

BRANCH AUDIT OF BANKS ADVANCES; IRAC NORMS & RBI CIRCULARS

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Branch audit – current environment

- ▶ RBI Circular March 2023 – PSB branch audit – coverage as per board approved policy
- ▶ Top 20 branches (covering at least 15% of gross advances) to be covered by SCA
- ▶ Not more than 2 branches shall be allotted per SBA
- ▶ GNPA / NNPA very low; PCR – 70% +
- ▶ Amendment to Banking Regulations Act in Nov 2024 giving freedom for PSB to fix the audit fee

Effect of automation – Bank's claims

- ▶ Large Scale Automation covering most of the areas of operations include loan processing; IRAC compliance; capital adequacy computation etc results of which are available at supervisory level
- ▶ Data available at Central level and can be verified by CSA
- ▶ Retail loans structured through LOS and processing and approval done at Processing Centres
- ▶ Large Advances covered by stringent RBI norms – CRILC reporting Prudential Frame work for stressed Assets; Large Exposure Frame work
- ▶ Advances are generally parked in big branches which are covered by CSA

Has automation resolved all issues

- ▶ Agricultural advance outside NPA automation
- ▶ Interest Reversal - Interest debited vs Interest accrued
- ▶ Appropriation of recovery in NPA accounts / OTS
- ▶ Erroneous / wrong credits not identified by system for NPA
- ▶ Entries for devolvement of bills / guarantees
- ▶ Misuse of office / suspense accounts
- ▶ Verification of documents – Processing centres vs Branches
- ▶ Deterioration in value of primary / collateral securities
- ▶ Terms – Sanction letter vs CBS vs LOS

Risk Assessment Review by RBI

- ▶ Integrity of Legacy data
- Several MIS reports are still based on manual inputs from branches
- Internal inspections/ concurrent audits follow structured pattern and are not customised to particular branch
- Sample size selected for audit are not representative
- Innovative methods for ever greening ???

Audit Preparedness

- ▶ Utilisation of Resources
- ▶ Technology effect
- ▶ Regulatory Changes

Objective of branch audit - RBI

The overall objective of the branch audit should be to have transaction testing and provide inputs to the Statutory central Auditors on adequacy of implementation of various policy and regulatory requirements, including efficacy of the system and assurance functions (risk management, compliance and internal audit) at branch level.

Verification of data integrity and data related control systems and processes should be carried out and commented upon, with the special thrust on those data inputs which are to be used for MIS at corporate office level and for supervisory reporting purposes

RBI circulars on advances- April 2024 to date

Date of circular	Title	Remarks
1.4.2024	Master Circular - Guarantees and Co-acceptances	Summary of circulars on NBF advances of banks - Last circular issued 7.1.2016
2.4.2024	Master Circular - Housing Finance	Summary of circulars on HL advances of banks - including RE / CRE ; PSL ; Builders - Last circular issued 13.9.2023
2.4.2024	Master Circular - IRAC	Last circular 16.11.2023
15.4.2024	Key Facts Statements for Loans and Advances	Guidelines on Digital Lending
16.4.2024	Master Circular - Deendayal Antyodaya Yojana	National Rural Livelihood Mission - Lending to Women SHG and related aspects - Last circular 27.6.2013
24.4.2024	Master Circular - Bank Finance to NBFC	Regulatory policy regarding financing of NBFCs by banks.

RBI circulars on advances- April 2024 to date

Date of circular	Title	Remarks
6.8.2024	Modified interest subvention scheme for 2024-25	For Short term loans for agriculture and allied activities availed through Kissan Credit Cards
30.9.2024	Gold Loans - Irregular practices	Review of irregular practices followed in loans against pledge of gold ornaments and jewellery and modifications suggested
6.12.2024	Credit flow to agriculture	Enhancement of limits for collateral free agricultural loans including for allied activities from Rs.1.60 lakhs to Rs.2 lakhs w.e.f.1 st January 2025
31.12.2024	Government Debt Relief Schemes	Compromise settlements and write off based on recommendations by SLBC and its treatment in accounts
21.3.2025	Presentation of Financial Statements	Change in classification of margin money deposits and Government Guaranteed advances

IRAC NORMS - Master circular 2.4.2024

Part A	General Definitions - Income Recognition , Asset classification , Provisioning for NPA
Part B	B1 - Frame work for resolution of Stressed Assets B2 - Prudential norms applicable to restructuring
Part C	Miscellaneous Wilful Defaulters / Non co-operative borrowers; Credit Risk Management; Registration with CERSAI etc
Part D	Annexure

IRAC NORMS - Master circular 2.4.2024

Part B

B1 - Frame work for resolution of Stressed Assets

B2 - Prudential norms applicable to restructuring

STRESSED ASSETS

- **‘Default’ means non-payment of debt when whole or any part of instalment of the debt has become due and payable and is not paid by the debtor**
- **Lenders shall recognize incipient stress in loan account immediately on default by classifying such assets as Special Mention Accounts (SMA)**
- **Applicable for all loans other than agricultural advances governed by crop season based classification norms**

STRESSED ASSETS

- **Restructuring” is an act in which a lender, for economic or legal reasons relating to borrowers financial difficulty, grants concessions to the borrower .**
- **A default shall be treated as an indicator of financial difficulty , irrespective of reasons of default**
- **Financial difficulty can identified even in the absence of arrears of an exposure**
- **In case of restructuring, the accounts classified as standard shall be immediately downgraded as NPA**

Audit 2025 - Key Areas

- ▶ **Penal Interest vs Penal Charges reversal – Fair Practices Code June 2024**
- ▶ **Loan against Term Deposits**
- ▶ **Agricultural Advances**
- ▶ **Agriculture Gold Loan Advances**
- ▶ **Gold Loan against Jewellery [other than for agriculture]**
- ▶ **Miscellaneous**

PENAL INTEREST VS PENAL CHARGES

- ▶ **RBI instructions – 18.8.2023 not to levy penal interest for non compliance with terms and conditions of loan**
- ▶ **RBI Fair Practices Code – Penal charges from June 2024 along with GST**
- ▶ **Reversal when NPA vs GST credit note**
- ▶ **CBIC circular 28th Jan 2025 based on 55th GST council recommendation**

LOAN AGAINST TERM DEPOSITS

- ▶ **Either as CC account or Term Loan**
- ▶ **Terms and Conditions as per sanction letter**
- ▶ **Period of Loan vs Balance period of deposit**
- ▶ **Non renewal on expiry**
- ▶ **Interest Accrual - Revenue loss**

AGRICULTURAL ADVANCES

- **NPA classification based on Crop Seasons and hence not AUTOMATED**
- **Crop Season as determined by SLBC and hence changes from state to state**
- **Crop Season based classification ONLY for activities identified as FARM CREDIT listed in Annexure 2 to circular**
- **Allied activities and those not listed in circular wrongly classified as Farm Credit and crop season based classification adopted leading to non identification of NPA**
- **RESTRUCTURING / RESCHEDULING without down grading possible only in case of natural calamities as declared by SLBC / District Consultative Committee - RBI Master Directions dated 17.10.2018**
- **New circular Government Debt Relief Schemes, 31.12.2024**

AGRICULTURAL ADVANCES

- **RBI Master Directions dated 17.10.2018 as modified by RBI circular dated 31.12.2024 to be looked into carefully to ascertain the asset classification as well as income recognition**
- **DRS circular dated 31.2.2024**
- **REs may decide on participating in a particular DRS notified by a Government, based on its Board approved policy, subject to the extant regulatory norms.**
- **The guidelines shall apply in respect of DRS notified on or after the date of issue of this guideline**
- **Restructuring / Rescheduling of advances other than amount covered by DRS will attract IRAC norms**

Agricultural Advances

- **Agriculture working capital loans – Diversion of funds for normal business**
- **Agriculture working capital loans renewal – remittance and withdrawal on same day in cash**
- **Wrong reporting as PSL; Lower interest rate charged**
- **Impact on Subsidy claim certificate**

Agriculture Gold LOANS

- The PSL guidelines are activity and beneficiary specific and are not based on type of collateral. Therefore, bank loans given to individuals/businesses for undertaking agriculture activities do not automatically become ineligible for priority sector classification, only on account of the fact that underlying asset is gold jewellery/ornament etc. Therefore, bank should have extended the loan based on scale of finance and assessment of credit requirement for undertaking the agriculture activity and not solely based on available collateral in the form of gold.
- FAQ on Master Direction on Priority Sector Lending – circular dated 21.6.2014

GOLD LOANS (OTHER THAN Agri)

- ▶ **OD facility to be renewed every year**
- ▶ **Regular servicing of interest as and when levied in case of Demand Loan – EMI based and Overdraft Account**
- ▶ **Repayment through Bullet Payment i.e. payment of interest and principal at maturity max. up to 12 months**

GOLD LOANS (OTHER THAN Agri)

- **Audit Finding : Fresh loans at enhanced value due to increase in market value; part proceeds used to close existing loans – IRAC norms ?? Roll Over ???**
- **Bank's answer : Top up loan based on the enhanced collateral value of jewellery and within LTV permitted; Bank using a business opportunity and not ever greening of loans**

IRAC NORMS - Master circular 2.4.2024

➤ INCOME RECOGNITION POLICY

- Interest on advances against bank term deposits, NSC, KVP and LIC can be recognized if margins are available - *this exemption not available for GL / Loans against Govt securities*

GOLD LOANS (OTHER THAN Agri)

- **RBI Master Circular on Loans and Advances – Statutory Restrictions dated 1.7.2015**
- **Loans (including bullet repayment loans) sanctioned by banks against pledge of gold ornaments and jewellery for non-agricultural purposes should not exceed 75 per cent of the value of gold ornaments and jewellery.**
- **Bullet repayment of loans extended against pledge of gold ornaments and jewellery for other than agricultural purposes should be subject to the prescribed guidelines :**

GOLD LOANS (OTHER THAN Agri)

- ▶ **The period of the loan shall not exceed 12 months from the date of sanction.**
- ▶ **Interest will be charged to the account at monthly rests but will become due for payment along with principal only at the maturity.**
- ▶ **Banks should prescribe a minimum margin to be maintained in case of such loans and accordingly, fix the loan limit taking into account the market value of the security (gold ornaments), expected price fluctuations, interest that will accrue during the tenure of the loan etc.**

GOLD LOANS (OTHER THAN Agri)

- ▶ **The account would be classified as Non-Performing Asset (sub-standard category) even before the due date of repayment, if the prescribed margin is not maintained.**
- ▶ **Such loans shall also be governed by other extant norms pertaining to income recognition, asset classification and provisioning which shall be applicable once the principal and interest become overdue.**

GOLD LOANS (OTHER THAN Agri)

- **RBI circular dated 30.9.2024**
- **Illustrative list of deficiencies observed during review of gold loans**
- **End use of funds was usually not verified for non-agriculture loans.**
- **Lack of proof or proper documentation obtained and retained in respect of agriculture gold loans.**
- **No fresh appraisal was done at the time of sanctioning these top up loans.**

GOLD LOANS (OTHER THAN Agri)

- ▶ **Gold loans disbursed in cash to total gold loans disbursed was high in some entities and the statutory limit specified under the Income Tax Act**
- ▶ **Weak governance and transaction monitoring as instances of unusually high number of gold loans being granted to the same individual with the same PAN during a financial year.**

GOLD LOANS (OTHER THAN Agri)

- ▶ **Practice of rolling over loans at the end of tenor, with only part payment**
- ▶ **Non-categorisation of gold loans as NPA in the system, ever greening by renewing overdue loans/issuing a fresh loans**

GOLD LOANS (OTHER THAN Agri)

- ▶ **Finance Minister reply in Parliament**
- ▶ **(c) To safeguard lenders against risks such as gold price fluctuations, valuation errors, *etc.*, as per the extant RBI instructions, regulated entities including banks and NBFCs are not permitted to extend loans exceeding 75 per cent of the value of gold ornaments and jewellery. This Loan-to-Value (LTV) ratio of 75% is required to be maintained throughout the tenure of the loan.**
- ▶ **(d) Further, for loans where both interest and principal are due for payment at maturity of the loan (bullet repayment loans), banks are not permitted to extend loans exceeding tenure of 12 months from the date of sanction so as to reduce the risk of loan defaults.**

Gold Loans rollover / fresh loan

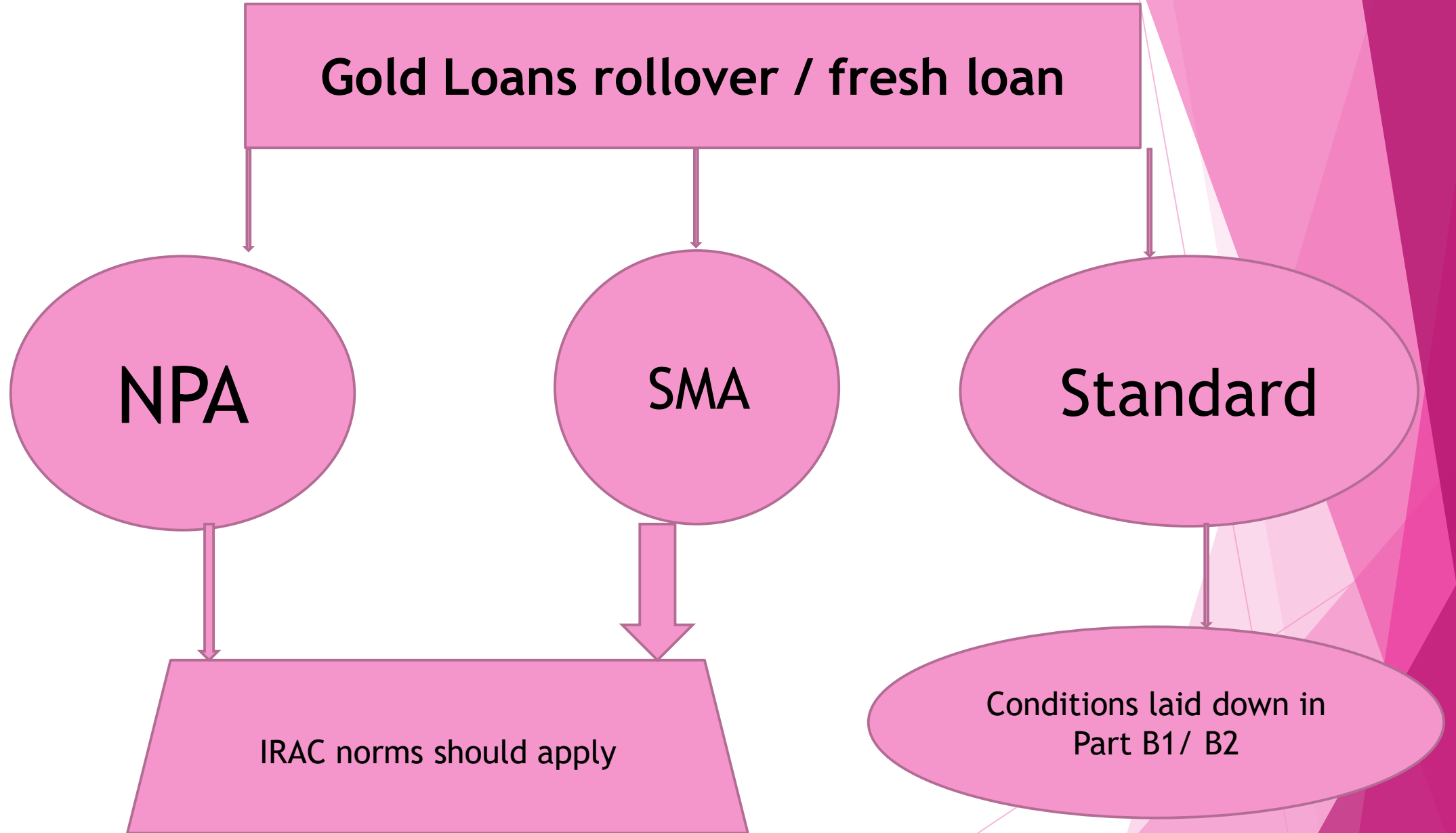
NPA

SMA

Standard

IRAC norms should apply

Conditions laid down in
Part B1/ B2



MASTER CIRCULAR – HOUSING FINANCE

- **Covers various aspects of HL except IRAC**
- **Covers Loan for Acquisition of land for construction of house; construction of building / ready built house; lending to intermediaries like Housing Finance Institutions / Housing Boards/Private Builders**
- **Classification into Commercial Real Estate (CRE); Commercial Real Estate - Residential Housing (CRE-RH);**
- **Classification under Priority Sector or otherwise - cost of construction**
- **Classification important since RW/ LTV and other conditions vary**

PROVISIONS ON STANDARD ASSETS

- **Farm Credit for agricultural activities ; HL for individuals – Advances to Small and Micro enterprises – 0.25%**
- **Commercial Real Estate (CRE) – 1% [other than residential housing]**
- **Commercial Real Estate (CRE) – Residential housing – 0.75%**
- **HL at teaser rates – at various rates**
- **Restructured advances – as per prescribed norms**
- **All others [including medium enterprises] – 0.40%**
- **Though automated, important in branch audits since data entry at branch levels and HIGH LEVELS of errors even now reported**

CHANGE IN CLASSIFICATION – RBI CIRCULAR

- ▶ Instructions for compilation of balance sheet specified in the Annex II Part A of the Reserve Bank of India (Financial Statements - Presentation and Disclosures) Directions, 2021.
- ▶ Margin money received in the form of deposits, where lien is marked by banks in the ordinary course of business.
- ▶ *Schedule 5: Other Liabilities and Provisions: Others (including provisions) - to be classified under Schedule 3: Deposits with suitable disclosures.*
- ▶ *Advances, to the extent they are covered by Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLH) and individual schemes under National Credit Guarantee Trustee Company Ltd. (NCGTC), which are backed by explicit Central Government Guarantee, shall also be disclosed under Schedule 9 (B) (ii) i.e. 'Advances Covered by Bank/Government Guarantee'.*

RBI expectations – Branch Audit 2025

- **Landholding details were either not recorded or incorrectly captured in the system, leading to misclassification of Small and Marginal Farmers (SMF).**
- **potential window dressing in KCC accounts and CC/OD accounts, particularly at month-end – SBA to specifically cover this in LFAR**
- **KCC accounts have been regularized or renewed without the actual receipt of outstanding amounts**
- **Bank guarantees issued based on the BG of another bank, which subsequently failed. SBAs must conduct a detailed review of such cases and report findings accordingly**

RBI expectations – Branch Audit 2025

- **Compliance with 30.9.2024 circular on Gold Loan / Agricultural advances**
- **Branch level controls to prevent double financing of HL on same property**
- **Deterioration in value of security – Primary / Collateral {incl standard assets}**
- **Renewals of Cash Credit accounts based on provisional / projections and non comparison with audited financials**

RBI expectations – Branch Audit 2025

- **Current accounts being used for ever greening cash credit accounts**
- **Compromise / OTS - accounts with higher security value were settled for a significantly lower amount.**
- **Claims against the bank not acknowledged as debts**
- **Operations in dormant accounts / DEAF transferred accounts ; Shortfall in amounts transferred to DEAF**
- **Several SB accounts linked to staff mobile number / BC mobile number**
- **Selection of accounts for verification – Advances / Deposits – product wise**
- **Significant observations be included in Audit Report , even if considered in LFAR**

Conclusion

- **Transaction level audit continues to be relevant ;**
- **Practices in Gold Loan being looked at closely by RBI**
- **Value Addition in Reports**