SIRC of ICAI
Workshop on Bank Branch Audit

Prudential Norms (IRAC)
- An Overview

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B.Com, FCA, DISA, CISA
Prudential norms on
INCOME RECOGNITION,
ASSET CLASSIFICATION
AND PROVISIONING NORMS
(IRAC NORMS)
OVER VIEW

► IRAC NORMS
► IDENTIFICATION OF NPA
► INCOME RECOGNITION
► ASSET CLASSIFICATION GUIDELINES
► PROVISIONING NORMS FOR NPA
► IMPORTANT ASPECTS OF MASTER CIRCULAR
► CERTAIN ISSUES
IRAC NORMS

► Master circular dated 01st July, 2015

(DBR No. BP.BC.2/21.04.048/2015-16)
ASSET TYPE

STANDARD ASSET / PERFORMING ASSET

The account is not non-performing and does not carry more than the normal risk attached to the business.
NON-PERFORMING ASSET (NPA)

The Asset ceases to generate income for the bank.
NON-PERFORMING ASSET (NPA)

- 2.1.2 NPA is a loan
  - i. Interest and/or instalment of principal remain overdue for more than 90 days – TL
  - ii. Account remains “out of order” – OD /CC
  - iii. Bill remains overdue for more than 90 days – BP/BD
  - iv. Instalment of principal or interest remains overdue for two crop seasons – short duration crops
  - v. Instalment of principal or interest remains overdue for one crop season – long duration crops
2.2 “Out of Order”

- The account is treated as ‘out of order’ if:
  - Outstanding Balance remains continuously in excess of sanction limit / drawing power for 90 days
  - Outstanding less than limit - No credits continuously for 90 days as on the date of Balance Sheet
  - Credits are not enough to cover the interest debited during the same period.

2.3 “Overdue” – amount not paid on due date
Income Recognition

- 3.1.1 – IR has to be objective and based on record of recovery – bank should not charge and take to income account interest on any NPA

- 3.1.2 – interest on advances against TD, NSC, IVP, KVP, Life policies may be taken on due date – provided adequate margin is available

- 3.1.3 – Fees and Commissions on renegotiation / rescheduling of outstanding debts should be recognised on accrual over the extended period
Income Recognition

3.2 Reversal of Income

3.2.1- In case of NPA, past periods interest not realised should be reversed

3.2.2 Fees, Commissions – ceases to accrue in current period – reverse past period if uncollected

3.2.3 Unrealised Finance Charge component of finance income on leased assets should be reversed
Income Recognition...

• 3.3 Appropriation of recovery in NPAs
  
  • 3.3.1 – Interest realised on NPAs may be taken to income – provided credits are not out of fresh / additional loans
  
  • 3.3.2 – Agreement to decide – in its absence, Bank should adopt an accounting principle - uniform and consistent

Usually it is in the order of priority – unrealised expenses, unrealised interest, principal outstanding
ASSET CLASSIFICATION

- **Standard Asset**
  The account is not non-performing.

- **4.1 Categories of NPAs**
  i. Substandard Assets
  ii. Doubtful Assets
  iii. Loss Assets
4.1.1 Substandard Assets - remained NPA for a period of less than or equal to 12 months (wef 31-3-2005)

4.1.2 Doubtful Assets – Remained in Substandard category for 12 months

Three Categories

<table>
<thead>
<tr>
<th>Category</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doubtful - I</td>
<td>Up to One Year</td>
</tr>
<tr>
<td>Doubtful - II</td>
<td>Up to Three Years</td>
</tr>
<tr>
<td>Doubtful - III</td>
<td>More than Three Years</td>
</tr>
</tbody>
</table>
4.1.3 Loss Assets

These are accounts, identified by the bank or internal or external auditors or by RBI Inspectors as wholly irrecoverable but the amount for which has not been written off wholly
CLASSIFICATION GUIDELINES

4.2 Guidelines for Classification of Assets

4.2.1 Based on degree of well-defined credit weakness and extent of dependence on collateral security for realisation of dues

4.2.2 Timely identification – specifically high value – any doubt about classification to be resolved in one month through internal channels

4.2.3 Availability of security or Net worth should not be taken into consideration for treating an account as NPA
CLASSIFICATION GUIDELINES

4.2 Guidelines for Classification of Assets

4.2.4 Temporary Deficiencies – non availability of DP based on Stock Statement, limit exceeding, non-submission of Stock Stmt, renewal etc

i) Outstanding in account based on DP calculated from stock statements older than 3 months – “irregular” – irregular drawings for continuous 90 days is NPA

ii) Regular / ad hoc limits need to be reviewed / regularised in 3 months – if not reviewed / renewed within 180 days from due date sanction will be treated as NPA
CLASSIFICATION GUIDELINES

4.2 Guidelines for Classification of Assets

4.2.5 Upgradation of NPAs

If arrears of interest and principal are paid by the borrower – account to be treated as Standard

4.2.6 Regularised near about BS date

Solitary or few credits before BS date – handle with care; If account indicates inherent weakness – treat as NPA
4.2 Guidelines for Classification of Assets

4.2.7 Borrower-wise not facility-wise

- i) If one account is NPA - All facilities granted and investment in all securities of the borrower need to be treated as NPA / NPI
- ii) Debits arising out of devolvement of LC or invoked BG should also be treated as NPA
- iii) Bills discounted under LC may not be classified as NPA – However, in case Documents under LC are not accepted on presentation or payment not made on due date by LC issuing bank and borrower does not pay immediately – treat it as NPA from date of other facility becoming NPA
CLASSIFICATION GUIDELINES

4.2 Guidelines for Classification of Assets

4.2.8 Advances under Consortium arrangements

- Based on record of recovery of the individual member banks

- Where remittances are pooled with one bank – not parting with member banks share – treat it as NPA

- Where remittances are pooled with one bank / lead Bank – get an express consent for transfer
4.2 Guidelines for Classification of Assets

4.2.9 Erosion in value of Security / Frauds

Where there are potential threats of recovery on account of erosion in value of security / non-availability of security and frauds – not prudent to go through various stages – directly classify as Doubtful or Loss assets

- Realisable value of security is less than 50% of value assessed by bank – Doubtful Asset
- Realisable value of security is less than 10% of the outstanding balance – Loss Asset
4.2 Guidelines for Classification of Assets

4.2.10 Advances to PACS/ FSS – under on-lending system – only that particular Credit facility which is in default shall be treated as NPA – not all facilities

4.2.11 Advances against TD/ NSC/ KVP/ IVP/ Life policies with adequate margin need not be treated as NPA

4.2.12 Loans with moratorium for payment of interest – should become due to be called overdue (date of debit of interest is not criteria); Similarly Housing loans to staff
CLASSIFICATION GUIDELINES

4.2 Guidelines for Classification of Assets

4.2.13 Agricultural Advances

i) Short duration Crops – principal or interest remains overdue for two crop seasons;

Long duration Crops - principal or interest remains overdue for one crop seasons;

Long duration – Crop season longer than one year

Crop Season – Period up to harvesting of crops raised as per SLBC

Short duration – which is not Long duration

Refer to : FIDD.CO.Plan.BC.54/04.09.01/2014-15 Dt 23 April, 2015

FIDD.No.FSD.BC.52/05.10.001/2014-15 Dt 25 March, 2015
4.2 Guidelines for Classification of Assets

4.2.13 Agricultural Advances

• i), ii), iii) Agricultural Advances affected by Natural Calamities

• Banks may decide to convert short term production loan to term loan or re-schedulement of term, sanction fresh short-term loan subject to conditions of RBI –

• NPA Classification governed by rescheduled terms

• Fresh Loans given after the rescheduled advances – regular norms

• Rural Housing Advances under Indira Awas Yojana & Golden Jubilee Rural Housing Finance Scheme – repayment to be linked to crop cycles
4.2 Guidelines for Classification of Assets

4.2.14 Government Guaranteed Advances

- Central Govt. – only when Guarantee Invoked
- Exemption NOT for Recognition of Income !!
- State Government – No such relaxation – Normal 90 days norms apply
CLASSIFICATION GUIDELINES

4.2 Guidelines for Classification of Assets

- 4.2.19 Advances granted under rehabilitation package approved by BIFR / TLI
  - Existing classification and provision to continue
  - Upgradation only after one year – if package worked satisfactorily.
  - Additional facilities sanctioned – IRAC will apply after one year.
4.2 Guidelines for Classification of Assets

4.2.21 Credit Card Accounts

- Minimum Due – Roll over the balance

- Minimum amount due not paid fully within 90 days from the next statement date – gap between statements should not be more than one month

- Banks should follow uniform method to determine overdue status
PROVISIONING NORMS

STANDARD ASSET

- Direct Advances to Agri. And SME @ 0.25%
- Commercial Real Estate (CRE) Sector @ 1%
- CRE – Residential Housing Sector @ 0.75%
- Res. Housing loans with teaser rates @ 2%
- All others (other than Restructured Adv) @ 0.40%
PROVISIONING NORMS

► SUB-STANDARD ASSET

15% of total outstanding  - Without considering ECGC

20% of total outstanding  - Unsecured portion (Infra)

25% of total outstanding  - Unsecured portion (Others)
# PROVISIONING NORMS

## DOUBTFUL ASSETS

<table>
<thead>
<tr>
<th>Period</th>
<th>Provision (Secured + Unsecured)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 1 year</td>
<td>25% + 100%</td>
</tr>
<tr>
<td>1 to 3 years</td>
<td>40% + 100%</td>
</tr>
<tr>
<td>More than 3 yrs</td>
<td>100% + 100%</td>
</tr>
</tbody>
</table>
LOSS ASSET:

100% should be provided for
IMPORTANT ASPECTS

Valuation of Securities

In respect of NPAs with the balance of Rs.5.00 crores & above, bank needs to formulate policy for annual stock audit by external agencies &

In respect of immovable properties, valuation to be carried out once in 3 years by approved valuer
GREENING ISSUES

- Sanction/extension of Additional facility/Adhoc facility.
- Enhancement of Limit.
- Conversion of Overdue Limits.
- Frequent Rescheduling of Term Loans.
- Adjusting Loan of one borrower against other borrower.
Auditors Role Vis a Vis IRAC

- Auto Classification
- Availability of security
- Good customer – healthy account operations
- Early warning signals ignored – system generated reports – probable NPA – special mention accounts
- Clean system data: Master Data – creation – modification – errors
Auditors Role Vis a Vis IRAC

- Force modification – exception reports
- Reversal of Interest & charges debited – uncollected
- Followup on recovery
- Failure to renew in time
- Analytical reporting – not just statistics
Few areas of caution:

Advances:

- Has the Branch identified and classified advances into Standard / Sub......
  - Categorical statement – not just based on our sample for appraisal
  - Disagreement – if material – mention in main report and report in MOC
  - Do not commit in LFAR for material deviations and not report in main report
Few areas of caution:

► Non–Agricultural Gold Loans – Bullet Payment
  - Quantum – as per Banks policy
  - Tenor shall not exceed 12 months
  - Interest charged at monthly rests for Standard a/cs
  - Normal IRAC shall apply once principal & interest become overdue
  - LTV of 75 % shall be maintained throughout
  - Rate is based on previous 30 days average

Few areas of caution:

- **EMI – Record of recovery – delay in payment**
  - Interest & Principal Due as per EMI table
  - Interest calculated on reducing balance
  - Credit summations Vs EMIs due
  - Interest and penal interest on delayed period?
  - What should be the DP Vs What is the DP

- Advance payments – set off against principal?
- Pre-payment - permitted; agreement, product
Few areas of caution:

- **Interest Rate change – impact on EMI**
  - Interest fixed at Base Rate + ___ %
  - Change of base rate during the year
  - Resetting of EMI – product based parameter
  - Communication to borrower
    - Any increase in rate makes EMI inadequate – tenor remaining same.
    - Verify the exception report for Interest Rate variations
Few areas of caution:

- **Upgradation of NPA during the year**
  - Is the total overdue realised?

- **Agricultural Advances – Long Term / Short term**
  - How are they reckoned – when single crop raised?
  - Draught / Floods – natural calamities?
  - Rephasement / Rescheduling only for loans of that period – not eligible for overdue loans
Few areas of caution: System related

- **Manual intervention**
  - Changing sanction date, Due Date, Renewal date
  - How do we get to reach them:
    - Say for Example in Bancs: Many reports would be pasted on ftp on a daily basis
    - CC_OD Balance File
    - Irregularity due to excess drawings (exception)
    - List of NPA accounts

- Date of irregularity; IRAC status, DP amount; Modification of date of NPA – impacts provision
Few areas of caution: System related

- **Manual intervention**
  - Changing IRAC status - code
  - How do we get to reach them:
    - IRAC status changed by Branch
    - New IRAC code Vs Old IRAC code
    - EMIs Due Vs EMIs paid

- IRAC code changed from 04 to 00; System stamped code & Dynamic stamping; Overdue EMIs > 3;
- SERVICE DESK - Requests
Branch Audit Practical Issues . . .

Few areas of caution: System related

- Indicative System parameters
  - Credit Summation “0”
  - Sanction date / Renewal Date “00/00/0000”
  - Security value as “0”
  - Interest Rate flag “0”
  - Number of accounts with same renewal date
  - Stock statement date – without actual receipt
  - Renewal of Agri CC loans – with only interest being serviced
Few areas of caution: Advances related

- **Pointers to NPAs**
  - Probable NPAs – Special mentioned accounts
  - Renewals / Review done in Q 4
  - Two short term reviews
  - Movement of NPAs – previous year SS continues in SS
  - Third party collateral securities
Project under Implementation

- Project Loan means any term loan which has been extended for the purpose of setting up of an economic venture. Banks should fix date of completion (DOC) and Date of Commencement of Commercial Operations (DCCO) for all project loans at the time of sanction of the loan / financial closure.

- For all projects financed by the FIs/banks after 28th May, 2002, the DOC and the DCCO of the project should be clearly spelt out at the time of financial closure of the project. (para 4.2.15)
Project Loans - Types

Project Loans of Two Types:
Infrastructure / Non Infrastructure

- Project Loan: A Term Loan extended for the purpose of setting up of an economic venture.

- A loan for an infrastructure / Non Infrastructure project will be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue), unless it is restructured and eligible for Standard classification.
Project Loans – Infrastructure Sector

- Classify as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue), unless restructured and eligible to be classified as standard. (4.2.15.2 & 4.2.15.3)

- Classify as NPA if its fails to commence commercial operations within two years from the original DCCO, even if regular as per record of recovery, unless restructured and eligible to be classified a standard.
## Project Loan – Asset Classification

<table>
<thead>
<tr>
<th></th>
<th>Infrastructure</th>
<th>Non Infrastructure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classified as NPA if it fails to commence commercial operations within</td>
<td>Two (2) years from the original DCCO, even if regular as per record of recovery.</td>
<td>One (1) years from the original DCCO, even if regular as per record of recovery.</td>
</tr>
<tr>
<td>Standard account Restructured any time during the period up to</td>
<td>Two (2) years from the original DCCO, it can be retained as standard.</td>
<td>Two (2) years from the original DCCO, it can be retained as standard.</td>
</tr>
<tr>
<td>Fresh DCCO is fixed 1. In cases involving court cases</td>
<td>Upto another Two (2) years (beyond extended period of 2 years) total 4 years</td>
<td>-</td>
</tr>
<tr>
<td>2. In cases involving other reasons beyond control of promoters</td>
<td>Upto another One (1) years (beyond extended period of 2 years) total 3 years</td>
<td>-</td>
</tr>
</tbody>
</table>
## Project under Implementation

<table>
<thead>
<tr>
<th></th>
<th>Infrastructure</th>
<th>Non Infrastructure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>This is subject to adherence to provisions regarding restructuring.</td>
<td></td>
</tr>
<tr>
<td>Application to be</td>
<td>Two (2) years from the original DCCO, when account is standard as per</td>
<td>One (1) years from the original DCCO, when account is standard as per record of recovery.</td>
</tr>
<tr>
<td>received for</td>
<td>record of recovery.</td>
<td></td>
</tr>
<tr>
<td>restructuring before</td>
<td></td>
<td></td>
</tr>
<tr>
<td>the expiry of period</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Provisioning</td>
<td>Additional provisioning if standard.</td>
<td>Additional provisioning if standard.</td>
</tr>
<tr>
<td></td>
<td>If appointed date is extended by concession authority, this will not be</td>
<td></td>
</tr>
<tr>
<td></td>
<td>restructuring</td>
<td></td>
</tr>
</tbody>
</table>

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VACA
Project Loans – Other Issues

- Mere extension of DCCO within permitted time limits & consequential shift in repayment period by equal or shorter duration would not mean restructure, provided all other terms & conditions remain unchanged.

- Multiple revisions of DCCO within the permitted time limits will not be considered as repeated restructuring.

- CRE projects merely extension of DCCO would not be considered as restructuring, if the revised DCCO falls within a period of 1 year from original DCCO & there is no change in other terms & conditions except possible shift of repayment schedule and servicing of loan. Such CRE projects will be treated as Standard.
Write Off – NPA’s

- Banks may write off accounts at HO Level even though the advances are still outstanding at branches. (8.4)

It is necessary that provision is made as per the classification accorded to the respective accounts.

- The banks should either make full provision as per the guidelines or write off such advances & claim such tax benefits as are applicable, by evolving appropriate methodology in consultation with their auditors/tax consultants. Recoveries made in such accounts should be offered for tax purposes as per the rules. (8.3)
Part B – Guidelines for Restructuring

Four Broad Categories:
Advances extended to Industrial Units
Advances extended to IU under CDR
Advances to SME
All other advances

CDR mechanism available only to borrowers engaged in industrial activities.

Eligibility
Any account classified under standard, sub standard and doubtful categories.
Eligibility Criteria for Restructuring

- Restructuring cannot be done retrospectively.
- While the restructuring proposal is under consideration, usual asset classification norms would continue to apply.
- Asset Classification status on date of approval of restructuring relevant to decide the asset classification status after such restructuring
- Restructuring should be subject to customer Application / consent for terms and conditions.
- Financial viability should be established and there is reasonable certainty of repayment.
- Borrowers indulging in frauds & malfeasance are ineligible.
- BIFR cases are not eligible without their express approval.
Restructuring of Advances

- Standard Asset would get reclassified as sub standard immediately.

- Account which is already NPA would continue to have the same classification.

- Additional finance would be treated as standard up to a period of one year.

- All restructured accounts, classified as NPA upon restructuring would be eligible for upgradation after observation of satisfactory performance during the specified period. (Annex 5 (viii) – during 1year it should not be out of order for more than 90 days and no overdue at the end)
Restructuring – Provisioning Norms

- Provision on restructured advance as per extant provisioning norms.
- Standard restructured advances will attract higher provision for first 2 years.
- NPA restructured advances when upgraded to standard attract higher provision in first year.
- Diminution in fair value is an economic loss to bank & needs additional provision on each BS date.
- For advances below Rs.1 crore, 5% of total exposure can be provided notionally for such diminution in faire value of advance.
Restructuring of Advances

Special Regulatory Treatment for asset classification.

- Not available to Consumer & Personnel Advances, Advances classified as Capital Market Exposure, Advances classified as Commercial Real Estate Exposure.

Incentive for quick implementation of package (up to 31.03.2015 as per 20.2.3)

The asset classification status may be restored if the approved package is implemented:

- Within in 120 days from the date of approval under CDR mechanism
- Within 120 days from the date of receipt of application by Bank in other cases.
Restructuring of Advances

Asset classification benefits
Standard advance will not be downgraded upon restructuring if following conditions are satisfied.

- Dues of the bank are fully secured by tangible security (except SSI borrower with outstanding upto Rs.25 lacs & infrastructure projects)
- Unit becomes viable in 8 years, if it is engaged in infrastructure activities and in 5 years in case of other units.
- Repayment period including moratorium does not exceed 15 years for infrastructure & 10 years for other projects (10 years ceiling won’t apply to restructured Home Loans).
Part C – Early Recognition of Financial Distress

Joint Lenders Forum (JLF) and Corrective Action Plan (CAP)

- Applicable for Consortium and Multiple Banking Advances read with Restructuring guidelines.

- Before an account becomes NPA, banks have to identify incipient stress in the account by creating three (3) Categories under Special Mention Accounts
### Early Recognition of Financial Distress

<table>
<thead>
<tr>
<th>SMA Subcategories</th>
<th>Basis for classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMA – 0</td>
<td>Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress (Please see Appendix to Part C)</td>
</tr>
<tr>
<td>SMA – 1</td>
<td>Principal or interest payment overdue between 31-60 days</td>
</tr>
<tr>
<td>SMA – 2</td>
<td>Principal or interest payment overdue between 61-90 days</td>
</tr>
</tbody>
</table>

Early Recognition of Financial Distress

RBI to set up Central Repository of Information on Large Credits (CRILC)

- Banks to report credit information of borrowers.
- Banks are advised that as soon as an account is reported by any of the lenders to CRILC as SMA-2, they should mandatorily form a committee to be called JLF if the aggregate exposure (AE) of lenders in that account is Rs. 1000 million & above.
- Lenders also have the option of forming a JLF even when the AE in an account is less than Rs.1000 million &/or when the account is reported as SMA-0 or SMA-1.
Early Recognition of Financial Distress

The JLF may explore various options to resolve the stress in the account to arrive at an early and feasible solution to preserve the economic value of the underlying assets as well as the lenders’ loans. Banks to report credit information of borrowers.

Options under Corrective Action Plan (CAP)
- Rectification
- Restructuring
- Recovery
Early Recognition of Financial Distress

Accelerated Provisioning Required

- In cases where banks fail to report SMA status of the accounts to CRILC or resort to methods with the intent to conceal the actual status of the accounts or evergreen the account, banks will be subjected to accelerated provisioning for these accounts and/or other supervisory actions as deemed appropriate by RBI.

These guidelines have become effective from April 1, 2014.
# Early Recognition of Financial Distress

<table>
<thead>
<tr>
<th>Asset Classification</th>
<th>Period as NPA</th>
<th>Current provisioning (%)</th>
<th>Revised Accelerated provisioning (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub – Standard</td>
<td>Up to 6 Months</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Secured</td>
<td>6 M to 1 Year</td>
<td></td>
<td>15</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>25</td>
</tr>
<tr>
<td>Sub – Standard</td>
<td>Up to 6 Months</td>
<td>25 (NI) /20 (I)</td>
<td>25 (NI)/20 (I)</td>
</tr>
<tr>
<td>Unsecured</td>
<td>6 M to 1 Year</td>
<td></td>
<td>25</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>40</td>
</tr>
<tr>
<td>Doubtful I</td>
<td>2\textsuperscript{nd} Year</td>
<td>25 (S)/100 (U)</td>
<td>40 (S)/100 (U)</td>
</tr>
<tr>
<td>Doubtful II</td>
<td>3\textsuperscript{rd} &amp; 4\textsuperscript{th} Year</td>
<td>40 (S)/100 (U)</td>
<td>100 (S &amp; U)</td>
</tr>
<tr>
<td>Doubtful III</td>
<td>5\textsuperscript{th} Year onwards</td>
<td>100 (S &amp; U)</td>
<td>100 (S &amp; U)</td>
</tr>
</tbody>
</table>
THANK YOU