanction will be treated as NPA.

Up gradation of Loan accounts classified as NPA

If **entire** arrears of interest and principal are paid by the borrower in the case of loan account classified as NPA, the account may be classified as standard account.

In case of borrower having more than one credit facility from a bank, loan account shall be upgraded from NPA to standard asset category only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities.

Accounts regularized near about the balance sheet date

Asset classification of borrower account where a solitary or few credits are recorded before the balance sheet date, should be handled with care. Banks must furnish satisfactory evidence to the Statutory Auditor about the manner of regularization of accounts.

Loans with Moratorium on payment of interest



If such accounts become NPA after the moratorium period is over the capitalized interest corresponding to the interest accrued during such moratorium period need not be reversed. In case where moratorium has been granted for repayment of interest, banks may recognize interest income on accrual basis, for accounts which are 'standard'.

In case of housing loan granted to staff members where interest is payable after recovery of principal interest need not be considered as overdue.

Asset classification to be borrower wise and not facility wise

If one facility given to the borrower becomes NPA all the facility granted by a bank to a borrower will have to be treated as NPA. The debts arising out of devolvment of letter of credit or invoked guarantees are parked in a separate account the balance outstanding in that account also should be treated as part of the borrowers for the purpose of application of prudential norms.

The bill discounted under LC favoring a borrower may not be classified as NPA where any other facility granted to the borrower is classified as NPA. However in case document under LC are not accepted on presentation or payment under the LC is not made on due date by LC issuing bank, the bill discounted to be classified as NPA, with effect from the date when the other facilities has been classified as NPA.

Advances under consortium arrangement

Asset classification of accounts under consortium should be based on record of recovery of the individual member bank. When the remittances are pooled with one bank and the bank receiving remittance is not parting the share, the account to be treated as NPA.

**Accounts where there is erosion
in the value of security /fraud
Committed by borrower .**

In respect of accounts when there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as fraud committed by borrowers, such accounts should be straight away be classified as doubtful or loss assets as appropriate.

If the realistic value of the security is less than 50 % of value assessed by the bank or assessed by RBI at the time of last inspection, such NPA may be classified as doubtful category. If realizable value is less than 10 % such accounts should be straightaway be classified as a loss asset.

Provisioning norms in respect of all cases of fraud

Banks should normally provide for the entire amount due to the bank immediately upon fraud being detected after adjusting the eligible financial collateral. Banks have the option to make the provisions over a period, not exceeding four quarters, from the quarter the fraud is detected. Banks have to make full disclosure regarding fraud accounts.

Advance against Term Deposit, NSC's, KVP's, IVP's etc..

Advance against term deposits, NSC's, KVP's and Life Insurance Policies need not be treated as NPA, provided adequate margin is available in the accounts. Advance against gold ornaments, Government Securities are not covered by this exemptions.

Advance to primary Agricultural credit societies(PACS)/ farmers service credit societies(FSS)

Only that particular credit facility granted to PACS/FSS which is in deficit for two crop season for short duration crops and one crop season for long duration crops, after it has become due will be classified as NPA and not all the credit facilities sanctioned.

Non – achievement of Date of Commencement of Commercial Operation (DCCO)

Date of Completion and Date of Commencement of Commercial Operation(DCCO) of the project is clearly spelt out at the time of financial closure of the project Non achievement of DCCO may lead to classification of the account as NPA.

Compulsory audit requirements of NPA A/c

In respect of NPA, the branch has to obtain Valuation Report from approved valuers for the immovable properties charged to the bank, once in three years.

In case of NPA with balance of Rs.5 crore and above, stock audit, at annual intervals by external agencies, would be mandatory.

Government Guaranteed Advances

The credit facilities backed by the guarantee of central government through overdue may be treated as NPA only when the government repudiates its guarantee when revoked. But this exemption is not for recognition of income. This special treatment is not available to state government guarantees.

Provisioning Norms

- Loss assets

Loss assets to be written off fully

- Doubtful Assets

100 % of the extent to which the advance is not covered by the realizable value of the security, realizable value is estimated on a realistic basis.

- In regard to the secured portion provision may be made on the following basis
- Period on which the advance has remained doubtful

	Provisioning requirement
Upto 1 Year	25%
1-3 Years	40%
More than 3 Years	100%

Substandard Assets

- A general provision of 15% on total outstanding should be made without making any allowance for ECGC guarantee covered and securities available.
- Unsecured exposure which is identified as 'substandard' would attract additional provisions of 10% i.e total of 25% on outstanding balance.

Standard Asset

- Farm credit to agricultural activities and small and micro enterprises sectors: 0.25%.
- Advance to commercial real estate sector: 1%.
- Advance to commercial real estate residential housing: 0.75%.
- All other loans and advances: 0.40%.

A wooden-framed chalkboard is mounted on a wall of horizontal wooden planks. The chalkboard is black and has the words "Thank You" written in white, serif, all-caps font, centered on the board. To the right of the chalkboard, a portion of a green leafy plant in a pot is visible. To the left, a red, rounded object, possibly a fire alarm pull station, is partially visible. The floor below the wall is a light-colored, textured surface.

Thank
You