BANK AUDIT MANUAL

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FOCUS POINTS

- Break Even Date for NPA is 01.01.2017 for the year 2016-2017 (repayment date extended for 90 days for the advances referred to vide RBI Circular no. DBR. No. BP.BC. 49/21.01.048 / 2016-17 dated 28.12.2016)

- Once an account has been classified as NPA, all the facilities granted to the borrower will be treated as NPA except in respect of Primary Agricultural Credit Societies (PACS)/Farmers Service Societies (FSS).

- Overdue period starts immediately on expiry of due date, concept of 'past due' has already been dispensed with in past years.

- Stock statements older than 3 months should not be considered

- Interest on advances (accrued and outstanding) should be calculated as on 31st March (few banks charges interest on advances few days prior to 31st March which should not be considered)

- Long outstanding entries (unexplainable and where there is no movement at all) in suspense account should be suggested for provisioning.

- 'NIL' MOC Certificate should be issued even if there is no MOC

- MOC should also be countersigned by Branch Manager (views of the BM if any has to be attached on a separate sheet duly signed by him)

- Submit all the REPORTS including TAX AUDIT REPORTS & LFAR immediately on completion of Audit and before leaving the branch

- Make a columnar list of documents to be submitted to branch/regional/zonal/other office before commencement of Audit. (it is advisable to get all documents in your custody duly signed by the Branch Manger at the beginning of Audit)

- Must get CERTIFICATE OF ATTENDENCE signed by Branch Manager in duplicate before leaving the branch

- Availability of security or net worth of borrower/guarantor should not be considered for the purpose of NPA recognition – it should always be based on recovery

- 100% provision is required for assets which has become doubtful for more than 3 years i.e. NPA date on or before 31.03.2013.

- To specifically report simultaneously to the CEO of the bank (and Audit Committee or Board as per the requirement of the Companies Act, 2013) and regional office of the Dept of Banking Supervision RBI where the HO of the bank is situated, any matter susceptible to be fraud or fraudulent activity or any foul play in any transactions. Any deliberate failure on part of the Auditors should render himself liable for action. If amount of fraud involve Rs 1 Crore or more – central office of the Dept of Banking Supervision, RBI, Mumbai (and Central Govt in Form ADT-4 as per the requirements of section 143(12) of the Companies Act, 2013 and Rules thereon) to be reported immediately.

Documentation

Following certificates should be obtained from management

- Cash Retention Limit duly certified by the Branch Manager
- A photo copy each of the confirmation certificates for Balances with RBI, SBI and other banks
- A copy of the reconciliation statement in respect of differences in such balances with RBI, SBI and other banks
- List of overdue or matured investments at the end of the year duly confirmed by the Branch Manager;
- A certificate stating that the Branch did not hold any investments on behalf of the Head Office (if there are no such investments held by the Branch)
- List of large advances i.e. those in respect of which the outstanding amount is in excess of 5% of the aggregate advances of the Branch or Rs.2.00 crores whichever is less duly certified by the Branch Manager
- A copy of the letter from Head Office regarding Sanction limit of the Branch Manager;
- List of cases where the Branch has not obtained stock/book debts statements at the end of the year;
- List of cases where insurance copies are yet to be received at the end of the year
- A copy of the Head office instructions for identification of NPAs and classification of advances
- List of major items pending for reconciliation under Inter-Branch Accounts;
- List of all fraud cases reported to RBI as fraud up to March 31st

Non applicability of CARO, 2016

- Statement of companies (Auditor's Report) order 2016 is not applicable to banking company as defined in clause (c) of section 5 of Banking regulation Act, 1949 **Banking company** means any company, which transacts the business of banking in India;
- Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking.

Auditors Report & Memorandum of Changes

- The Auditors Report should be a self- contained document and should not contain reference of any point made in any other report including the LFAR;
- Include Audit Qualifications in the Auditors Report and not in the LFAR;
- Quantify the Audit Qualifications for a better appreciation of the point made to the reader;
- For suggesting any changes in the financial statements of the branch, quantify the same in the Memorandum of Changes (MOC) and make it a subject matter of qualification and annexe it to the Auditors Report.
- Summary of Memorandum of Changes (MOC) is required to be given in Auditors Report as per revised format as issued by ICAI.

Long Form Audit Report (LFAR)

- Study the LFAR Questionnaire thoroughly;
- Plan the LFAR work along with the statutory audit right from day one;
- The LFAR questionnaire is a useful tool for planning the statutory audit of a bank's branch;
- Complete and submit the Auditors Audit Report as well as the LFAR simultaneously;
- Be specific while replying the LFAR;
- Give instances of shortcomings/weaknesses existing in the respective areas of the branch functioning in the LFAR;
- Advances check-list for giving list of accounts with adverse features;
- The LFAR should be sufficiently detailed and quantified so that they can be expeditiously consolidated by the bank.

Important Audit Checks

1. General

- Send a letter of your requirements to the branch before commencing the audit.
- Meet the manager and understand the profile of the branch.
- Obtain the latest status of cases involving fraud, vigilance and matters under investigation having effect on the accounts and its reporting requirement.
- Obtain Written Representation
- Obtain a certificate from Branch-in-charge on specific issues.
- Obtain the bank's balance sheet and profit and loss account.
- Compare the current year figures with the previous year figures and identify heads with unusual variances
- Review the

 previous year's audit report/ LFAR,

 current period's Internal Audit Report/ Concurrent Audit Report

 Revenue Audit Report

 IT System Audit Report

 RBI Inspection Report

 compliance of the branch to all of the above and

 any other special review report .

- Understand the system in CBS at Branch

a) verify controls

b) start of day and end of day report

c) verify exceptional report

d) understand the editable & uneditable fields at Branch,

e) creation & entries in Masters,

f) Various short-cut keys for checking the accounts

g) system of downgrading & upgrading of accounts,

h) interest calculations,

i) Generation of reports relating to advances classification and Capital Adequacy calculation, etc.

2. General Ledger Review

- Review one month Ledger with that of the previous month
- Identify cases of unusual variance
- Deep Dive into the unusual variance cases & report on unusual transactions if they are not adequately supported
- The months showing unusual variance can be selected for sample
- Use V Look up for GL Review. The GL Number for every item can be the parameter to check.
- This will help to study the business of the client during the period of audit

3. Cash, bank balances, stationery, unused DDs and valuable securities

- Physically verify the cash balance/ATM cash balance as on March 31, 2017 or reconcile the cash balance from the date of verification to March 31, 2017.
- Confirm and reconcile the balances with banks as on March 31, 2017.
- Physically verify
  - ➢ stationery,
  - ➢ unused DD etc
  - ➢ and valuable securities
- Note down
  - Shortage of cash appearing in Trial Balance
  - loss/theft DDs reported to respected authority

4. **Investments**

- Physically verify the investments held by the branch on behalf of Head Office and issue certificate of physical verification of investments to bank's Investments Department.
- Check receipt of interest and its subsequent credit to be given to Head Office.

5. Fixed Assets

- Check additions/deduction/transfers of fixed assets, supported by proper bills/invoices and confirmation of date put to use.
- Compliance of Accounting Standard (AS)-6, AS10,AS 26 and AS28 related to fixed assets
- Check Depreciation on additions, deduction during the year and on existing assets as per the policy of the bank.
- Verification of Fixed Assets Schedule for furniture & fixtures and other assets and reconciliation with figures appearing in the Balance Sheet and FA management software used by the bank (if any).
- Check inter-branch transfer memos relating to fixed assets and whether they have been correctly classified in the accounts and depreciation accounting thereof.

6. **Inter Branch Reconciliation (IBR)**

- Understand the IBR system.
- The large volume of Inter Branch Transactions and the large number of unreconciled entries in the banking system makes the area fraud-prone.
- Check up head office inward communication to branch to ascertain date up to which statements relating to inter-branch reconciliation have been sent.

Check& Report

- Reversal of any large/old/unexplained entries, which had remained outstanding in IBR.
- Items of revenue nature, cash-in-transit (for example, cash meant for deposit into currency chest) which remains pending for more than a reasonable period.
- Double responses to the entries in the accounts.

Test check accuracy and correctness

The auditor should duly consider the extent of non-reconciliation in forming his opinion on the financial statements. Where the amounts involved are material, the auditor should suitably qualify his audit report. Attention is drawn on the paper on "Certain Significant Aspect of Statutory Audit of banks" issued by the Council of ICAI in March 1994, published in the C. A. journal.

Further, vide its circular No. BP.BC.22/21.04.018/99 dated March 24, 1999, the Reserve Bank of India (RBI) advised the banks to maintain category-wise (head-wise) accounts for various types of transactions put through inter-branch accounts so that the netting can be done category-wise. **Further, RBI advised banks to make 100 percent provision (category-wise) for net debit position in their inter-branch accounts arising out of the unreconciled entries, both debit and credit, outstanding for more than two years.**

7. **Suspense accounts, sundry deposits, etc**

Suspense accounts are adjustment accounts in which certain debit transactions are temporarily posted whose authorisation is pending for approval.

Sundry Deposit accounts are adjustment accounts in which certain credit transactions are temporarily posted whose authorisation is pending for approval.

As and when the transactions are duly authorised by the concerned officials they are posted to the respective accounts and the Suspense account/Sundry Deposit account is credited/debited respectively.

- Ask for and analyse their year-wise break-up.
- Check the nature of entries parked in such Accounts.
- Check any movement in such old balances and whether the same is genuine and has been properly authorised by the competent authority.
- Check for any revenue items lying in such accounts and whether proper treatment has been given for the same.

8. **Deposits**

- Verify transactions during the year relating to:
  - ✓ New Accounts opened;
  - ✓ Accounts closed;
  - ✓ Dormant Accounts;
  - ✓ Interest calculations;
  - ✓ Scrutiny of account statements for unusual/large/overdraft transactions; Overdue Term deposits & its policies and practices of renewal;

- ✓ Accrual of interest; RBI Norms for Non-resident deposits & its operations - giving due importance to opening and operation of accounts like NRE, NRNR, FCNR, RFC, etc.; interest on various types of deposits;
- ✓ Tax Deducted at Source.

- Large deposits placed at the end of the year (probable window dressing).
- Examine unusual trend in account opening or account closing, dormant accounts that have suddenly been reactivated by heavy cash withdrawals or deposits, overdrawings, etc
- Check the KYC Norms
- Verification of Anti Money Laundering guidelines and Compliance with KYC norms on test check basis
- Check the overdue deposits, matured time deposits, cash certificates and certificates of deposits are shown in Demand Deposits.
- Interest accrued but not due should not be included in deposits but, should be shown under other liability.
- Check TDS compliance on the interest paid and on test check basis checking of Form 15G & 15H and confirm whether those forms are submitted with respective Income Tax Authority
- Movement of Deposit vis-à-vis movement in interest expense.

9. Verification of Advances (refer loan verification referencer for detailed points)

- Review monitoring reports (irregularity reports) sent by the branch to the controlling authorities in respect of irregular advances.
- Review appraisal system, Files of large as well as critical borrowers, sanctions, disbursement, renewals, documentation, systems, securities, etc.
- Review on test check basis operations in the Advances Accounts.
- o Compliance of sanction terms and conditions in the case of new advances.
- Whether the borrower is regular in submission of stock statements, book debt statements, insurance policies, balance sheets, half yearly results, etc. and whether penal interest is charged in case of default/delay in submission of such data.
- Charge of interest and recovery for each quarter or as applicable to be verified.
- Review the monitoring system, i.e. monitoring end use of funds, analytical system prevalent for the advances, cash flow monitoring, branch follow-up, consortium meetings, inspection reports, stock audit reports, market intelligence (industry analysis), securities updation, etc.

- Check classification of advances, income recognition and provisioning as per RBI Norms/Circulars.
- Examine interest trends as compared to average annual advances (monthly average figures).
- Scrutinize the final advances statements with regard to assets classification, security value, documentation, drawing power, outstandings, provisions, etc.
- Check whether Non-Fund based (Letter of Credits/Bank Guarantees) exposure of the borrowers is within the sanctioned limits.
  - Compare projected financial figures given at the time of project appraisal with actual figures from audited financial statements for relevant period and ascertain reasons for large variance.

10. Balance Sheet Review

- Scrutiny of Balance Sheet, particularly –

i. that all the balances are shown in proper heads and broadly compare previous year figure to understand material variance

ii. check in case of advances that:

a. interest accrued but not due on loans is not included in advances.

b. credit balances in O/D, C/C inoperative current accounts should not be netted off with advances and the same should be shown under demand deposits.

c. Verification of Anti Money Laundering guidelines and Compliance with KYC norms on test check basis

- Checking,

i. Liability under Bank Guarantee/ L/C and effects of expired BGs.

ii. Reconciliation of General Ledger and Subsidiary Ledger."

11. Profit & Loss Account

Income/Expenditure: Verify:

- Short debit of interest/commission on advances;
- Excess credit of interest on deposits;
- In case the discrepancies are existing in large number of cases, the auditor should consider the impact of the same on the accounts;
- Determine whether the discrepancies noticed are intentional or by error;

- Check whether the recurrence of such discrepancies are general or in respect of some specific clients;
- Proper authority in sanction and disbursement of expenses as also the correctness of the accounting treatment given as to revenue/capital/deferred expenses.
- Check accrual of income/expenditure especially for the last month of the financial year.

Divergent Trends:

- Divergent trends in income/expenditure of the current year may be analysed with the figures of the previous year.
    - Wherever a divergent trend is observed, obtain an explanation along with supporting evidences like monthly average figures, composition of the income/expenditure, etc.

12. System

- Review off-site backup and daily backup procedure of Bank
- Exception reports viz. password errors, limit verification, irregular advances
- Custodian of pass word and unauthorized access of password, computer room
- Periodical report to controlling authority on functioning of computerised system and compliance of controlling authority instructions in this respect

LOAN VERIFICATION REFRENCER

Item REMARK

1 Credit Appraisal

1.1 Loan application not on record at branch.

1.2 The appraisal form was not filled up correctly and thereby the appraisal and assessment was not done properly.

1.3 Loan application is not in the form prescribed by Head Office.

1.4 The bank did not receive certain necessary documents and Annexures required with the application form.

1.5 Basic documents such as Memorandum & Articles of Association, Partnership deed, etc., which are a pre-requisite to determine the status of the borrower, not obtained.

1.6 Certain adverse features of the borrower not incorporated in the appraisal note forwarded to the management.

1.7 Industry/group exposure and past experience of the bank is not dealt in the appraisal note sent to the management for sanction.

1.8 The level for inventory/book-debts/creditors for finding out the working capital is not properly assessed.

1.9 Techno-economic feasibility report, which is required to know the technical aspects of the borrower's business, is not obtained from Technical Cell.

1.10 Credit report on principal borrowers and confidential report from their banks are not insisted from the borrowers.

1.11 The opinion reports of the associate and/or sister concerns of the borrower are not scrutinised.

1.12 The opinion reports of the associate and/or sister concerns of the borrower are not called for.

1.13 The opinion reports of the associate and/or sister concerns of the borrower are not updated.

1.14 The opinion reports of the associate and/or sister concerns of the borrower are not satisfactory.

1.15 The opinion reports of the associate and/or sister concerns of the borrower are not scrutinised/called for/not updated/not satisfactory.

1.16 The procedure/instructions of head office regarding preparation of proposals for grant not followed.

1.17 The procedure/instructions of head office regarding preparation of proposals for renewal of advances not followed.

1.18 The procedure/instructions of head office regarding preparation of proposals for enhancement of limits, etc. not followed.

1.19 No exposure limits are fixed for forward contract for foreign exchange sales/purchase transactions.

2 Sanctioning and disbursement

2.1 Credit facility sanctioned beyond the delegated authority or limit of the branch

2.2 Certain proposals were sanctioned pending approval of higher authorities wherever required.

2.3 Ad hoc limits were granted for which sanctions were pending since long.

2.4 Facilities were disbursed before completion of documentation.

2.5 Facilities were disbursed without following sanction terms.

2.6 Facilities were disbursed without any sanction.

2.7 Sanction letter was missing in the branch.

2.8 Guarantor as required in the sanction letter was not obtained.

2.9 Required promoters stake not invested before disbursement of loan.

2.10 Sanctions were made without proper appraisal.

2.11 Security charge not created before disbursement as required by sanction letter/renewed letter.

2.12 Full disbursement of the facility not made.

2.13 Sanction terms were not complied with or were not recorded.

2.14 Disbursement made without proper sanction.

2.15 Term loan was disbursed by creating the cash credit or savings account of the borrower.

3 Documentation

3.1 The security against which the advance was sanction was not available/was not on record.

3.2 Mortgage for the property given as security is not created.

3.3 Mortgage for the property given as security created, was inadequate, as compared to terms of sanction.

3.4 Second charge as required, on assets is not created in favour of the bank.

3.5 Documents of second charge on assets is not on the record.

3.6 Documents pertaining to registration of charges with ROC or any other concerned authority requiring charging of assets is not obtained.

3.7 Copies evidencing lodgment of the original conveyance/sale deeds with the Sub-Registrars for registration not on record.

3.8 Authority letter/Power of Attorney to the bank to collect the original documents from the Sub-Registrar not on record.

3.9 Documents pertaining to consortium advances not yet executed/not available with bank.

3.10 Documents signed by persons not duly authorised to sign or who have signed in other capacity accepted by the bank.

3.11 Signatures of the executants were not found on all the pages of the documents

3.12 Some of the documents on record were blank, without signatures of Branch Manager, witnesses, or guarantors, etc.

3.13 Revival letters in respect of documents to be reviewed from the borrowers not received.

3.14 Guarantors have expired.

3.15 Guarantors not on record.

3.16 Guarantors not renewed.

3.17 Guarantors not assigned.

3.18 Worth of the guarantors not available.

3.19 Stamping not as per the amended Stamps Act.

3.20 Documents have become mutilated, soiled, time barred or not obtained.

3.21 Opinion report by the field officer for the borrowers not found on record.

3.23 “Nil Encumbrance Certificate/s” or “No Dues Certificate/s” or “No Lien Letters” not obtained for the mortgage/s.

3.24 Advances for vehicle loans, Registration certificate, transfer certificate, etc. not obtained.

3.25 Work completion certificate, sale deeds, share certificates in societies, etc. not on record for housing loans.

3.26 Documents are not duly attested/signed by concerned officials/not renewed.

3.27 The agreements for hypothecation do not contain details regarding goods hypothecated.

3.28 Copy of Bills/receipts, on the basis of which the amount was disbursed not found on record. For example Vehicle Loans, Plant and Machinery.

3.29 Charge on main &/or collateral securities not created in terms of sanction letter.

3.30 Original security papers/sale deed/lease deed/title deed/agreement of sale not available on record.

3.31 TDR are not discharged or renewed.

3.32 Control returns not sent to the H.O.

3.33 The branch has not taken any action for not compliance with terms of agreement

3.34 No documents executed for enhancement of limit/document not on record.

3.35 ECGC post shipment policy not obtained.

3.36 Credit facility released without execution of all necessary documents.

3.37 Common Seal not affixed on Letter of Comfort.

3.38 Confirm orders for export credit not found on record for facilities released.

4 Review/Monitoring/Supervision

4.1 The account is frequently overdrawn.

4.2 The account is continuously overdrawn.

4.3 The account is overdrawn and the branches have not taken sufficient steps to regularise the accounts promptly.

4.4 The balance outstanding have exceeded the drawing power.

4.5 Balance confirmation and acknowledgment of debt not obtained.

4.6 The stock, book-debts statements not received regularly/promptly.

4.7 The FFI/financial statements/audited statements/FFR 1 & 2/other operational data, etc., not received regularly/promptly.

4.8 The stock, book-debts statements, etc., not scrutinised and no suitable action is taken.

4.9 The FFI/financial statements/audited statements/FFR 1 & 2/other operational data, etc., not received regularly/promptly/not scrutinised and no suitable action is taken.

4.10 Non-moving stock is not deducted to arrive at the drawing power.

4.11 The age-wise break-up of debtors is not found on record. The borrowers are allowed to draw money on entire outstanding debt, which must rather be for the recent debts as prescribed for particular industries and as per margin prescribed in the sanction letter.

4.12 Wide discrepancies observed in the stock statements and stock figures in the annual audited financial statements.

4.13 No penal interest has been charged for delay in submission of various statements as per the terms of agreement depending upon the type of loan/credit availed by the borrower.

4.14 Many branches have not adhered to the prescribed frequency of physical verification of securities given against loans and advances.

4.15 Drawing power limits are not revised as per market value of shares for advances against security of shares.

4.16 End-use of funds not ensured/not known funds utilised for purpose other than for which granted.

4.17 The projections submitted by the borrower stay far beyond the actual performance. Further, no explanation for the same is taken from the borrower.

4.18 Major sale proceeds of the borrower not routed through the bank.

4.19 Audited statements of non-corporate borrowers having limit beyond Rs. 10 lakhs not received.

4.20 Renewal proposals of advances not received on time and in many cases the limits are not renewed.

4.21 Application of wrong rate of interest, processing charges, commission, other charges, etc. resulting in income leakage/excess booking of interest of the Bank.

4.22 Insurance cover for stock/property is inadequate/not on record/not renewed/not endorsed in favour of the Bank.

4.23 Inspection/physical verification of security charged, not been carried out.

4.24 Expired bills/foreign currency sight bills which are outstanding, have not been crystallised.

4.25 EBW statements on write-off of overdue export bills of ECM not found on record.

4.26 Confirmation as to genuineness of export transactions not obtained from Bank's foreign offices/correspondents/customs department.

4.27 Import credit, bill of entry evidencing import of goods not found.

4.28 Documents are not obtained for bills discounted under Letter of Credit.

4.29 Advances, which are eligible for whole turnover packing credit guarantee cover of ECGC, are not brought under its cover.

4.30 Though government guaranteed accounts are irregular since long, the issue of invocation of guarantee does not seem to have been considered.

4.31 Prescribed margins not maintained as per sanctions.

4.32 Allocated limits, full terms of sanctions, stock statements, inspection reports, margin, etc. not available at monitoring branches.

4.33 For allocated limits, inordinate delays were noticed in responding to transfer by the allocator branch.

4.34 Regular meetings not held with other consortium members to review the performance of borrowers and to assess the current state of affairs/not been held as per norms.

4.35 Individual members of the consortium are not advised about the quarterly operating limits/D. P. allocated to each one of them.

4.36 Minutes of the consortium meetings not found on record/not been held as per norms.

4.37 Inspection report from the consortium members not obtained.

4.38 The capital of the borrower has eroded/networth is negative/decreasing. Close monitoring needs to be done.

4.39 The drawing power is calculated wrongly and/or hence the borrower is allowed to enjoy excess credit than actually eligible.

4.40 Signboard of SBI is not displayed in godown, where the pledged/hypothecated stock is stored.

4.41 Limit not fully utilised by the borrower/No commitment charge is levied for the limit not fully utilised by the borrower.

4.42 Loan against TDR/STDR, which is matured, is neither renewed nor credited to loan account.

4.43 The Stock and Debtors Audit Report not found on record. No audit has been done for accounts of the borrower.

4.44 The valuation report in respect of tangible security from government approved valuer have not been obtained.

4.45 Guarantees, Opinion Reports Financial statements, IT assessment orders and etc. of the guarantor are not found on record.

4.46 Opinion report on guarantor is not obtained.

4.47 For small Government sponsored loan accounts, security cover could not be ascertained since neither any record was available at branch nor physical verification conducted by the branch.

4.48 Pre-sanctions and/or post-sanctions inspection reports were not on record.

4.49 The account was overdue for repayment and/or no credit was received from the borrower for a long time.

4.50 The borrower is absconding or deceased and legal formalities are incomplete and there is wilful default from the borrower. Either establishment was closed or security was disposed of or no action taken by the branch.

4.51 Subsidy claim process was incomplete or subsidy was yet to be received or needs follow-up.

4.52 Security disposed of/entity closed by borrower and no action taken by the branch.

4.53 Irregularity not advised to controllers.

4.54 Letter of subordination of deposits not taken.

4.55 Secured and unsecured portion not segregated properly in advance return of the branch.

4.56 Renewal of limits was done before the receipt of financial statements.

4.57 Heavy cash withdrawal for which consent of corporate Guarantor is not taken.

4.58 Proper valuation of stock not done/needs critical scrutiny.

4.59 Security obtained is inadequate/lower as compared to amount of outstanding/no collateral security.

4.60 The party was dealing with other bank also tough it was not permitted.

4.61 Sticky accounts require close follow-up by the management.

5 Bad and doubtful advances

5.1 The IRAC norms for classification of advances were not followed and the same is implemented through Memorandum of Changes by auditors during audit.

5.2 Instalments were not received from the borrowers.

5.3 Interest was not received from the borrowers.

5.4 Legal action for recovery of advances was not taken although authorised by the Board/Controlling Authority.

5.5 Discontinuance of application of interest not followed although authorised by the Board/Controlling Authority.

5.6 Government guarantees have expired and fresh guarantees not obtained/not renewed.

5.7 Terms of the BIFR scheme not complied.

5.8 Payment from government not received although guarantees were unconditional, irrevocable and payable on demand.

5.9 Delays in the settlement/repayment in respect of sanctioned proposals.

5.10 The repayment accepted in case of compromise cases inadequate *vis-à-vis* value of security.

5.11 Compromise proposals pending at various levels where local government/outside agencies are involved as guarantors.

5.12 Copy of Search Report not on record.

5.13 Decree awarded but no further steps taken for recovery.

5.14 DI&CGC claims submitted/rejected/pending data not available.

5.15 Irregular/sticky advance not reported to the controlling authority promptly.

5.16 Compromise/OTS proposal is recommended and is under negotiation since long but not finalised. Suit is filed in the court/DRT and pending to be finalised.

5.17 ECGC claim not submitted/lodged for recovery.

Non Performing Assets

INCOME RECOGNITION & ASSET CLASSIFICATON

- An asset, including a leased asset, becomes non performing when it ceases to generate income for the bank.

- Banks should, classify an account as NPA only if the **interest due and charged** during any quarter is not serviced fully within 90 days from the end of the quarter.

FACILITY WISE CHART:

Credit Facility	Basis for treating a Credit Facility as NPA	Remarks
Term loans	Interest and/or instalment of principal remain **overdue** for a period of more than 90 days. **Agricultural Advances: Position upto 29th Sept 2004**: In respect of advances granted for agricultural purposes where interest and/or instalment of principal remains overdue for a period of more than two harvest seasons but for a period not exceeding two half years, the advance should be treated as NPA. **Position wef 30th Sept 2004**: A loan granted for **short duration crops** will be treated as NPA, if the instalment of principle or interest remain overdue for two crop season and a loan granted for **long duration crops** will be treated as NPA, if the instalment of principle or interest remain overdue for one crop season **Long duration** crops means crops with crop season longer than one year **Short duration** crops are those other than long duration crops	**Overdue:** An amount due to the bank under any credit facility is 'Overdue' if it is not paid on the due date fixed by the bank. **Crop Season**: The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State.

Cash Credits and Overdrafts	The account remains continuously "**out of order**" for a period of more than 90 days; i.e., outstanding balance remains continuously in excess of the sanctioned limit/drawing power **or** there are no credits continuously for a period of 90 days as on the date of Balance Sheet **or** credits are not enough to cover the interest debited during the same period.	Banks may not classify an account merely due to existence of some deficiencies, which are of temporary nature such as non-availability of adequate drawing power, balance outstanding exceeding the limit, non-submission of stock statements and non-renewal of the limits on the due date, etc. However, generally stock statements older than three months would be deemed irregular and the working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory. Regular and ad hoc credit limits need to be reviewed/ regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.
Bills Purchased and Discounted	The bills purchased/discounted remains overdue for a period of more than 90 days.	Overdue interest should not be charged and taken to income account in respect of overdue bills unless it is realised.
Securitisation Transaction	The amount of liquidity facility remains outstanding for more than 90 days	Securitisation Transaction undertaken in terms of guidelines dated 01.02.2006.
Derivative Transactions	the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for	

	a period of 90 days from the specified due date for payment.	
Other Accounts	Any amount to be received in respect of that facility remains overdue for a period of more than 90 days.	
Government guaranteed advances	As on 31.03.2017, **State government guaranteed** advances and investment in State government guaranteed Securities would attract asset classification and provisioning norms if interest and/or principle or any other amount due to the bank remains **overdue** for more than 90 days.	The credit facilities backed by guarantee of **Central government** though overdue may be treated as NPA only when the government repudiates its guarantee when invoked. However, **income shall not be recognised** if the interest or instalment has remained overdue or the account has remained continuously out of order or the bills or any other facility has remained overdue for a period of more than 90 days.

Important Points for NPA

1. Exclusions from NPA

Undermentioned categories of advances should be excluded, as NPA norms are not normally applicable to them:

- Advances granted on or afte**r 01.01.2017;**
- All staff loans sanctioned under various staff loan schemes including housing loans;
- Project Finance (within Moratorium), Education Loan, Agriculture Loan etc. wherein moratorium period is not completed and interest/installment have not fallen due;
- Advances against Banks deposits, NSC, IVP, KVP and LIP etc provided adequate margin is available to cover the unrealized interest;
- Relief granted to the Agricultural borrowers affected by natural calamities in the form of conversion of short term loan or re-schedulement of term loan;
- Credit facilities backed by Central Govt Guaranteed (if not repudiated) ;
- Restructured accounts under Standard category;
- Credit facilities backed by State Govt. Guarantees where the default does not exceed 90 days as on 31.03.2017;
- All Standard and Regular Advances.

2. All Facilities

- Once an account has been classified as NPA, all the facilities granted by a bank to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI except in respect of advances granted under on-landing facility to Primary Agricultural Credit Societies (PACS)/Farmers Service Societies (FSS).
- In respect of additional facilities sanctioned as per package finalised by BIFR and/or term lending institutions, provision may be made after a period of one year from the date of disbursement in respect of additional facilities sanctioned under the rehabilitation package.
- The original facilities granted would however continue to be classified as sub-standard/doubtful, as the case may be.

3. Adequate Margin

- Interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
- Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

4. Reversal of Income

- Till the time the account is identified as NPA, income is recognised irrespective of whether realised or not.
- Where an account is identified as NPA during the year, unrealised income should not be recognised for the year. Banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest.
- However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.
- **This will apply to Government guaranteed accounts also.**
- In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

Leased Assets

- The *finance charge* component of finance income [as defined in 'AS 19 Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI)] on the leased asset which has accrued and was credited to income account before the asset became nonperforming, and remaining unrealised, should be reversed or provided for in the current accounting period.

5. Regularised before balance sheet date

- The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity.
- Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA.
- In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.

6. 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 non-performing and may be classified as 'standard' accounts.

7. Income recognition

- Income on NPA accounts to be recognized on realisation basis (conservative approach).
- However, banks may recognise income on accrual basis in respect of the projects under implementation, which are classified as 'standard'.

- **Funded Interest**: Income recognition in respect of the NPAs, regardless of whether these are or are not subjected to restructuring/ rescheduling/ renegotiation of terms of the loan agreement, should be done strictly on cash basis, only on realisation and not if the amount of interest overdue has been funded.
- If, however, the amount of funded interest is recognised as income, a provision for an equal amount should also be made simultaneously.
- In other words, any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.

8. Loans with moratorium for payment of interest

- In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over.
- Therefore, such amounts of interest do not become overdue and hence do not become NPA, with reference to the date of debit of interest.
- They become overdue after due date for payment of interest, if uncollected.
- In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards.
- Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates.

9. Appropriation of recovery in NPAs

- Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.
- In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest

due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

10. Credit Card Accounts

- In credit card accounts, the amount spent is billed to the card users through a monthly statement with a definite due date for repayment.
- Banks give an option to the card users to pay either the full amount or a fraction of it, i.e., minimum amount due, on the due date and roll-over the balance amount to the subsequent months' billing cycle.

- A credit card account will be treated as non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date.
- The gap between two statements should not be more than a month.
- Banks should follow this uniform method of determining over-due status for credit card accounts while reporting to credit information companies and for the purpose of levying of penal charges, viz. late payment charges, etc., if any.

11. LOC or guarantees

If the debits arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

Signs of Stress in Special Mentioned Accounts (SMAs)

SMA-0	Principal or interest payment not overdue for more than 30 days but account showing signs of incipient stress
SMA-1	Principal or interest payment overdue between 31-60 days
SMA-2	Principal or interest payment overdue between 61-90 days

llustrative list of signs of stress for categorising an account as SMA-0

1. **Delay of 90 days or more in**
(a) submission of stock statement /other stipulated operating control statements or
(b) credit monitoring or financial statements or
(c) Non-renewal of facilities based on audited financials.

2. **Actual sales / operating profits falling short of projections accepted for loan sanction by 40% or more;** or a single event of non-cooperation / prevention from conduct of stock audits by banks; or reduction of Drawing Power (DP) **by 20% or more after a stock audit;** or evidence of diversion of funds for unapproved purpose; or drop in internal risk rating by 2 or more notches in a single review.

3. **Return of 3 or more cheques (or electronic debit instructions)** issued by borrowers in 30 days on grounds of non-availability of balance/DP in the account or return of 3 or more bills / cheques discounted or sent under collection by the borrower.

4**. Devolvement of Deferred Payment Guarantee (DPG)** instalments or Letters of Credit (LCs) or invocation of Bank Guarantees (BGs) and its non-payment within 30 days.

5. **Third request for extension of time** either for creation or perfection of securities as against time specified in original sanction terms or for compliance with any other terms and conditions of sanction.

6. **Increase in frequency of overdrafts in current accounts.**

7. The borrower reporting stress in the business and financials.

8. Promoter(s) pledging/selling their shares in the borrower company due to financial stress.

Wilful Defaulters

- The provisioning in respect of existing loans/exposures of banks to companies having director/s (other than nominee directors of government/financial institutions brought on board at the time of distress), whose name/s appear more than once in the list of wilful defaulters will be 5% in cases of standard accounts; if such account is classified as NPA, it will attract accelerated provisioning.

- This is a prudential measure since the expected losses on exposures to such borrowers are likely to be higher.

- It is reiterated that no additional facilities should be granted by any bank/FI to the listed wilful defaulters, in terms of paragraph 2.5 (a) of Master Circular of RBI on Wilful Defaulters dated July 1, 2014.

- With a view to discouraging borrowers/defaulters from being unreasonable and non-cooperative with lenders in their bonafide resolution/recovery efforts, banks may classify such borrowers as non-cooperative borrowers, after giving them due notice if satisfactory clarifications are not furnished.

- Banks will be required to report classification of such borrowers to CRILC.

- Further, if any particular entity reported as non-cooperative, any fresh exposure to such a borrower will by implication entail greater risk necessitating higher provisioning.

- Banks/FIs will therefore be required to make higher provisioning as applicable to substandard assets in respect of new loans sanctioned to such borrowers as also new loans sanctioned to any other company that has on its board of directors any of the whole time directors/promoters of a non-cooperative borrowing company or any firm in which such a non-cooperative borrower is in charge of management of the affairs.

- However, for the purpose of asset classification and income recognition, the new loans would be treated as standard assets.

- This is a prudential measure since the expected losses on exposures to such non-cooperative borrowers are likely to be higher.

Asset Classification & Provisioning Norms

Quarter of NPA		ASSET CLASSIFICATION					Provision for 2016-2017
Year	Quarter	March 2013	March 2014	March 2015	March 2016	March 2017	
2013	Mar	SST	D1	D2	D2	D3	100 % of outstanding for all NPAs on or before 31.03.2013, irrespective of securities available
	Jun		SST	D1	D2	D2	40 % of Secured portion of outstanding and 100% of Unsecured portion of outstanding for NPAs from 01.04.2013 to 31.03.2015
	Sep		SST	D1	D2	D2	
	Dec		SST	D1	D2	D2	
2014	Mar		SST	D1	D2	D2	
	Jun			SST	D1	D2	
	Sep			SST	D1	D2	
	Dec			SST	D1	D2	
2015	Mar			SST	D1	D2	
	Jun				SST	D1	25 % of Secured portion of outstanding and 100% of Unsecured portion of outstanding for NPAs from 01.04.2015 to 31.03.2016
	Sep				SST	D1	
	Dec				SST	D1	
2016	Mar				SST	D1	
	Jun					SST	General – 15% of outstanding (25% of outstanding if ab-initio unsecured) for NPAs on or after 01.04.2016
	Sep					SST	
	Dec					SST	
2017	Mar					SST	

ASSET CLASSIFICATION — AT A GLANCE			
Category	**Conditions to be satisfied**	**Provision amount**	**Remarks**
Standard Assets	Does not disclose any problem and which does not carry any more than normal risks attached to business	Agriculture/SME Adv – **0.25%** Commercial Real Estate (**CRE**) - **1%** CRE-Residential Housing Sector – **0.75%** HL (teaser rate period) – **2%** Other Loan & Advances – **0.4%** **[Special rates for restructured advances as mentioned in remarks column]**	Such an asset is not a NPA. [Provision requirement in case of Restructured account from Standard – **4.25%** for 2014-15 (for two years from restructuring /moratorium date), Restructured (upgraded from NPA to Standard) – as prescribed from time to time (for one year from the date of upgradation)]
Sub-Standard Assets	Classified as NPA for a period not exceeding **Twelve** months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected. Classification of an asset should not be upgraded merely as a result of rescheduling, unless there is satisfactory compliance of the required conditions at least for one year.	• A general provision of 15% on total outstanding should be made without making any allowance for ECGC guarantee cover and **securities available**. • Additional provision of 10% on **unsecured exposure.** **Unsecured Exposure** means exposure where realizable value of security is not more than 10%, *ab-initio*, of the outstanding exposure.	In respect of accounts where there are potential threats of recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers, it will not be prudent for banks to first classify them as sub-standard and then as doubtful after expiry of 12 mths from the date the account has become sub-standard. Such accounts should be straightaway classified as doubtful or loss asset, as appropriate, irrespective of the period for which it has remained as NPA. **a.** Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be

			straightaway classified under doubtful category. **b.** If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset.
Doubtful Assets	Remained **Substandard** for a period of **Twelve** months.	100% to the extent to which the advances are not covered by the realisable value of the security to which the bank has a valid recourse and the realizable value is estimated on realistic basis. Over and above the aforesaid, depending upon the period for which the asset has remained doubtful, provision on the secured portion to be made on the following basis: 1. Up to 1 year 25% 2. 1 to 3 years 40% 3. Over 3 years: 100%	It has all the weaknesses inherent in that of a sub-standard asset with the added characteristic that the weaknesses make the collection / liquidation in full, highly questionable and improbable, on the basis of current known facts, conditions and values. **Stock Audit** required in cases involving NPAs balances above 5 Crores. **Valuation** of Security to be done every three years.
Loss Assets	Loss asset is one where loss has been identified by the bank, external or internal auditors or the RBI inspection, but the amount has not been written off (wholly/partly).	100% of the outstanding should be provided for/written off.	Such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recoverable value.

Prudential Guidelines on Restructuring of Advances by Banks

(RBI Master Circular No **RBI/2015-16/101** DBR.No.BP.BC.2/21.04.048/2015-16 dated 01.07.2015)

Link to download full text of circular

https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9908

15. Background

15.1 The guidelines issued by the Reserve Bank of India on restructuring of advances (other than those restructured under a separate set of guidelines issued by the Rural Planning and Credit Department (RPCD) of the RBI on restructuring of advances on account of natural calamities) are divided into the following four categories :

(i) Guidelines on restructuring of advances extended to industrial units.

(ii) Guidelines on restructuring of advances extended to industrial units under the Corporate Debt Restructuring (CDR) Mechanism

(iii) Guidelines on restructuring of advances extended to Small and Medium Enterprises (SME)

(iv) Guidelines on restructuring of all other advances.

In these four sets of guidelines on restructuring of advances, the differentiations were broadly made based on whether a borrower is engaged in an industrial activity or a non-industrial activity. In addition, an elaborate institutional mechanism was laid down for accounts restructured under CDR Mechanism. The major difference in the prudential regulations was in the stipulation that subject to certain conditions, the accounts of borrowers engaged in industrial activities (under CDR Mechanism, SME Debt Restructuring Mechanism and outside these mechanisms) continued to be classified in the existing asset classification category upon restructuring. This benefit of retention of asset classification on restructuring was not made available to the accounts of borrowers engaged in non-industrial activities except to SME borrowers. Another difference was that the prudential regulations covering the CDR Mechanism and restructuring of advances extended to SMEs were more detailed and comprehensive than that covering the restructuring of the rest of the advances including the advances extended to the industrial units, outside CDR Mechanism. Further, the CDR Mechanism was made available only to the borrowers engaged in industrial activities.

15.2 Since the principles underlying the restructuring of all advances were identical, it was felt that the prudential regulations needed to be aligned in all cases. Accordingly, the prudential norms across all categories of debt restructuring mechanisms, other than those restructured on account of natural calamities which will continue to be covered by the extant guidelines issued by the RPCD, were harmonised in August 2008.

15.3 In the backdrop of extraordinary rise in restructured standard advances, these prudential norms were further revised by taking into account the recommendations of the Working Group (Chairman: Shri B. Mahapatra) to review the existing prudential guidelines on restructuring of advances by banks/financial institutions. These prudential norms applicable to all restructurings including those under CDR Mechanism are included in this circular. The details of the institutional / organizational framework for CDR Mechanism and SME Debt Restructuring Mechanism are given in Annex - 4.

15.4 The CDR Mechanism (Annex - 4) will also be available to the corporates engaged in non-industrial activities, if they are otherwise eligible for restructuring as per the criteria laid down for this purpose. Further, banks are also encouraged to strengthen the co-ordination among themselves in the matter of restructuring of consortium / multiple banking accounts, which are not covered under the CDR Mechanism.

16. Key Concepts

Key concepts used in these guidelines are defined in Annex - 5.

17. General Principles and Prudential Norms for Restructured Advances

The principles and prudential norms laid down in this paragraph are applicable to all advances including the borrowers, who are eligible for special regulatory treatment for asset classification as specified in para 20.

17.1 **Eligibility criteria for restructuring of advances**

17.1.1 Banks may restructure the accounts classified under 'standard', 'sub- standard' and 'doubtful' categories.

17.1.2 Banks cannot reschedule / restructure / renegotiate borrowal accounts with retrospective effect. While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply. The process of re- classification of an asset should not stop merely because restructuring proposal is under consideration. The asset classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring / rescheduling / renegotiation. In case there is undue delay in sanctioning a restructuring package and in the meantime the asset classification status of the account undergoes deterioration, it would be a matter of supervisory concern.

17.1.3 Normally, restructuring cannot take place unless alteration / changes in the original loan agreement are made with the formal consent / application of the debtor. However, the process of restructuring can be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.

17.1.4 No account will be taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects / activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns / action. Banks should accelerate the recovery measures in respect of such accounts. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them, which may be applied on a case-by-case basis, depending on merits of each case. Illustratively, the parameters may include the Return on Capital Employed, Debt Service Coverage Ratio, Gap between the Internal Rate of Return and Cost of Funds and the amount of provision required in lieu of the diminution in the fair value of the restructured advance. As different sectors of economy have different performance indicators, it will be desirable that banks adopt these broad benchmarks with suitable modifications. Therefore, it has been decided that the viability should be determined by the banks based on the acceptable viability parameters and benchmarks for

each parameter determined by them. The benchmarks for the viability parameters adopted by the CDR Mechanism are given in the Appendix to Part – B of this Master Circular and individual banks may suitably adopt them with appropriate adjustments, if any, for specific sectors while restructuring of accounts in non-CDR cases.
17.1.5 While the borrowers indulging in frauds and malfeasance will continue to remain ineligible for restructuring, banks may review the reasons for classification of the borrowers as wilful defaulters, specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent, and satisfy itself that the borrower is in a position to rectify the wilful default. The restructuring of such cases may be done with Board's approval, while for such accounts the restructuring under the CDR Mechanism may be carried out with the approval of the Core Group only.
17.1.6 BIFR cases are not eligible for restructuring without their express approval. CDR Core Group in the case of advances restructured under CDR Mechanism, the lead bank in the case of SME Debt Restructuring Mechanism and the individual banks in other cases, may consider the proposals for restructuring in such cases, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.
17.2 **Asset classification norms**
Restructuring of advances could take place in the following stages:
(a) before commencement of commercial production / operation;
(b) after commencement of commercial production / operation but before the asset has been classified as 'sub-standard';
(c) after commencement of commercial production / operation and the asset has been classified as 'sub-standard' or 'doubtful'.
17.2.1 The accounts classified as 'standard assets' should be immediately re- classified as 'sub-standard assets' upon restructuring.
17.2.2 The non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-restructuring repayment schedule.
17.2.3 Standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the bank should be upgraded only when all the outstanding loan/facilities in the account perform satisfactorily during the 'specified period' (Annex - 5), i.e. principal and interest on all facilities in the account are serviced as per terms of payment during that period.
17.2.4 In case, however, satisfactory performance after the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.
17.2.5 Any additional finance may be treated as 'standard asset' during the specified period (Annex – 5) under the approved restructuring package. However, in the case of accounts where the pre-restructuring facilities were classified as 'sub-standard' and 'doubtful', interest income on the additional finance should be recognised only on cash basis. If the restructured asset does not qualify for upgradation at the end of the above specified period, the additional finance shall be placed in the same asset classification category as the restructured debt.

17.2.6 If a restructured asset, which is a standard asset on restructuring in terms of para 20.2, is subjected to restructuring on a subsequent occasion, it should be classified as substandard. If the restructured asset is a sub-standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion. However, such advances restructured on second or more occasion may be allowed to be upgraded to standard category after the specified period (Annex-5) in terms of the current restructuring package, subject to satisfactory performance.

17.3 **Income recognition norms**

Subject to provisions of paragraphs 17.2.5, 18.2 and 19.2, interest income in respect of restructured accounts classified as 'standard assets' will be recognized on accrual basis and that in respect of the accounts classified as 'non-performing assets' will be recognized on cash basis.

17.4 **Provisioning norms**

17.4.1 ***Provision on restructured advances***

(i) Banks will hold provision against the restructured advances as per the extant provisioning norms.

(ii) Restructured accounts classified as standard advances will attract a higher provision (as prescribed from time to time) in the first two years from the date of restructuring. In cases of moratorium on payment of interest/principal after restructuring, such advances will attract the prescribed higher provision for the period covering moratorium and two years thereafter.

(iii) Restructured accounts classified as non-performing assets, when upgraded to standard category will attract a higher provision (as prescribed from time to time) in the first year from the date of upgradation.

(iv) The above-mentioned higher provision on restructured standard advances (2.75 per cent as prescribed vide circular dated November 26, 2012) would increase to 5 per cent in respect of new restructured standard accounts (flow) with effect from June 1, 2013 and increase in a phased manner for the stock of restructured standard accounts as on May 31, 2013 as under :

- 3.50 per cent - with effect from March 31, 2014 (spread over the four quarters of 2013-14)
- 4.25 per cent - with effect from March 31, 2015 (spread over the four quarters of 2014-15)
- 5.00 per cent - - with effect from March 31, 2016 (spread over the four quarters of 2015-16)

17.4.2 ***Provision for diminution in the fair value of restructured advances***

(i) Reduction in the rate of interest and / or reschedulement of the repayment of principal amount, as part of the restructuring, will result in diminution in the fair value of the advance. Such diminution in value is an economic loss for the bank and will have impact on the bank's market value of equity. It is, therefore, necessary for banks to measure such diminution in the fair value of the advance and make provisions for it by debit to Profit & Loss Account. Such provision should be held in addition to the provisions as per existing provisioning norms as indicated in para 17.4.1 above, and in an account distinct from that for normal provisions.

For this purpose, the erosion in the fair value of the advance should be computed as the difference between the fair value of the loan before and after restructuring. Fair value of the loan before restructuring will be computed as the present value of cash flows representing the interest at the existing rate charged on the advance before restructuring and the principal, discounted at a rate equal to the bank's BPLR or base rate[5] (whichever is applicable to the borrower) as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring. Fair value of the loan after restructuring will be computed as the present value of cash flows representing the interest at the rate charged on the advance on restructuring and the principal, discounted at a rate equal to the bank's BPLR or base rate (whichever is applicable to the borrower) as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring.

The above formula moderates the swing in the diminution of present value of loans with the interest rate cycle and will have to be followed consistently by banks in future. Further, it is reiterated that the provisions required as above arise due to the action of the banks resulting in change in contractual terms of the loan upon restructuring which are in the nature of financial concessions. These provisions are distinct from the provisions which are linked to the asset classification of the account classified as NPA and reflect the impairment due to deterioration in the credit quality of the loan. Thus, the two types of the provisions are not substitute for each other.

ii) It was observed that on a few occasions, there were divergences in the calculation of diminution of fair value of accounts by banks. Illustratively, divergences could occur if banks are not appropriately factoring in the term premium on account of elongation of repayment period on restructuring. In such a case the term premium used while calculating the present value of cash flows after restructuring would be higher than the term premium used while calculating the present value of cash flows before restructuring. Further, the amount of principal converted into debt/equity instruments on restructuring would need to be held under AFS and valued as per usual valuation norms. Since these instruments are getting marked to market, the erosion in fair value gets captured on such valuation. Therefore, for the purpose of arriving at the erosion in the fair value, the NPV calculation of the portion of principal not converted into debt/equity has to be carried out separately. However, the total sacrifice involved for the bank would be NPV of the above portion plus valuation loss on account of conversion into debt/equity instruments.

Banks are therefore advised that they should correctly capture the diminution in fair value of restructured accounts as it will have a bearing not only on the provisioning required to be made by them but also on the amount of sacrifice required from the promoters (Ref. para 20.2.2.iv). Further, there should not be any effort on the part of banks to artificially reduce the net present value of cash flows by resorting to any sort of financial engineering. Banks are also advised to put in place a proper mechanism of checks and balances to ensure accurate calculation of erosion in the fair value of restructured accounts.

(iii) In the case of working capital facilities, the diminution in the fair value of the cash credit / overdraft component may be computed as indicated in para (i) above, reckoning the higher of the outstanding amount or the limit sanctioned as the principal amount and taking the tenor of the advance as one year. The term premium in the discount factor would be as applicable for one year. The fair value of the term loan components (Working Capital Term Loan and Funded Interest Term Loan) would be computed as per actual cash flows and taking the term premium in the discount factor as applicable for the maturity of the respective term loan components.

(iv) In the event any security is taken in lieu of the diminution in the fair value of the advance, it should be valued at Re.1/- till maturity of the security. This will ensure that the effect of charging off the economic sacrifice to the Profit & Loss account is not negated.

(v) The diminution in the fair value may be re-computed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in BPLR or base rate (whichever is applicable to the borrower), term premium and the credit category of the borrower. Consequently, banks may provide for the shortfall in provision or reverse the amount of excess provision held in the distinct account.

(vi) If due to lack of expertise / appropriate infrastructure, a bank finds it difficult to ensure computation of diminution in the fair value of advances, as an alternative to the methodology prescribed above for computing the amount of diminution in the fair value, banks will have the option of notionally computing the amount of diminution in the fair value and providing therefor, at five per cent of the total exposure, in respect of all restructured accounts where the total dues to bank(s) are less than rupees one crore.

17.4.3 The total provisions required against an account (normal provisions plus provisions in lieu of diminution in the fair value of the advance) are capped at 100% of the outstanding debt amount.

17.5 **Risk-Weights**

a. Restructured housing loans should be risk weighted with an additional risk weight of 25 percentage points.

b. With a view to reflecting a higher element of inherent risk which may be latent in entities whose obligations have been subjected to restructuring / rescheduling either by banks on their own or along with other bankers / creditors, the unrated standard / performing claims on corporates should be assigned a higher risk weight of 125% until satisfactory performance under the revised payment schedule has been established for one year from the date when the first payment of interest / principal falls due under the revised schedule.

c. For details on risk weights, Master Circular DBR.No.BP.BC.1/21.06.201/2015-16 dated July 1, 2015 on 'Basel III Capital Regulations' may be referred.

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5 This change has been introduced as a result of the introduction of Base Rate System w.e.f. July 1, 2010 vide circular DBOD.No.Dir.BC.88/13.03.00/2009-10 dated April 9, 2010 on 'Guidelines on the Base Rate'.

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DBR.No.BP.BC.49/21.04.048/2016-17 December 28, 2016

All Regulated Entities

Madam / Dear Sir,

Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

Please refer to circular DBR.No.BP.BC.37/21.04.048/2016-17 dated November 21, 2016.

2. On a review, it has been decided to:

(i) Provide 30 days, in addition to the 60 days provided vide the abovementioned circular, in the following categories of loans:

(a) Running working capital accounts (OD/CC)/crop loans, with any bank, the sanctioned limit whereof is ₹1 crore or less;

(b) Term loans for business purposes, secured or otherwise, the original sanctioned amount whereof is ₹1 crore or less, on the books of any bank or any NBFC, including NBFC (MFI). This shall include agriculture loans.

Note: The limits at (a) and (b) above are mutually exclusive limits applicable to respective category of loans.

The above dispensation will apply to dues payable between November 1, 2016 and December 31, 2016.

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RBI/2016-17/143
DBR.No.BP.BC.37/21.04.048/2016-17 November 21, 2016

All Entities Regulated by the Reserve Bank of India

Madam / Dear Sir,

Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

It has been represented to us that consequent upon withdrawal of the legal tender status of the existing ₹ 500 and ₹ 1,000 notes (SBN) small borrowers may need some more time to repay their loan dues. Taking these representations into consideration, it has been decided to provide an additional 60 days beyond what is applicable for the concerned regulated entity(RE) for recognition of a loan account as substandard in the following cases:

(i) Running working capital accounts (OD/CC)/crop loans, with any bank, the sanctioned limit whereof is ₹ 1 crore or less;

(ii) Term loans, whether business or personal, secured or otherwise, the original sanctioned amount whereof is ₹ 1 crore or less, on the books of any bank or any NBFC, including NBFC (MFI). This shall include housing loans and agriculture loans.

Note: The limits at (i) and (ii) above are mutually exclusive limits applicable to respective category of loans.

(iii) Loans sanctioned by banks to NBFC (MFI), NBFCs, Housing Finance Companies, and PACs and by State Cooperative Banks to DCCBs.

(iv) The above guidelines will also be applicable to loans extended by DCCBs.

2. The above dispensation will be subject to following conditions:

(i) It applies to dues payable between November 1, 2016 and December 31, 2016. REs shall note to ensure that this is a short-term deferment of classification as substandard due to delay in payment of dues arising during the period specified above and does not result in restructuring of the loans.

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