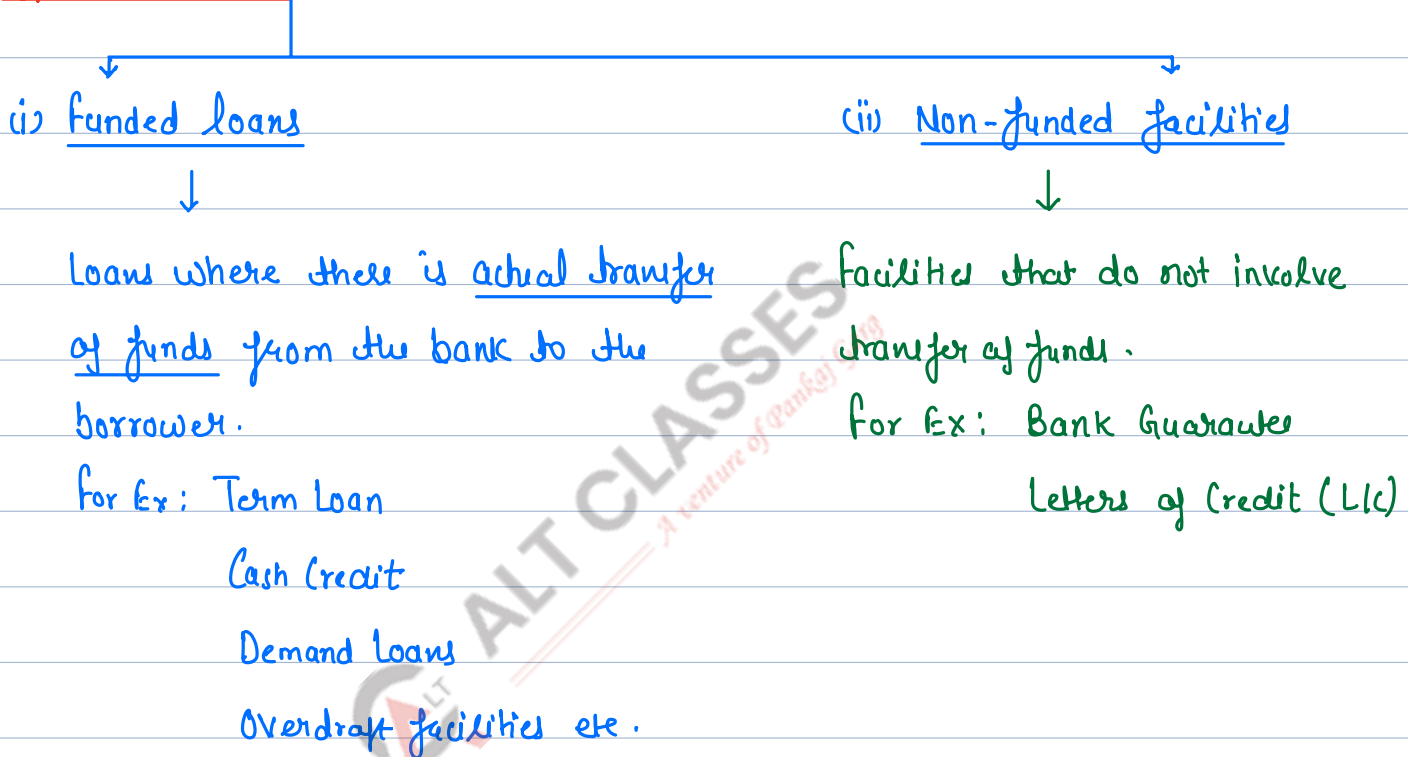


Chapter - 10 "Audit of Banks"

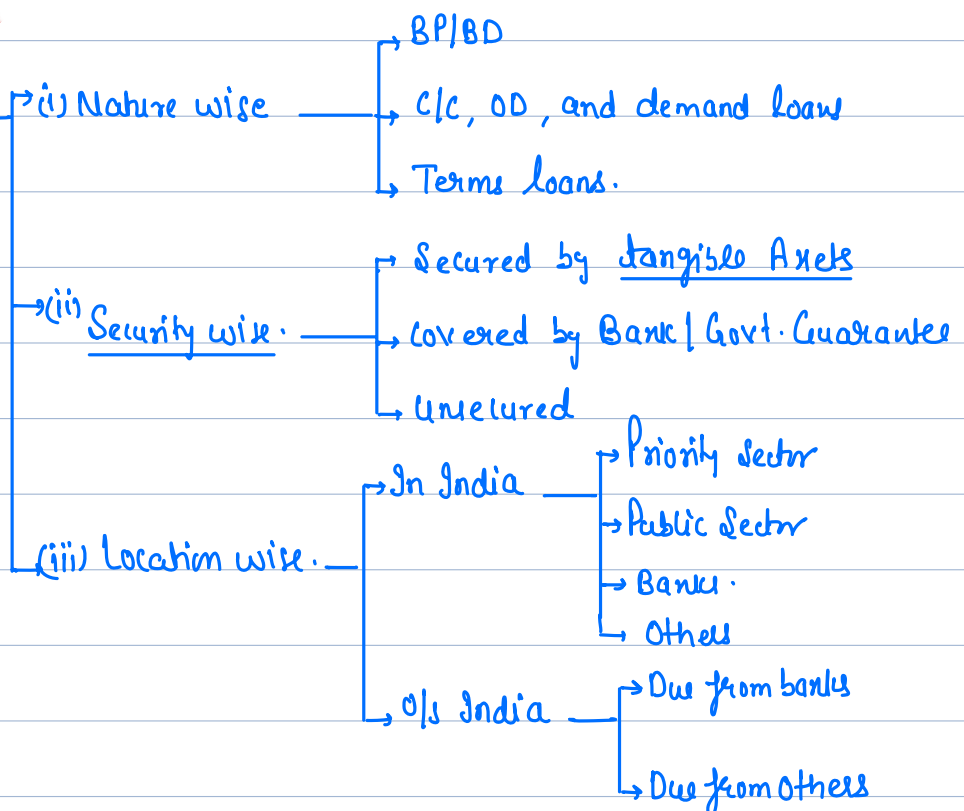
- Topics Covered:
- I. Banking Operations
 - II. Auditing Framework

III. Types and Classification of Advances:

(A) Types of Advances:

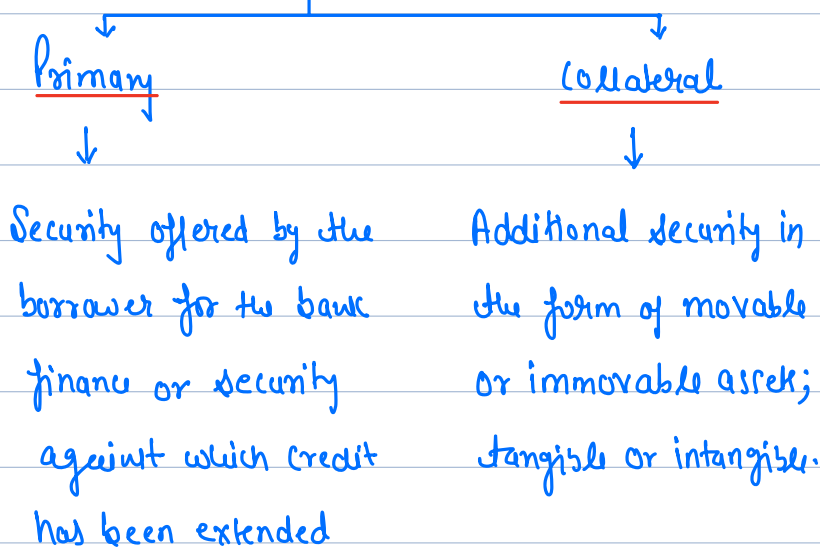


(B) Disclosure Requirements:



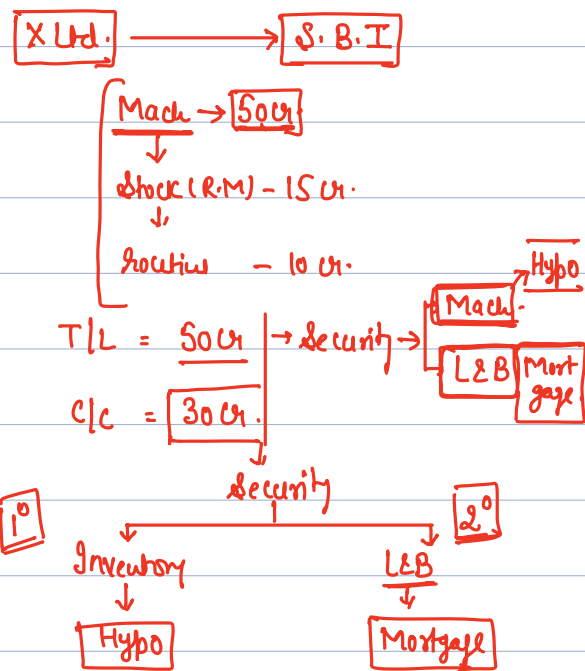
(C) Creation of Security:

(i) Types of Security:



(ii) Examples of Securities:

- Inventories / Trade receivable
- Immovable Properties like land and buildings
- Security Market Instruments like shares, debⁿ.
- Personal security of Guarantor
- Movable assets like Gold, bullion, Machinery
- Plantations (in case of Ag. Advances)
- Life Insurance Policies, fixed deposits, NSCs, KVPs etc.



→ Hypothecation - Charge equitable

→ Mortgage - [Equitable → deposit of T/D
Regd. → S.R.]

→ Pledge → Physical / Tangible asset → H/o.

→ Lien → Creation of charge - F.D. (Gold) UBL

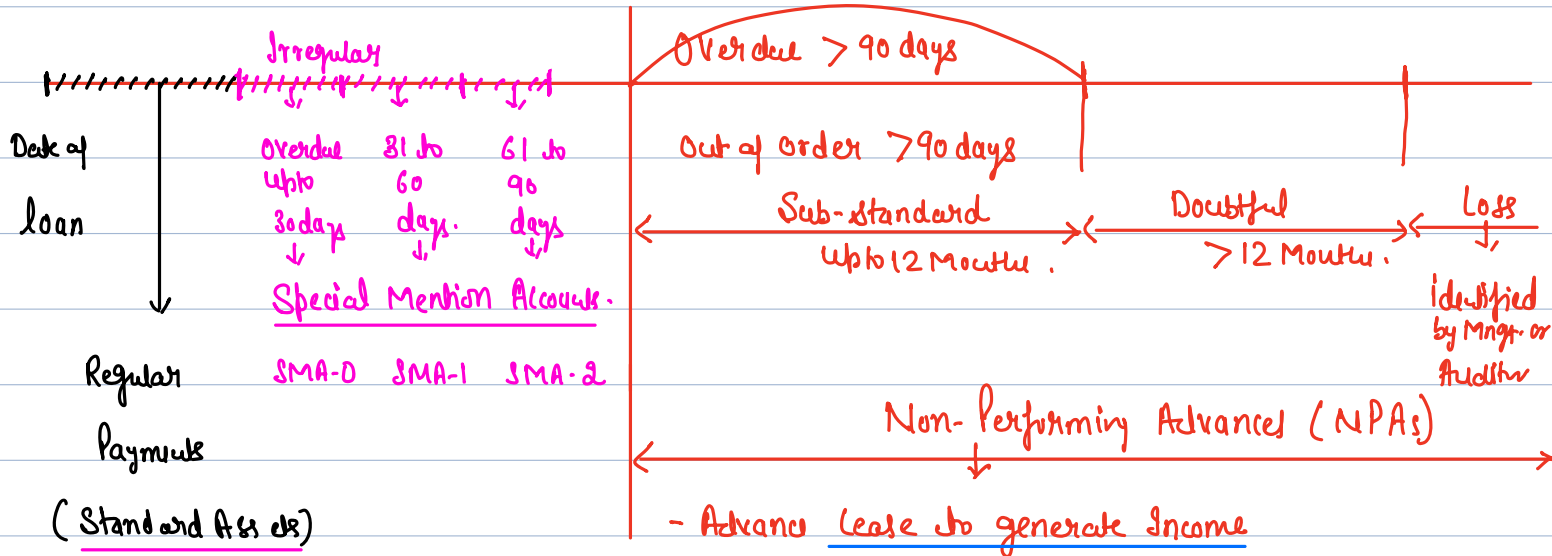
→ Assignment - Transfer of rights ← E
F

→ Set-off - Creditr / dr balancer
↓
(Credit Bal. nu) LIC Policies

(iii) Modes of Creation of Securities:

- Mortgage: By deposit of title deeds (Equitable); Signing mortgage deed (Registered)
- Pledge: Physical transfer of possession of goods (e.g. Movable properties like Gold)
- Hypothecation: Creation of equitable charge in case of movable assets like stock
- Lien: Creation of legal charge with consent of other (e.g. Lien over FDs)
- Assignment: Transfer of existing and future rights to others (e.g. LIC Policies)
- Set-off: Statutory right of creditor to adjust debit balance in debtor account against credit balance in another account of debtor.

(D) Prudential Norms: (IRAC Norms)



- Principal / Interest Overdue > 90 days - term loan
- A/c - out of order > 90 days - C/C or O/D

- O/S Bal > sanctioned limit or D.P.
- No credit in A/c
or
Credit < Interest debited.

- Bills remain Overdue > 90 days - BP/BD

Non-performing Advances: An advance shall be classified as NPA if:

- (a) It ceases to generate income for a bank;
- (b) Interest and/or Principal remain overdue > 90 days in respect of term loan
 - * Amount due not paid on due date fixed by the bank.
- (c) A/c remain out of order > 90 days in respect of C/C/O.D.
 - * O/S Balance > sanctioned limit or D.P.; or
 - No credit continuously for 90 days; or
 - Credits are not enough to cover the interest debited.
- (d) Bills remain Overdue > 90 days in case of Bills purchased or discounted.

Classification of NPAs:

(A) Sub-standard



Assets remained NPA
for a period \leq 12 Months.

(B) Doubtful



Assets remained in
NPA for a period
 $>$ 12 Months.

(C) Loss Assets.



Assets in respect of which
loss has been identified by
the bank or internal auditor
or RBI Inspection team, but
the amount has not been
written off fully.

Provisioning Requirements:

(A) Standard Assets:

0.40%

(B) Sub-standard Assets:

15%

(C) Doubtful assets:

(i) Unsecured portion = 100%

(ii) Secured " = 25% - 100% depending upon period.

Upto 1 year = 25%

$>$ 1 year - 3 years = 40%

$>$ 3 years = 100%

(D) Loss Assets:

100%

Special Mention Accounts: - Those accounts which are resulting signs of stress leading to the possibility that borrower may default in debt obligations.

- Such classification is significant as early recognition of such accounts enables banks to take remedial actions timely.

- SMA 0 - Account showing stress signal

SMA 1 - Overdue between 31 to 60 days

SMA 2 - " " 61 to 90 days.

(E) NPA Classification in special cases:

(i) Asset Classification - Borrower wise:

All the facilities granted by the bank to the borrower shall be treated as NPA and not the particular facility.

Ex. XYZ Ltd. (Borrower) - Loan 1 = ₹ 10.00 lakh
Same bank. Loan 2 = ₹ 15.00 lakh
" 3 = ₹ 25.00 lakh
Loan-1 Irregular > 90 days; Loan 2 & 3 - Regular
which loan accounts to be classified as NPA - 1, 2, 3

(ii) Account regularised near B/s date:

An account shall be classified as NPA, if it appears that it has inherent weaknesses and few credits near B/s date tries to make it regular.

For this purpose, auditor should check sample transactions immediate before and after the B/s date to get knowledge of objective behind such transactions.

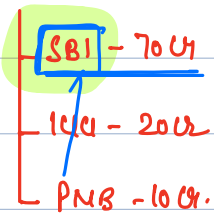
(iii) Govt. Guaranteed Advances:

- Credit facilities backed by C.G. Guarantee, though overdue/out of order, will be classified as NPA only when C.G. repudiates its guarantee when invoked.
- Credit facilities backed by S.G. Guarantee, should be classified as NPA in normal way.
- This exception in case of C.G. Guarantee is only for Asset classification and Provisioning and not for the purposes of Income recognition.
Interest on such advances to be taken into account only on realisation.

<u>Irregular Account</u>	Guaranteed by	(A)	C.G.	(B)	S.G.
(i)	Asset Classification	Performing		Non-performing	
(ii)	Provisioning	"		"	
(iii)	Income Recognition	Non-performing		"	

(iv) Advances under Consortium:

XYZ Ltd - 100 Cr. Project loan



- Advancing loans to a borrower by ≥ 2 Banks jointly.
- Bank with higher share will lead the Consortium.
- Consortium advances should be classified based on record of recovery of respective individual bank and other aspects having a bearing on the recoverability of advances.

Note: Where the remittances are pooled by one bank and that bank is not parting with share of other member banks, account shall be treated as not serviced in the books of other member banks and therefore to be classified as NPA. Hence, banks participating in consortium need to arrange to get their share from lead bank, to ensure proper asset classification.

(v) Erosion In Value of Securities:

Erosion $> 50\%$ of value assessed by Bank or accepted by RBI Inspection team at the time of last inspection

Such erosion to be considered as "Significant"

Asset shall be directly classified as "Doubtful"

Realisable value of security $< 10\%$ of Outstanding in borrower account

Existence of security should be "Ignored"

Asset shall be classified as "Loss Asset" and need to be written off or fully provided for.

Example: Loan Amount = ₹ 2 Cr.

Value of security = ₹ 3 Cr.

Situation - I : Value of security reduces to ₹ 1.30 Cr. - Doubtful Asset

Situation - II : " " " " " ₹ 0.15 Cr. - Loss Asset

(vi) Agricultural loans: Agricultural advances shall be classified as NPA, if Interest and/or instalment of Principal is Overdue for

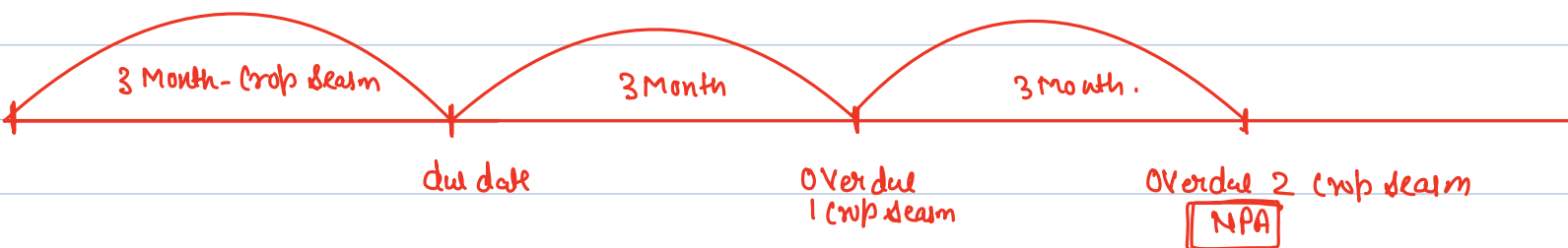
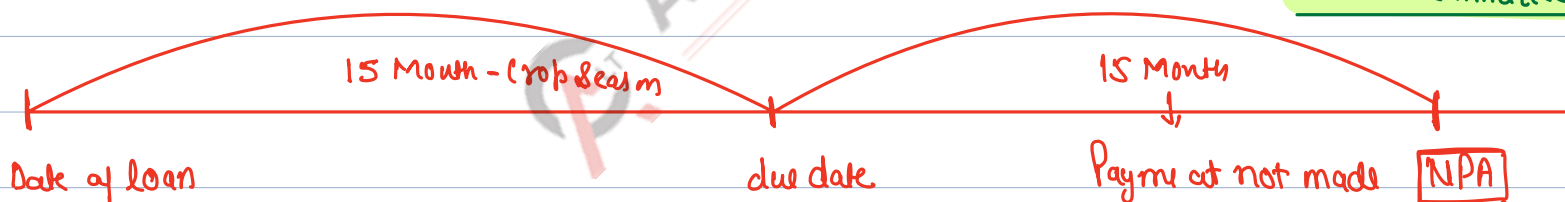
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2 Crop seasons

↓
If loans granted for short duration crops
(Crops other than long duration)

↓
1 Crop season

↓
If loan granted for long duration crop -
(Crops with crop seasons # longer than one year)

as determined by State Level Bankers Committee.



(vii) Agricultural advances affected by Natural calamities:

If due to natural calamities, short term agricultural loans converted into term loans or repayment period is rescheduled or fresh short-term loans are sanctioned, term loan as well as fresh short term loan are considered as current due and not classified as NPA.