

Webinar on Bank Audit

Recent changes in NPA/IRAC norms for
Banks and NBFC

CA Pankaj Tiwari
CNK & Associates LLP



Recent news items:

RBI new norms likely to increase NBFCs bad loans
by one-third: Study

RBI clarifies norms for
upgrading of accounts classified
as NPAs

**RBI's new norms could lead to spike
in NPAs for NBFCs: ICRA**

**RBI asks banks to standardise NPAs only on
full interest, principal payments**

Recent important circulars issued by RBI:

□ Banks/Banking Companies (BC):

- Master Direction on Financial Statements - Presentation and Disclosures- 31st August 2021 (amended -15th November 2021)- **SCA's**
- Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances- 1st October 2021- **SCA's + SBA's**
- Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarifications- 12th November 21- **SCA's + SBA's**

□ NBFC Companies:

- Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarifications- 12th November 21
- Prompt Corrective Action (PCA) Framework for Non-Banking Financial Companies (NBFCs)- 15th December 2021

Recent RBI Divergence/observations:

- Non-implementation of RP-7th June 2019:
 - Defaults not rectified within the review period of 30 days or viable RP not implemented within 180 days
 - Additional provision made only on FB exposure portion and not on total o/s amount (FB+NFB)

- DP computed based on the expired stock statements- to be classified as NPA

- Wrongful upgradation of NPA accounts before implementation of restructuring plan

- Wrongful reversal of provision on change in ownership before expiry of monitoring period

- Realisable value of security less than 10% of o/s- not classified as Loss assets

Changes in presentation of FS of Banks/BC:

Item	Earlier	Now	Impact
MTM provision for depreciation on Investments (including reversal of excess provision)	Under Provisions & Contingencies	Under Other Income	+/- in Operating profit
Recoveries from W/off accounts **	Under Other Income	Under Provision & Contingencies	+/- in operating profit
Term reverse repo (> 14 days)	Under Bank Balance	Under Advances	NPA Ratio
Short Term loans (original maturity of 1 YR)	Under Term loans \$	Under CC & Loan repayable on demand	NA

*** this change has been removed w.e.f. 15th November 2021*

\$ different banks were following different practice

Changes in presentation of FS of Banks/BC:

PARTICULARS	FOR THE QUARTER ENDED 30.09.2021	FOR THE QUARTER ENDED 30.06.2021
	(Unaudited)	(Unaudited)
1. Interest earned (a)+(b)+(c)+(d)	16,336,01	16,003,46
(a) Interest/discount on advances/bills	11,986,74	11,881,46
(b) Income on Investments	3,521,64	3,428,20
(c) Interest on balances with Reserve Bank of India and other inter-bank funds	405,35	259,90
(d) Others	422,28	433,90
2. Other Income [Refer note 2 & 3]	3,798,38	3,358,46
3. TOTAL INCOME (1+2)	20,134,39	19,361,92
4. Interest Expended	8,435,71	8,243,19
5. Operating expenses (i)+(ii)	5,770,51	4,932,40
(i) Employees cost	1,935,54	1,851,87
(ii) Other operating expenses	3,834,97	3,080,53
6. TOTAL EXPENDITURE (4+5) (Excluding Provisions and Contingencies)	14,206,22	13,175,59
7. OPERATING PROFIT (3-6) [Profit before Provisions & Contingencies]	5,928,17	6,186,33
8. Provisions (other than tax) and Contingencies (Net) [Refer note 3]	1,735,09	3,302,30
9. Exceptional Items	-	-
10. Profit/(Loss) from Ordinary Activities before Tax (7-8-9)	4,193,08	2,884,03
11. Tax expense	1,059,76	723,88
12. Net Profit/(Loss) from Ordinary Activities after Tax (10-11)	3,133,32	2,160,15

Changes in **IRAC norms** for Banks/BC:

Earlier requirements:

Timeline for implementation of viable RP	Additional provisions to be made as a % of total outstanding, if RP not implemented within the timeline
180 days from the end of Review Period	20%
365 days from the commencement of Review Period	15% (i.e. total additional provisioning of 35%)

New requirements:

Timeline for implementation of viable RP	Additional provisions to be made as a % of total outstanding (funded+non-funded), if RP not implemented within the timeline
180 days from the end of Review Period	20%
365 days from the commencement of Review Period	15% (i.e. total additional provisioning of 35%)

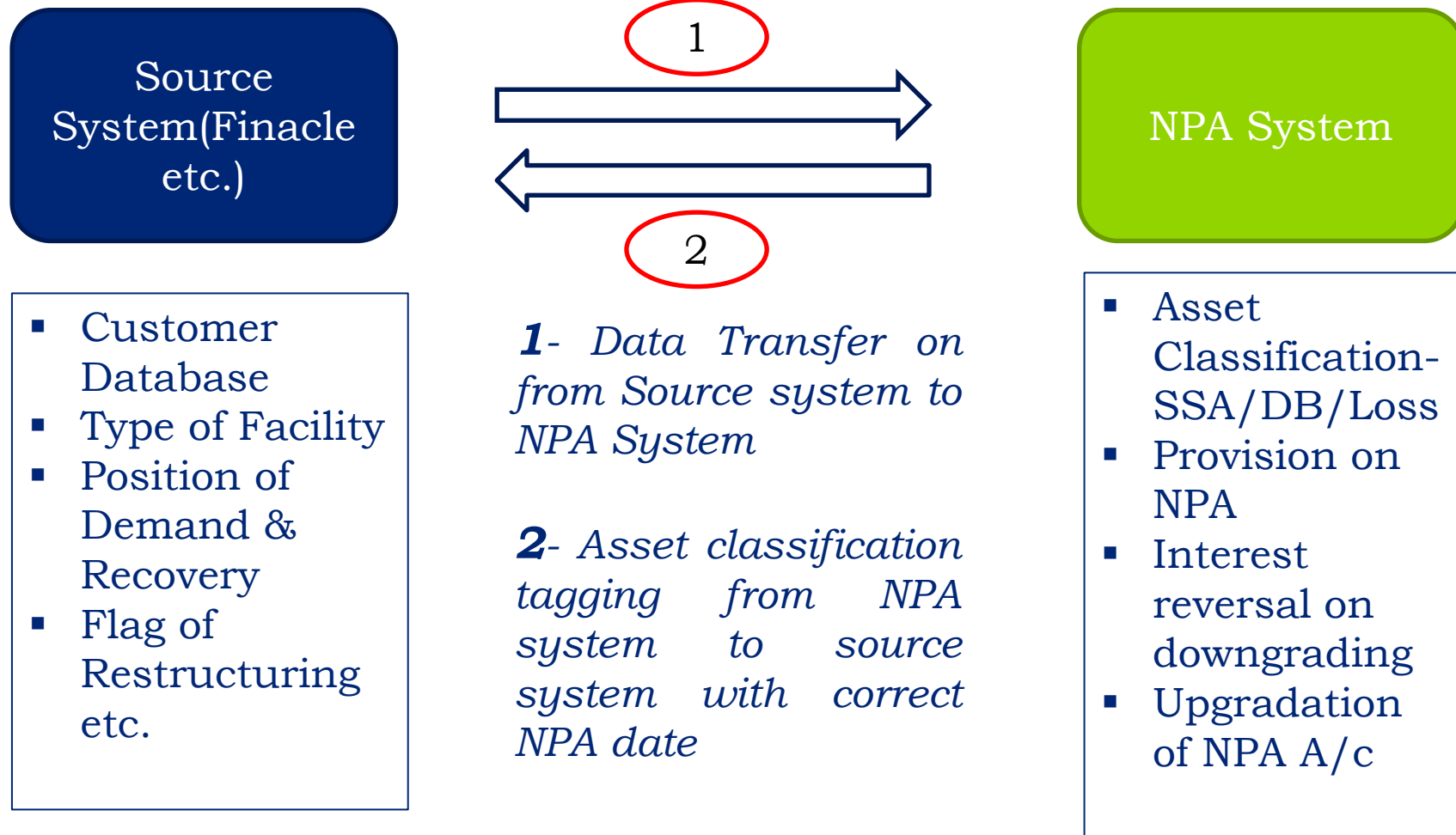
IRAC Norms – Clarifications/changes for Banks:

Major points of clarifications in 12th November 2021 circular:

- Specification of due date/repayment date in loan agreement
- **Classification of SMA & NPA –part of day-end process**
- **Clarification regarding definition of ‘out of order’**
- NPA classification in case of interest payments
- ~~➤ Upgradation to standard status –not relevant for banks~~
- **Income recognition policy in case of loans with moratorium on interest**
- Consumer education

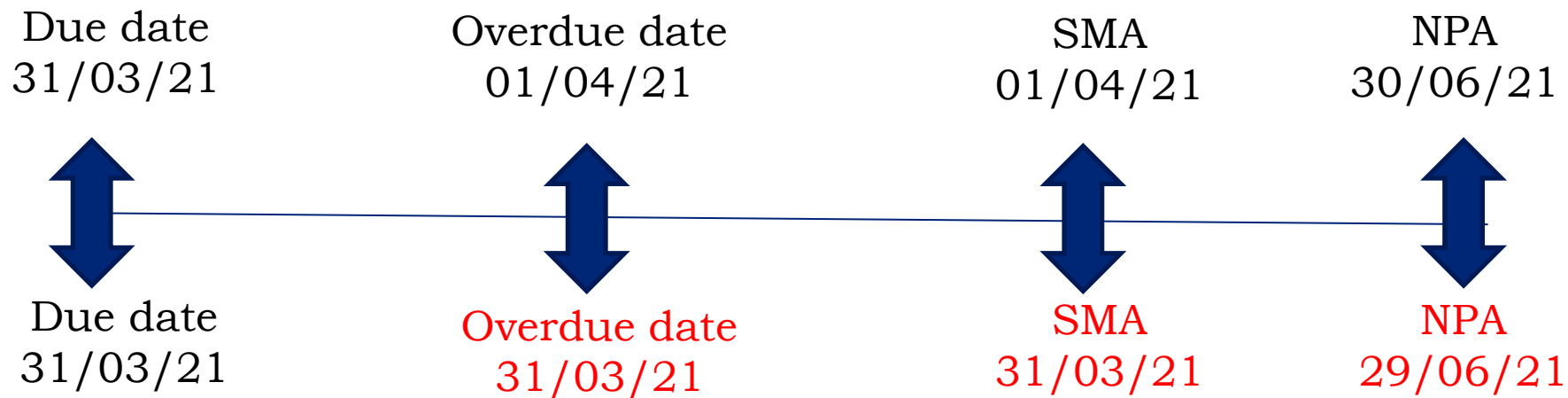
IRAC Norms – Clarifications/changes for Banks:

Usual day-end process in case independent system used for NPA:



IRAC Norms – Clarifications/changes for Banks:

Classification of SMA & NPA –part of day-end process:



- ❑ Different banks were following different practice of identification of account as NPA- monthly/quarterly/daily
- ❑ September 2020 circular and November 2021 circulars now requires SCB to identify the NPA on daily basis through system- **June 2021**
- ❑ No exceptions are given for Saturday/Sunday/Holidays- NPA process need to run to identify any account as NPA- **LFAR point**
- ❑ Major impact- total overdue recovery for NPA vs. Partial recovery in Standard accounts

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding definition of 'out of order':

Changes in the wording of definition:

An account should be treated as '**out of order**'

if the outstanding balance in the CC/OD accounts remains continuously in excess of the sanctioned limit/drawing power for 90 days or 1

~~In cases where~~ the outstanding balance in the CC/OD accounts ~~in the principal operating account~~ is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days, ~~as on the date of Balance Sheet~~ or 2

the outstanding balance in CC/OD account is less than the sanctioned limit/drawing power but credits are not enough to cover the interest debited during the same previous 90 days -period, ~~these accounts should be treated as 'out of order'~~. 3

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding definition of 'out of order':

Existing practice for classification of account as NPA- under 3rd condition- quarterly basis:

Testing 3rd condition for quarter ended 31st December 2021:

Months	Interest Debits	Credits	Closing Balance
July	15	15	-
August	20	0	20
September	21	0	41
October		10	31
November		10	21
December		10-A 25-B	11/-4

Situation- A

Total Debits-56

Total Credits-45

Conclusion- **NPA**

Situation- B

Total Debits-56

Total Credits-60

Conclusion- **STD**

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding definition of ‘out of order’:

*Clarification –view-1- Daily NPA classification-Previous 90 days period’ :
Testing 3rd condition for quarter ended 31st December 2021:*

Dates	Interest Debits	Credits	Previous 90 days
31-07-2021	13		02-05-2021
02-08-2021		13	04-05-2021
31-08-2021	11		02-06-2021
02-09-2021		11	04-06-2021
30-09-2021	12		02-07-2021
02-10-2021		12	04-07-2021
31-10-2021	13		02-08-2021
01-11-2021		0	03-08-2021

On 31-10-2021

PR 90 days Debits-36
PR 90 days Credits-36
Conclusion- **STD**

On 01-11-2021

PR 90 days Debits-36
PR 90 days Credits-23
Conclusion- **NPA**

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding definition of ‘out of order’:- View-1

- Circular requires that credits in the account should be able to cover the interest debited during the previous 90 days period;
- Post September 2020 circulars all the banks are required to run the NPA on “Daily basis”- therefore each day 3rd condition of the circular will be tested by the bank to classify an account as NPA.
- **In view-1-**
 - 31st October 2021- as part of day end process for 31st October- the system will consider all the credits & debits since 2nd August 2021 i.e. previous 90 days- in example sufficient recovery & **hence it will STD account.**
 - 1st November 2021- here the previous 90 days will start from 3rd August and hence recovery made on 2nd August 2021 will not be covered & therefore it may be NPA account.
 - NPA because of one-month dues is not logical & unintentional.

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding definition of ‘out of order’:

*Clarification –view-2- Daily NPA classification-Previous 90 days period’ :
Testing 3rd condition for quarter ended 31st December 2021:*

Dates	Interest Debits	Credits	DPD
31-07-2021	15		1
01-08-2021		-	2
02-08-2021		15	0
31-08-2021	11		1
01-09-2021		-	2
02-09-2021		11	0
30-09-2021	12		1
01-10-2021		-	2
02-10-2021		12	0
31-10-2021	13		1
01-11-2021		0	2

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding definition of ‘out of order’:- View-2

- Circular requires that credits in the account should be able to cover the interest debited during the previous 90 days period- which can be interpreted as interest should not remain overdue for 90 days;
- In this view- interest charged in the CC account will be treated as demand created in the account and if there are no credits within 90 days the account will be treated as out of order.
- The view removes the difference between term loans and CC facility w.r.t. interest recovery- however it still differentiate between the two by way of credit in the account vs. one way recovery in term loans.
- On transition to this rule, the banks need to identify the interest overdues in the account based on **90 days subsequent credits** and if not covered the same will be treated as NPA on transition.
- Different views/approach adopted by different bank in following 3rd condition of out of order.

IRAC Norms – Clarifications/changes for Banks:

Relevance of the Principle of 'First In First Out' (FIFO) in appropriation of payments into the borrowal account:

The Principle of FIFO i.e., 'First In, First Out' accounting method is relevant to arrive at the No. of days of overdue for determining the SMA / NPA status. The FIFO principle assumes that, the oldest outstanding dues in the loan account needs to be cleared first. The FIFO method thus requires that what is due first must be paid by the borrower first. For example;

if in any loan account as on 01.02.2021 there are no overdues and an amount of Rs. X is due for payment towards principal instalment/interest/charges, any payment being credited on or after 01.02.2021 in the loan account will be used to pay off the dues outstanding on 01.02.2021.

Assuming that nothing is paid /or there is partial payment (Rs Y) of dues during the month of February, the overdue as on 01.03.2021 will be Rs .X-Y.

Additionally, an amount of Rs.Z becomes due as on 01.03.2021. Now any payment /partial payment into the account on or after 01.03.2021 will be first utilized to pay off the partial due of 01.02.2021 (Rs X – Rs.Y) . If there is more recovery than the Rs X – Rs.Y, then, after recovering dues of 01.02.2021, the remaining amount will be treated as recovery towards due of 01.03.2021.

IRAC Norms – Clarifications/changes for Banks:

Due date of payment	Payment Date	Payment covers	Age of oldest dues in days	SMA / NPA Categorisation	SMA since Date /SMA class date	NPA categorization	NPA Date
01.02.2022	01.02.2022	Partly paid dues of 01.02.2022	1	SMA-0	01.02.2022	NA	NA
01.02.2022	02.02.2022	Partly paid dues of 01.02.2022	2	SMA-0	01.02.2022	NA	NA
01.03.2022		Dues of 01.02.2022 not fully paid 01.03.2022 is also due at EOD 01.03.2022	29	SMA-0	01.02.2022	NA	NA
		Dues of 01.02.2022 fully paid , Due for 01.03.2022 not paid at EOD 01.03.2022	1	SMA-0	01.03.2022	NA	NA
		No payment of full dues of 01.02.2022 and 01.03.2022 at EOD 03.03.2022	31	SMA-1	01.02.2022 / 03.03.2022	NA	NA
		Dues of 01.02.2022 fully paid , Due for 01.03.2022 not fully paid at EOD 1.03.2022	1	SMA-0	01.03.2022	NA	NA
01.04.2022		No payment of dues of 01.02.2022 ,01.03.2022 and amount due on 01.4.2022 at EOD 01.04.2022	60	SMA 1	01.02.2022 / 03.03.2022	NA	NA
		No payment of dues of 01.02.2022 till 01.04.22 at EOD 02.04.2022	61	SMA 2	01.02.2022 /02.04.2022	NA	NA
01.05.2022		No payment of dues of 01.02.2022 till 01.05.22 at EOD 01.05.2022	90	SMA 2	01.02.2022 /02.04.2022	NA	NA
		No payment of dues of 01.02.2022 till 01.05.2022 at EOD 02.05.2022	91	NPA	NA	NPA	02.05.2022

Case Study-5

- ❑ ABC Pvt. Ltd. has availed CC facility from the bank. The bank has closed current account with borrower as per new RBI guidelines. The company has also taken Rupee Term Loan and Capex LC was sanctioned as sub-limit to this facility. The company had taken LC against the capex expenditure and on due date of LC the bank had disbursed RTL to close these LC's.
- ❑ The disbursement against the capex LC were routed through the CC/OD account and the payment were made from this account itself. The account is classified as Standard based on out of order criteria [credits are sufficient].
- ❑ On careful verification of the account statement, the auditor has observed that the business credits in the account were not sufficient to cover the interest debited during the period of previous 90 days. However, the system had classified the account as STD considering the disbursement credits in the CC/OD account.
- ❑ As an auditor what is your view on such practice and compliance with IRAC norms.

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding interest during moratorium period:

12. The extant instructions (compiled at paragraph 3.2 of the [Master Circular on IRACP norms dated October 1, 2021](#)) require that once an account is classified as NPA, the entire interest accrued and credited to income account in the past periods, must be reversed to the extent it remains unrealised. It is clarified that if loans with moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest corresponding to the interest accrued during such moratorium period need not be reversed.

- Mainly applicable for Educational loans- where accrued interest during the repayment holiday period is added to the principal and repayment in Equated Monthly Instalments (EMI) fixed.
- Different views among the auditors/banks on treatment of the above interest once the account is classified as “NPA”.

IRAC Norms – Clarifications/changes for Banks:

Major points of clarifications – 15th February 2022 circular:

- Out of order- applicable to all loan products being offered as an overdraft facility
- Previous 90 days period- inclusive of the day for which the day-end process is being run- **IMP clarification**
- Upgradation of the facility-only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities- **IMP clarification**

IRAC Norms – Clarifications/changes for Banks:

Major points of clarifications – 15th February 2022 circular:

➤ Upgradation of loan account:

1st October 2021 IRAC norms:

4.2.5 Upgradation of loan accounts classified as NPAs

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as nonperforming and may be classified as 'standard' accounts. With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of DCCO, etc., the instructions as specified for such cases shall be applicable.

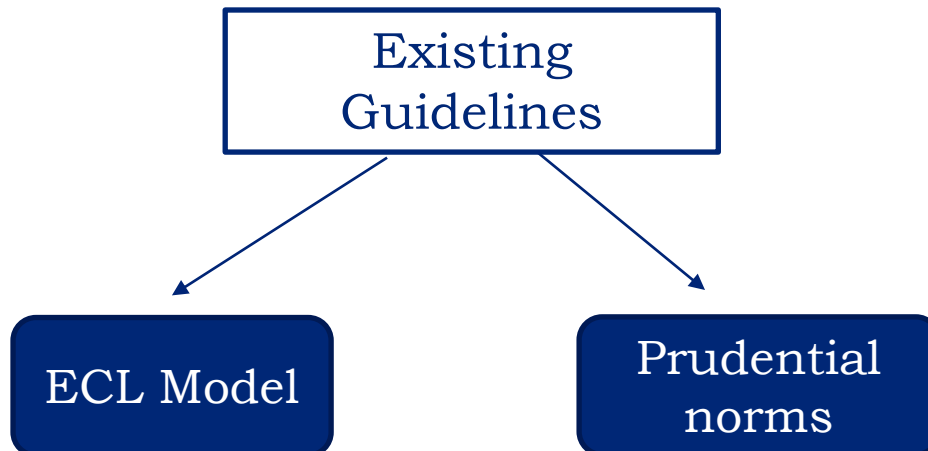
15th February 2022- Clarification:

- (iii) In case of borrowers having more than one credit facility from a lending institution, loan accounts 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.

IRAC Norms – Clarifications/changes for NBFC:

Major points of clarifications in 12th November 2021 circular:

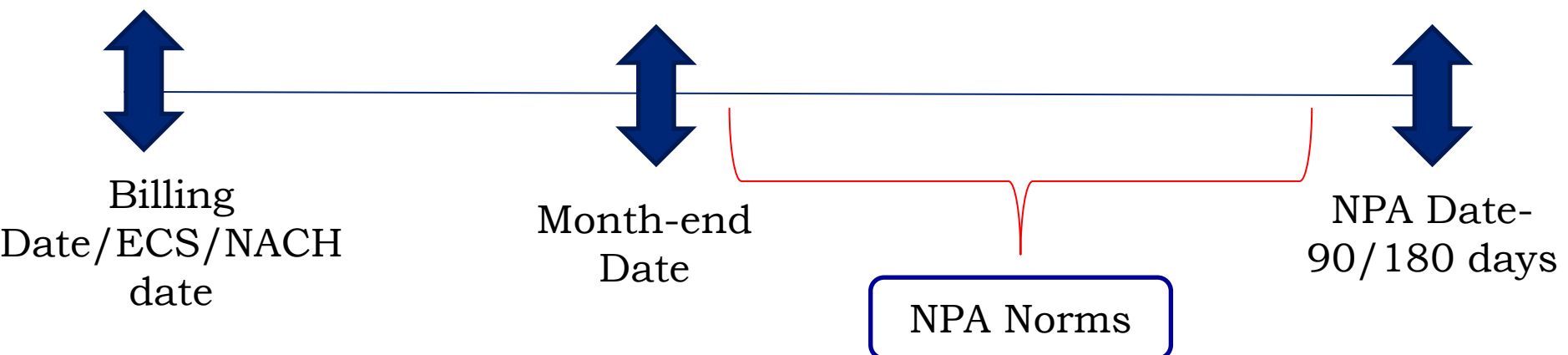
- Specification of due date/repayment date in loan agreement
- **Classification of SMA & NPA –part of day-end process**
- **Upgradation of accounts classified as NPA**
- Consumer education



IRAC Norms – Clarifications/changes for NBFC:

Classification of SMA & NPA –part of day-end process:

4. In the above context, it is further clarified that borrower accounts shall be flagged as overdue by the lending institutions as part of their day-end processes for the due date, irrespective of the time of running such processes. Similarly, classification of borrower accounts as SMA as well as NPA shall be done as part of day-end process for the relevant date and the SMA or NPA classification date shall be the calendar date for which the day end process is run. In other words, the date of SMA/NPA shall reflect the asset classification status of an account at the day-end of that calendar date.



IRAC Norms – Clarifications/changes for NBFC:

Classification of SMA & NPA –part of day-end process:

- September 2020 circular requiring system driven NPA classification on daily basis only for Banks
- Note the circular requires daily stamping of accounts instead of monthly or quarterly stamping done by NBFC;
- Earlier NBFC customer were making payment with some delay- as identification was done on month end or quarter end
- Major issue- once classified as NPA- require total recovery before upgradation
- Billing/demand is created in the system of NBFC's or HFC's for the recovery purposes
- NACH/ECS mandate is taken for practical purposes- Salary cycle etc.
- No specific due dates are prescribed in the loan agreement except payment date
- *Whether the overdue for DPD purposes should be counted from NACH date or from the month end date?*

IRAC Norms – Clarifications/changes for NBFC:

Upgradation of accounts classified as NPA

overdues, etc. In order to avoid any ambiguity in this regard, it is clarified that loan accounts classified as NPAs may be upgraded as 'standard' asset only if entire arrears of interest and principal are paid by the borrower. With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of date of commencement of commercial operations (DCCO), etc., the instructions as specified for such cases shall continue to be applicable.

- NBFC/HFC master direction was silent on the policy of the upgradation till now;
- Accounts with DPD more than 90 days were considered as NPA on cut-off date;
- Accounts below DPD of 90 days were considered as Standard **irrespective of previous months classification**
- One of many areas for the benefit of NBFC's & HFC's as compared to Banks
- May warrant change in appropriation rule – interest & principal first as compared to other dues

IRAC Norms – Clarifications/changes for NBFC:

Upgradation of accounts classified as NPA- Impact

Impact on	Ind-AS NBFC & HFC	Non-Ind AS NBFC & HFC
Provisioning & Contingencies	May not affect since provision is done as ECL model	Will affect the provision on NPA
Quantum of NPA	May affect movement from Stage-3 to Standard category on partial dues	Will increase the NPA figure
GNPA/NNPA ratio	Will affect these ratio	Will affect these ratio
Credit Rating	Will affect considering the increase in asset in Stage-3 & NPA ratio	Will affect considering the increase in NPA & NPA ratio
Borrowing Capacity	Will affect for initial period	Will get impacted for long term
Regulatory restriction	PCA framework basis NPA ratio	PCA framework basis NPA ratio

Points for Auditors –Banks & NBFC:

- Timely compliance of November 12 circular to avoid any observations from RBI- impact in LFAR reporting
- Reporting on different practice followed by the banks- CC/OD classification- LFAR reporting – compliance of IRAC norms
- Daily classification of accounts as NPA- mainly in Direct assignment cases where the details are shared in one month lag- appropriate reporting in LFAR
- Daily asset classification – NBFC's & HFC's- no relaxation provided- to applied immediately- impact on Annual certificate by Auditor
- Impact on ECL model for cases under NPA as per clarified norms but having less than 90 days DPD- can be treated as separate class?

RBI Clarification- NBFC:

विषय: Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarification issued by RBI on November 12, 2021 – Request for relief to NBFCs

Please refer to your representations dated November 18, 2021 and December 9, 2021 on the subject. In this regard, you are requested to refer to the discussion held in the virtual meeting dated December 9, 2021 held by Shri Saurav Sinha, Executive Director, Reserve Bank of India with the members of the FIDC. We reiterate that the circular dated November 12, 2021 does not prescribe any revision to the extant prudential norms on asset classification as applicable to NBFCs. The circular clarifies the regulatory intent behind the existing prudential norms so that there is uniformity in implementation of the same, across all lending institutions. As such, we express our inability to accede to your request for granting forbearance from the prudential norms under reference. All lending institutions shall ensure compliance to the instructions issued vide the aforesaid circular as per the timelines specified therein.

Thank You

pankajtiwari@enkindia.com