

AUDIT OF STRESSED ASSETS RECOVERY BRANCHES (SARBS)

The Stressed Assets Recovery Branches (SARBs) of the State Bank of India (SBI) play a crucial role in managing and recovering the bank's non-performing assets (NPAs), also known as stressed assets. Here's a breakdown of their primary functions:

Key Functions:

- **Recovery of Bad Loans:**

- The core function is to recover outstanding debts from borrowers who have defaulted on their loan repayments.

- **Loan Restructuring:**

- SARBs work with borrowers to find viable solutions, such as restructuring loan terms, extending repayment periods, or adjusting interest rates, to help them repay their debts.

- **Settlement Negotiations:**

- They engage in negotiations with borrowers to reach settlements, which may involve partial repayment of the loan in exchange for writing off the remaining debt.

- **Asset Sales:**

- In cases where borrowers cannot repay, SARBs may facilitate the sale of the borrower's assets that were used as collateral to recover the loan amount.

- **Legal Action:**

- As a last resort, SARBs initiate legal proceedings against defaulting borrowers to recover the owed funds. This may involve actions under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act



or filing lawsuits in Debt Recovery Tribunals (DRTs) and courts.

- **NCLT involvement:**

- They also manage and monitor cases that are filed under the Insolvency and Bankruptcy Code (IBC) through the National Company Law Tribunal (NCLT).

- **Asset Management:**

- SARB's are also involved in the sale of assets to Asset Reconstruction Companies (ARCs).

Overall Goals:

- Minimize losses for the bank.
- Improve the bank's asset quality.
- Ensure efficient recovery of funds.

In essence, SBI's SARBs are specialized units dedicated to resolving problematic loans, thereby safeguarding the bank's financial health.



When auditing a Stressed Assets Recovery Branch, the program should focus on verifying compliance with RBI guidelines, assessing asset classification accuracy, reviewing recovery mechanisms, and ensuring adequate provisioning. Below is a structured audit program informed by banking standards and regulatory frameworks:

1. Pre-Audit Preparation

- **Review internal policies:** Assess the branch's policies for stressed asset identification, restructuring, and recovery⁴⁷.
- **Obtain documentation:**
 - List of stressed assets (NPA, restructured, and written-off accounts).
 - RBI circulars/master circulars applicable to stressed assets.
 - Minutes of meetings with recovery/restructuring committees.
 - Legal and forensic reports on asset tracing.

2. Verification of Asset Classification

- **Confirm NPA classification:**
 - Validate that NPAs are classified as per RBI norms (90+ days overdue for loans, 30+ days for revolving credits)⁴⁷.
 - Check for "evergreening" (artificial regularization via superficial repayments)⁴.
- **Review restructuring processes:**
 - Ensure restructuring involves viability assessments and adheres to RBI's Prudential Framework.
 - Verify compliance with conditions like promoter contribution, independent credit evaluation, and timelines.

3. Provisioning Adequacy



- **Validate provisioning calculations:**

- Confirm provisions align with RBI guidelines (e.g., 15–40% for secured/unsecured NPAs).
- Check reversals of income on NPAs and ensure uncollected fees/commission are reversed.

- **Review collateral valuation:**

- Assess whether collateral values are updated and provisions adjusted accordingly.
- Verify third-party valuation reports for accuracy.

4. Recovery Process Audit

- **Evaluate recovery strategies:**

- Inspect records of recovery actions (e.g., SARFAESI, DRT, Lok Adalat).
- Confirm compliance with legal timelines for notices and auctions.

- **Asset tracing and forensic review:**

- Validate efforts to trace diverted funds or hidden assets using forensic audits.
- Check adequacy of insurance coverage for recoverable assets.

5. Compliance and Reporting

- **Regulatory compliance:**

- Ensure timely reporting of NPAs to RBI's Central Repository.
- Verify adherence to Income Recognition and Asset Classification (IRAC) norms.

- **LFAR and audit reports:**

- Cross-check disclosures in Long Form Audit Report (LFAR) regarding stressed assets.



- Confirm tax audit annexures align with provisioning and recovery data.

6. Key Documents to Verify

Document Type	Purpose
Stock audit reports	Verify inventory valuation and existence for secured assets.
Legal opinions	Confirm enforceability of guarantees/collateral.
Forensic audit reports	Assess fund diversion and asset-tracing outcomes.
Restructuring agreements	Check for compliance with RBI's restructuring conditions.
Recovery committee minutes	Evaluate decision-making processes for recoveries.

7. Reporting Findings

- **Quantitative discrepancies:** Note under-provisioning, misclassification, or delays in recovery actions.
- **Qualitative issues:** Highlight gaps in internal controls, non-compliance with RBI norms, or inadequate collateral management.
- **Recommendations:** Suggest improvements in asset tracing, collateral valuation frequency, and staff training on IRAC norms.

This program balances regulatory compliance (RBI circulars), financial accuracy (provisioning), and operational efficacy (recovery mechanisms). For detailed guidance, refer to ICAI's *Guidance Note on Audit of Banks*.



Planning a stressed assets recovery branch audit involves several key steps to ensure a thorough and effective review. Here's a structured approach:

1. Engagement and Preparation

- **Appointment of Auditor:** Confirm the engagement letter and clarify the scope of the audit with the bank's management.
- **Gather Relevant Documentation:** Collect essential documents such as:
 - Trial balance as of the audit date.
 - Previous years' audit reports and Long Form Audit Reports (LFAR).
 - RBI master circulars on asset classification and income recognition.
 - Lists of stressed, restructured, and NPA accounts.

2. Risk Assessment

- **Identify Key Risk Areas:** Focus on areas such as:
 - Classification of stressed assets (Standard, SMA, NPA).
 - Adequacy of provisions for NPAs.
 - Compliance with RBI guidelines and internal policies regarding asset recovery.
- **Evaluate Recovery Strategies:** Review the effectiveness of recovery measures in place for stressed assets, including legal actions and restructuring efforts.

3. Detailed Planning

- **Develop an Audit Plan:** Outline specific objectives, timelines, and resources required for the audit. This should include:



- Allocation of tasks among audit team members based on expertise.
- Identification of key accounts for in-depth review.
- **Schedule Meetings:** Plan discussions with branch management to understand their perspectives on stressed asset management.

4. Execution Preparation

- **Obtain Lists of Stressed Accounts:** Request updated lists of stressed accounts at least two weeks before the audit to facilitate thorough examination.
- **Review Recovery Plans:** Assess existing recovery plans against regulatory requirements and best practices to ensure they are robust and actionable.

5. Compliance Review

- **Check Adherence to Regulatory Guidelines:** Ensure that the branch complies with all relevant RBI guidelines regarding asset classification, income recognition, and provisioning.
- **Review Internal Controls:** Evaluate the effectiveness of internal controls related to the management of stressed assets, including monitoring processes and reporting mechanisms.

6. Fieldwork Execution

- **Conduct On-Site Audit Procedures:** Perform detailed testing on selected accounts, focusing on:
 - Verification of asset classification accuracy.
 - Examination of recovery actions taken.
 - Analysis of provisioning adequacy based on current regulations.



- **Document Findings:** Keep detailed records of observations, discrepancies, and compliance issues for reporting purposes.

7. Reporting

- **Draft Audit Report:** Prepare a comprehensive report summarizing findings, including:
 - Key risk areas identified.
 - Recommendations for improvement in asset management practices.
- **Discuss Findings with Management:** Present preliminary findings to branch management for feedback before finalizing the report.

8. Follow-Up

- **Monitor Implementation of Recommendations:** After submitting the final report, follow up on the implementation status of recommendations made to ensure continuous improvement in asset recovery processes.

This structured approach will help ensure that the audit is comprehensive, focused on critical areas, and aligned with regulatory expectations.



Here's a structured audit program for a Stressed Assets Recovery Branch audit, incorporating RBI guidelines, statutory requirements, and risk-based procedures:

Audit Program for Stressed Assets Recovery Branch

Aligned with RBI's Prudential Framework, ICAI Guidance Note (2024), and Banking Regulation Act, 1949

I. Pre-Audit Preparation

1. Regulatory Compliance Review:

- Obtain latest RBI circulars on stressed assets (e.g., **DOR.STR.REC.85/21.04.048/2023-24**[16](#)).
- Collect board-approved policies for recovery, restructuring, compromise settlements, and asset sales[18](#).

2. Documentation Gathering:

- Lists of NPAs, restructured accounts, written-off loans, and accounts under IBC resolution[25](#).
- Minutes of recovery committee meetings and forensic audit reports[13](#).
- Trial balance, LFAR from previous audits, and RBI inspection reports[36](#).

II. Asset Classification & Income Recognition

1. NPA Verification:

- Confirm NPA tagging per IRAC norms (90+ days overdue for term loans, 30+ days for cash credits)[12](#).
- Check for **evergreening** via unrelated deposits/withdrawals to avoid NPA classification[26](#).

2. Restructured Accounts:

- Validate restructuring agreements for adherence to RBI's viability criteria and promoter contribution (minimum 20% sacrifice)[18](#).



- Verify independent credit evaluations and compliance with timelines under RBI's Prudential Framework¹⁶.

III. Provisioning & Collateral Management

1. Provisioning Adequacy:

- Reconcile provisions with RBI-prescribed rates (e.g., 15% for secured NPAs, 25% for unsecured)¹⁶.
- Check reversal of uncollected interest/fees and collateral valuation updates¹².

2. Collateral Audit:

- Review third-party valuation reports for immovable properties/pledged stocks⁴⁶.
- Confirm insurance coverage for recoverable assets (e.g., machinery, inventory)¹⁴.

IV. Recovery Process & Legal Compliance

1. Legal Recovery Mechanisms:

- Scrutinize SARFAESI/DRT/IBC case logs for adherence to timelines (e.g., 330-day IBC resolution, 30-day auction notices)¹⁷.
- Verify write-off approvals and post-write-off recovery efforts (e.g., monitoring "technical write-offs")²⁵.

2. Compromise Settlements:

- Examine settlements above ₹1 crore for board approvals and deviations from RBI policy¹⁶.
- Validate documentation for sacrifices exceeding stipulated limits¹⁸.

V. Fraud & Internal Control Review

1. Fraud Vigilance:

- Analyze fraud registers for timely RBI reporting, provisioning adequacy, and corrective actions¹³.



- Test controls to prevent fund diversion (e.g., falsified invoices, round-tripping, shell companies)[16](#).

2. KYC/AML Compliance:

- Verify updated KYC/AML policies and transaction monitoring systems[16](#).
- Test sample accounts for adherence to RBI's PAN/address proof norms[14](#).

VI. Key Documents & Testing

Document	Audit Procedure
Stock audit reports 4	Confirm marketability of pledged stocks and reconcile with borrower statements.
IBC resolution plans 7	Verify haircut approvals and compliance with CoC decisions.
Inter-branch reconciliation	Age-wise analysis of uncleared entries (>90 days) and provisioning compliance 12 .
Suspense accounts	Scrutinize unusual entries and clearance timelines 13 .

VII. Reporting & LFAR Disclosures

1. Quantitative Findings:

- Under-provisioning, misclassification, or delays in recovery actions[16](#).
- Divergences in restructured accounts vs. RBI guidelines[13](#).

2. Qualitative Recommendations:

- Enhance early warning systems (EWS) for stress detection[68](#).
- Improve collateral revaluation frequency and staff training on IRAC norms[14](#).



3. LFAR Compliance:

- Disclose deviations in restructuring, recovery policy breaches, and IBC delays¹⁷.

VIII. Post-Audit Follow-Up

- Track implementation of audit recommendations through subsequent quarterly reviews⁶⁷.



The "Framework for Resolution of Stressed Assets" outlined in the RBI Master Circular No. RBI/2024-25/12 DOR.STR.REC.8/21.04.048/2024-25, dated April 2, 2024, provides comprehensive guidelines for banks regarding the management of stressed assets. Here are the key components of this framework:

1. Objective of the Framework

The framework aims to ensure that banks adopt a systematic approach to identify, classify, and resolve stressed assets while aligning with international best practices. It emphasizes transparency and consistency in financial reporting.

2. Classification of Assets

- **Special Mention Accounts (SMA):** Banks must recognize incipient stress in borrower accounts and classify them as SMA based on overdue periods:
 - **SMA-0:** Up to 30 days overdue
 - **SMA-1:** More than 30 days and up to 60 days overdue
 - **SMA-2:** More than 60 days and up to 90 days overdue
- **Non-Performing Assets (NPA):** An asset is classified as an NPA when it remains overdue for more than 90 days.

3. Income Recognition

- Income should be recognized based on actual cash flows rather than accruals, ensuring that banks do not report income from accounts that are not generating cash.

4. Provisioning Requirements

- Banks are required to maintain provisions based on the classification of assets:
 - A minimum provision of 15% for secured NPAs and 25% for unsecured NPAs.
 - Higher provisioning may be required based on the age of the NPA and the realizable value of collateral.



5. Resolution Plans

- Banks must develop resolution plans for stressed assets, which include:
 - Viability assessments to determine whether restructuring is feasible.
 - Timelines for implementing recovery measures.

6. Legal Framework

- The framework encourages banks to utilize legal mechanisms such as SARFAESI Act, IBC (Insolvency and Bankruptcy Code), and DRT (Debt Recovery Tribunal) for asset recovery.

7. Monitoring and Reporting

- Banks are required to monitor the performance of stressed assets continuously and report their status regularly to the RBI, ensuring compliance with regulatory requirements.

8. Governance and Oversight

- The board of directors must oversee the implementation of this framework, ensuring that policies are adhered to and that there is accountability in managing stressed assets.

Conclusion

The RBI's framework emphasizes a proactive approach towards managing stressed assets, focusing on early identification, timely intervention, and effective recovery strategies. This ensures that banks maintain financial health while adhering to regulatory standards.

