

Statutory Audit of Bank Branches



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of the Institute of Chartered Accountants of India**

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Audit of Advances & Income

Recognition and Asset

Classification Norms



Coverage



- Classification & Types of Advances
- Revenue Recognition in Banks
- IRAC Norms (Master Circular)
 - NPA Definition
 - Identification & classification
 - Provisioning
 - Practical issues
- Audit of Advances
 - Pre-Sanction
 - Sanction & Disbursement
 - Post Sanction - Documentation
 - Review , Monitoring & Renewal
 - Verification of Statement of advances



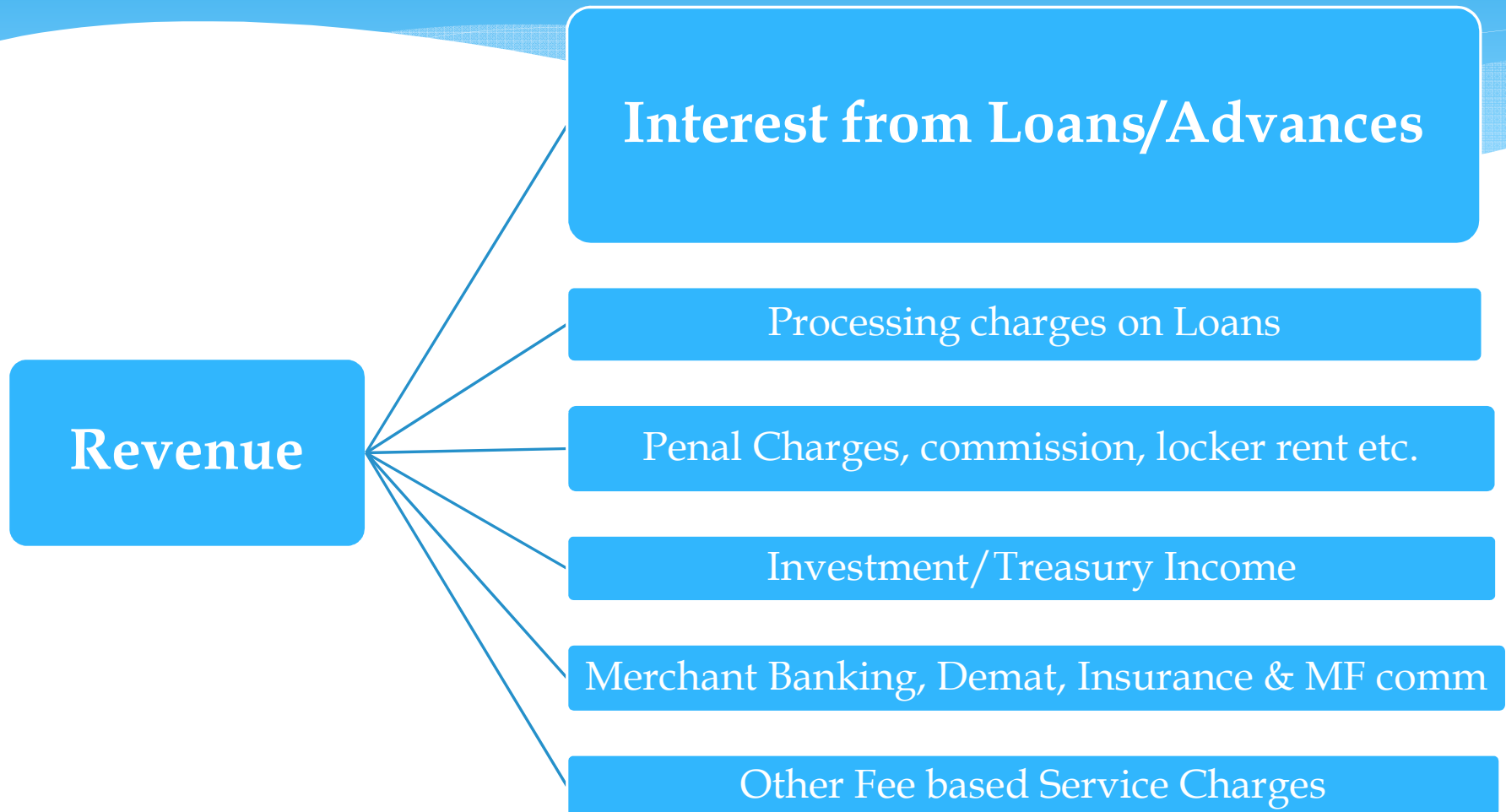
Classification of Advances

Based On	Description	Examples
Funds	Fund and Non Fund based	Term loans, CC/OD, BG LOC etc.
Place of making Advance	Inland and Export	Domestic TL, Packing/Pre-shipment Credit, Post-shipment Credit
Security	Secured and Unsecured	Mortgage, Hypothecation, pledge, clean, credit card
Sector	Priority sector and Non-Priority Sector	Agricultural, Home loans, Educational, small & medium enterprises

Types of Advances/facilities

Type	Description
Demand	Repayable on demand in a single or pre-determined instalments generally upto 3 years
Term Loan	If demand loan's repayment exceeds 36 months, it is called Term Loan
Cash Credit (CC)	Credit Facility is generally granted against security of stock/book debts
Overdraft (OD)	Credit Facility similar to cash Credit but no security or other security like FD's, NSC receipts, Lien on LIC policies
Bill Purchased /Discounted	Advance against a sale bill (factoring etc.)

Various Revenue Streams in a Bank



Revenue Recognition

- ➔ Policy of income recognition has to be objective and based on the record of recovery rather than subjective considerations
- ➔ Largely on accrual except in specified cases
- ➔ Now recognized through CBS
- ➔ Base Rate card (term, market & other risks)
- ➔ Other charges levied by the bank (accounting manual/Significant Accounting Polices)



Income Recognition and Asset Classification (IRAC) Norms



Income Recognition and Asset Classification norms (IRAC)

- ➔ Master Circular DBOD. No.BP.BC.9/21.04.048/2012-13 dated July 2, 2012
 - ➔ Definition
 - ➔ Income Recognition
 - ➔ Asset Classification
 - ➔ Provisioning

- ➔ Prudential Guidelines for sale & purchase of financial assets & on restructures advances



Asset Classification - NPA

An asset, including a leased asset, becomes non performing asset (NPA) when it ceases to generate income for the bank



Identification of NPA:

- Term Loan – interest and/or installment remain overdue for a period > 90 days
- CC/OD – out of order*
- Bills – overdue for a period > 90 days
- Agri – short term crops – principal & interest overdue for two crop seasons
- Agri – long term crops – principal & interest overdue for one crop season

- Others any amount which is overdue for a period > 90 days
- Other technical reasons

- * Out of order – o/s bal in excess of sanction limit/DP or no credits or not enough credits to cover interest debited during a period 90 days

NPA – Other Areas

- ➔ Income recognition of objective basis and not on subjective basis (based on recovery only)
- ➔ On recovery basis and not accrual
- ➔ Interest application only in memorandum account
- ➔ In case of NSC, IVP, KVP and insurance policies, interest may be accrued provided adequate margins are there
- ➔ Government guaranteed advances become NPA
- ➔ Reversal of un-serviced/ unrealized interest and charges
- ➔ No debits allowed in NPA
- ➔ Appropriation of recovery in NPA
- ➔ Borrower wise asset classification & facility wise
- ➔ Up gradation of NPA
- ➔ Consortium advances



Asset Classification

- ➔ Substandard Assets – NPA for a period less than 12 months
- ➔ Doubtful Assets
 - ➔ Doubtful – I – Substandard upto 1 year
 - ➔ Doubtful – II – Doubtful for 1-3 years
 - ➔ Doubtful – III - Doubtful over 3 years
- ➔ Loss Assets – identifies by management, internal or external auditors, RBI inspectors – wholly irrecoverable

Provisioning Norms

- ➔ Substandard Assets – 15% on total outstanding w/o ECGC guarantee + additional 10% on unsecured portion
- ➔ Doubtful Assets
 - ➔ Doubtful – I – 25 % on secured + 100% on unsecured
 - ➔ Doubtful – II – 40 % on secured + 100% on unsecured
 - ➔ Doubtful – III - 100 % on secured + 100% on unsecured
- ➔ Loss Assets – 100%
- ➔ Standard Assets – 0.25% - 2% based on categories, 0.4% others

Practical Issues

- ➔ Systems driven identification and marking
- ➔ Watchlist Accounts / Potential NPAs
- ➔ Partial Recovery
- ➔ Recovery post reporting date but before signing
- ➔ Provision after adjustment of margin (FDR etc.)
- ➔ Devolvement of BG – further debits in NPA
- ➔ Tracking of bank charges, insurance, legal charges in NPA
- ➔ Accommodation – in case of multiple banking arrangement
- ➔ Educational & Agri loans with moratorium period
- ➔ Staff loans, against own FDs kept as margin, gold loans,
- ➔ Ever-greening & TOD, debits in SB A/c, Credit card outstandings

Classification Overview

Loans & Advances

Agricultural Advances

Long Term Crop Loans

Interest or Instalment remaining overdue for more than one crop season

Short Term Crop Loans

Interest or Instalment remaining overdue for more than two crop season

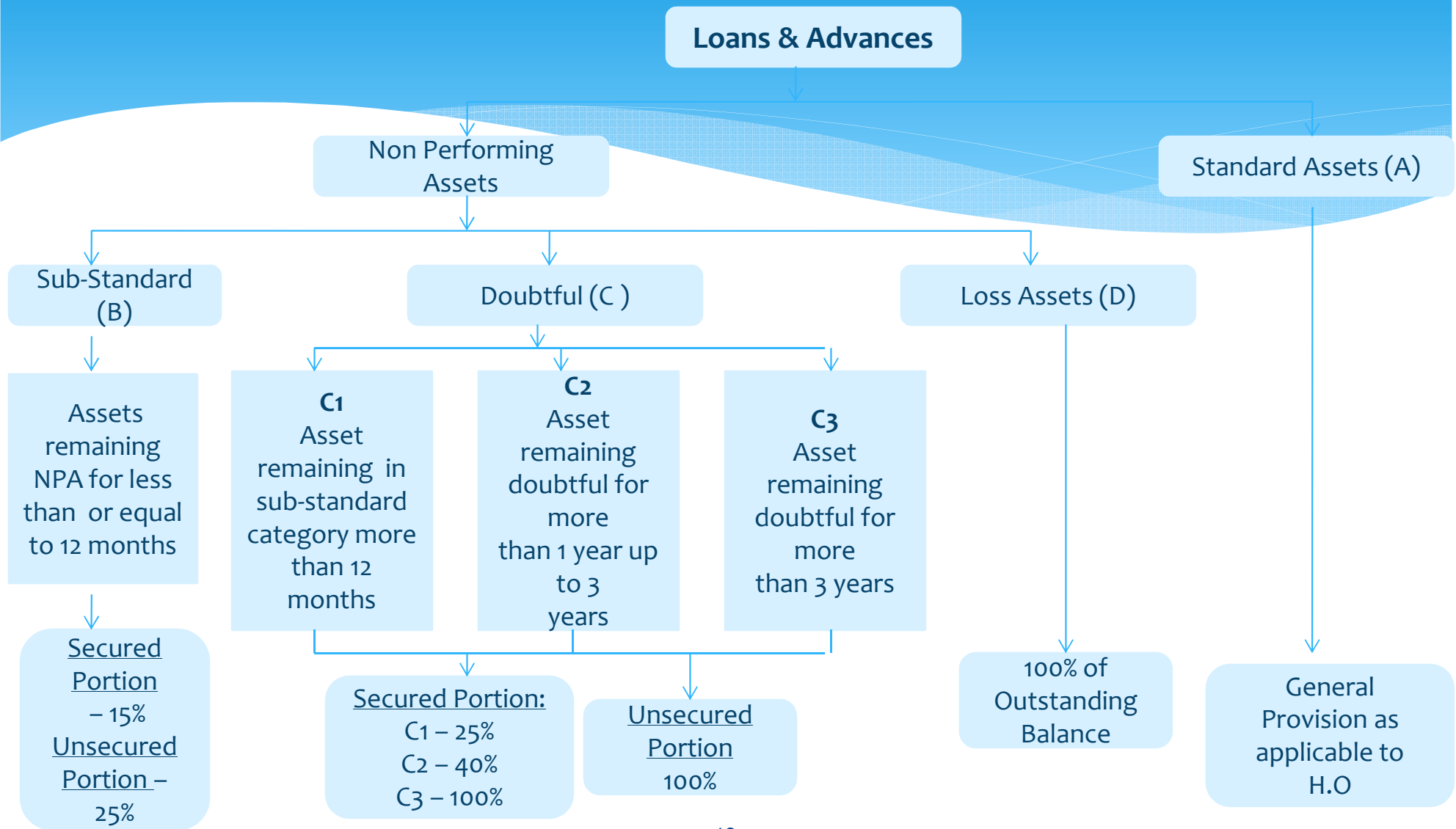
Non - Agricultural Advances

- Interest and /or installment remaining Overdue for 90 days or more.
- Bills discontinued remains overdue for more than 90 days

Cash Credits & Overdrafts

- Account remaining continuously overdraft more than 90 days
- No credits or credits insufficient to cover 90 days interest
- Stock/Receivable statements not received*
- Borrower account is not renewed/reviewed for a period of more than 90 days*

Provision Overview





Audit of Advances

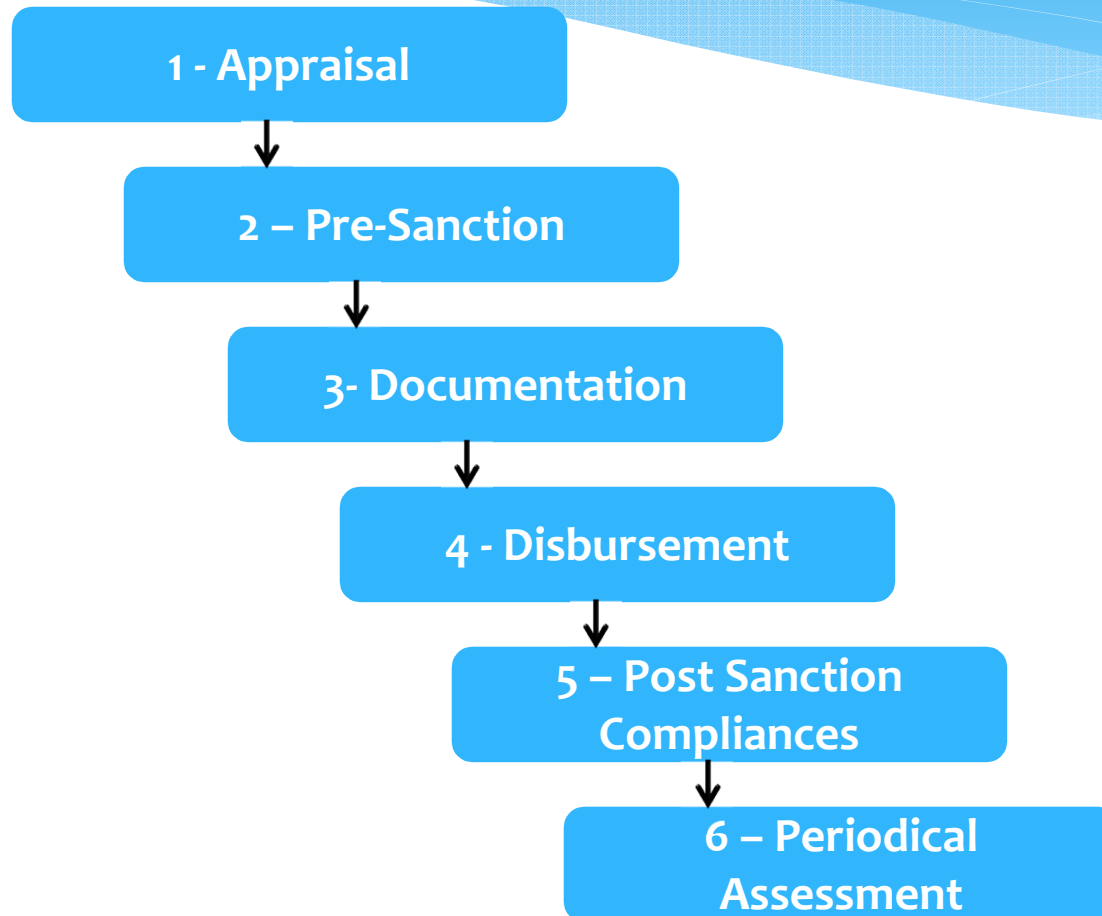


Evaluation of the Internal Control System



- Discussion with management & any operating manuals
- Level of implementation of the IC system
- Sanctioning process in the Bank
 - Sanctioning Authority and Powers
 - Extent of computerization & Documentaion
 - Internal Communication with RO/HO
 - Quality and trained Staff
- External Inspection
- Actual Verification
- Work Culture and environment

Steps followed for Sanctioning an advance Credit Facility / Term Loans





Extent of Checking and Materiality Levels

- New Sanctions
- Large Advances (5% of Advances or 2 crs)
- Adverse Remarks in
 - Concurrent Audit Report
 - PY LFAR
 - RBI Inspection
 - Internal Inspection
- Major movements (upgrades & down grades) in NPA / Restructured advances
- Type of Branch



Areas to be covered

- ➔ Pre Sanction Stage
- ➔ Sanction & Disbursement
- ➔ Post Sanction Stage – Documentation
- ➔ Review, Monitoring & Renewal
- ➔ Verification of Statement of advances





Pre sanction stage

- ➔ Loan Application Scrutiny
- ➔ Review of credit appraisal system
- ➔ KYC compliance - RBI guidelines
- ➔ Adequacy of Security & credit rating of borrower
- ➔ Standing of promoters/ guarantors
- ➔ Within overall exposure limit



Sanction and Disbursement



- ➔ Sanctioning Authority (within powers)
- ➔ Terms of sanction have been complied
- ➔ Proper disbursement
- ➔ Charge has been created in f/o the bank
- ➔ Inspection, Valuation and site visit reports
- ➔ Terms of disbursement (upfront or in stages)
- ➔ Verification of end use of funds



Post Sanction & Documentation



- ➔ Loan Documents - agreement to AOD
- ➔ Legal approval
- ➔ Original Title Deeds
- ➔ Final sign off
- ➔ Loans under consortium
- ➔ Inadequate documents?



Review, Monitoring & Renewal



- ➔ Submission of certified stock & book debt statements
- ➔ Drawing Power correctly calculated & updated
- ➔ Inspection/stock verification is done by the Bank
- ➔ Stock Audit
- ➔ Insurance & valuation of security
- ➔ Watch list accounts are properly monitored
- ➔ Inspection & Visits
- ➔ Quarterly accounts and annual audited FS
- ➔ Penal Interest & commitment charges





Verification of statements:

- ➔ Verification of various returns & statements
- ➔ classification of advances as per RBI guidelines
- ➔ Tallying with bks of a/cs & other statements
- ➔ Correctness wrt classification, security value etc.
- ➔ Priority classification



Drawing Power

Stock Value

Less : Creditors for Stock

Less : Margin

DP as per Stock

Debtors Value

Less : Debtors > 90 days

Less : Margin

DP as per Debtors

- ➡ Monthly submission & certified by a Chartered Accountant
- ➡ Compare with Audited Accounts
- ➡ Regular computation and updating in system

Issues in Non-Funded Advances

- ➔ Off-Balance Sheet items – therefore outside books
- ➔ Various Registers are maintained – cross tally with contingent liability in BS
- ➔ Expired limits are not cancelled
- ➔ Adjustments of margin
- ➔ LC, BG, letter of comfort etc.

List of Requirements @ commencement



- ➔ RBI Master Circulars
- ➔ Bank's Internal Policies (HO circulars etc.)
- ➔ Closing circular
- ➔ RBI inspection Report
- ➔ Internal Inspection and Concurrent audit Reports
- ➔ Other information about branch (NPA etc)
- ➔ Previous year's AR & LFAR
- ➔ Significant accounting policies of the bank



