

BANK AUDIT SEMINAR

APRIL 1ST 2018

Presenter : CA Akesh Vyas

DISCLAIMER

The views expressed in the following presentation should not be construed as the view of ICAI or my firm.

The views opined herein should not be considered as a professional advice

This presentation should not be reproduced in part or in whole, in any manner or form, without my written permission.

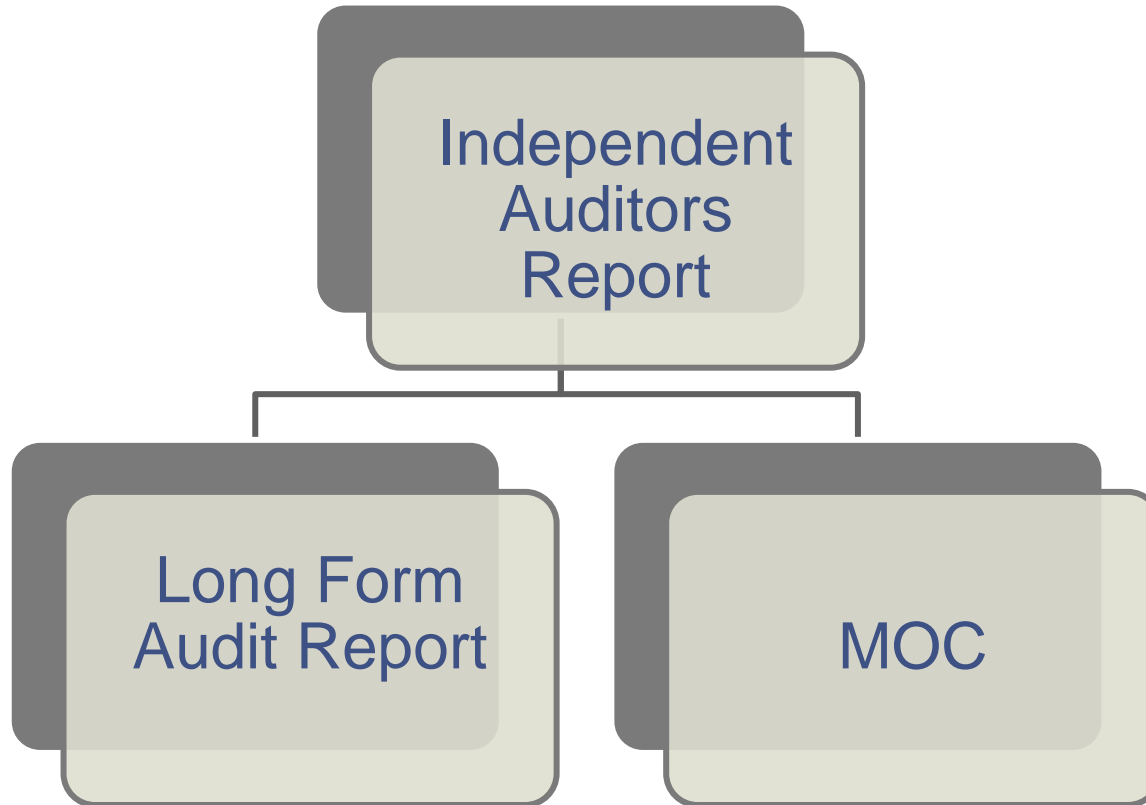
The failure of such may attract civil or criminal liabilities.

VARIOUS TYPES OF BANK AUDITS

TYPES OF BANK AUDITS

1. RBI Annual Financial Inspection
2. Bank and Branch Statutory Audit
3. Concurrent Audit
4. Revenue Audit
5. Credit Audit
6. Stock Audit
7. Risk Based Internal Audit
8. Information System Audit
9. Forensic Audit
10. Miscellaneous Audit

BANK BRANCH AUDIT



LONG FORM AUDIT REPORT- CERTAIN IMPORTANT CLAUSES

Indicate the cases of advances to non-corporate entities with limits beyond Rs.10 lakhs where the branch has not obtained the accounts of borrowers, duly audited under RBI guidelines with regard to compulsory audit or under any other statute :

-Required under RBI's circular dated 12th April 1985

- Applicable on non corporate entities enjoying working capital limits of Rs. 10 lacs or more from the banking system.

-Separate prescribed formats of financial statements for trading and manufacturing entities, fund flow statements , auditors report and special audit report for consideration of RBI . Formats prepared by IBA (Indian Banking Association) in consultation with ICAI as published in “ Guide note on audit of accounts of non corporate entities” dated 3rd June 1985

Does the examination of the accounts indicate possible window dressing?

WINDOW DRESSING is a term used to describe the act of making the performance in financial statements better than the actuals.

Resorted to by branches normally at quarter/year end mainly to inflate business figures.

(like transferring unavailed CC limits to current accounts)

Adverse impact in long term

Are there any other matter which you, as branch auditor, would like to bring to the notice of the management or the Central Statutory Auditors?

Specific comments on gross violation of prescribed systems and procedures , cases of serious money laundering including trade based money laundering (Useful Finacle command FTI, NEWACTR)

MOC

MOC Effecting :

Asset Classification

Provisioning

Security and sector wise classification

Profit & Loss account

Others

TAX AUDIT REPORT- TDS RELATED ISSUE

Special attention required

i) for accuracy of information relating to TDS on interest on deposits- Section 194-A requiring following columns to fill :

- Total amount of payment
 - Total amount on which tax is required to be deducted
 - Total amount on which tax was deducted
- (Useful Finacle command- TDSIP)

ii) For TDS applicability on payments to professionals like valuer, advocates etc

- **Bank's Credit Policy from Bank's Intranet** : Important bank's policy relating to loans and advances like ceiling on single/group borrower limit, Guidelines for sanctioning of various types of loans, Calculation of Drawing Power, Stock audit, Review/renewal of accounts, compulsory audit of borrower accounts etc.
- Bank's Circulars from Bank's Intranet
- **Bank's internet site** : Latest service charges relating to advances, various loan schemes, latest rate of interest
- **RBI site** : Master circulars /Master directions
- Bank's Books of Instructions
- System generated reports

SOURCE OF USEFUL SYSTEM GENERATED REPORTS

BANK	SOURCE OF REPORTS
Allahabad Bank, Central Bank of India, Bank of Maharashtra	Short cut to reports
Bank of India	MISRPT
Bank of Baroda	BOBMENU
Indian Bank	CDC reports
United Bank of India	EODDRPT, UNIRPT
Indian Overseas Bank	FINRPT
Oriental Bank of Commerce	MISREP
Punjab National Bank	PNBRPT
Punjab & Sind Bank	PSBRPT
Syndicate Bank	Day end reports

OTHER USEFUL REPORTS

Exceptional Reports

High value transactions in newly opened accounts

Alerts – Offsite monitoring

Monthly branch reports- Advances sanctioned during the month, TOD , Excess granted, KYC Compliance certificate, STR (If any), balancing certificate

Report on yield on advances and cost of deposits

IMPORTANT FINANCE COMMANDS

ACLI

1. To View Ledger account : Account No + F4
2. To view Rate of Interest : Account No.+ Control E+0 (at option code)+F4+F6
3. To view Sector (Priority/Non Priority) : Account No +Control E +V (At option code)+F4
4. To view Sanction detail : Account No +Control E +H (At option code)+F4+ S (at operation option)
5. To view Drawing Power : Account No +Control E +H (At option code)+F4+ D (at operation option)
6. To View Asset Classification (Standard/NPA) : Account No +Control E +Y (At option code)
7. To view Documents detail : Account No +Control E +X (At option code)
8. To view overdue installments in term loan accounts :
Account No. + Control E+ E (at option code) +F4

In addition , various other information like PAN, Beneficial owners, Cust. ID, TOD detail, Lien in account etc can be obtained.

ACS

1. To view account opened during a period : Open date (low)+open date (high) +F6+Scheme type (CCA for CC, ODA for OD and LAA for loans)
2. To view NPA accounts : F6+002 (at main asset classification)+F4
3. To view all accounts of a customer : Cust ID+F4

SRM

To view detail of stock statement and insurance

For detail of stock statement :

Linkage Type A + Insurance Type Y + Account No + F4

For detail of insurance :

Linkage Type A + Insurance Type Y + Account No + F4 + N (at option code)+F4

LOANS RELATED TOPICS



STATUTORY & REGULATORY RESTRICTIONS



STATUTORY RESTRICTIONS

Restrictions which are governed under section 20 (1) of the Banking Regulation Act , 1949.

Prohibits :

1. Loans to Directors
2. The companies in which director is director , manager, guarantor , employee or in which he holds substantial interest (exempted company Subsidiary of a banking company or a company registered under section 8 of the Companies Act 2013 or a government company)
3. A firm in which director is partner, manager, employee or guarantor.

Exempted category : Loan against government securities, LIC and FDRs.

4. Loans against security of its own shares

REGULATORY RESTRICTIONS

Restrictions issued by RBI :

Prohibits banks to grant :

- Loans to relatives of the directors unless approved by the Board.
- Loans of Rs. 25 lacs and above to the director of any other Bank, any firm in which a director of other bank is partner or guarantor or a company in which such director holds substantial interest or is a director or guarantor unless approved by the Board. (Loans will not include loans against government securities, LIC and FDRs)
- Loans against partly paid up shares
- Investment in small savings instruments
- Prime security of Shares and debentures to proprietorship/partnership concerns.
- FDRs of other Banks



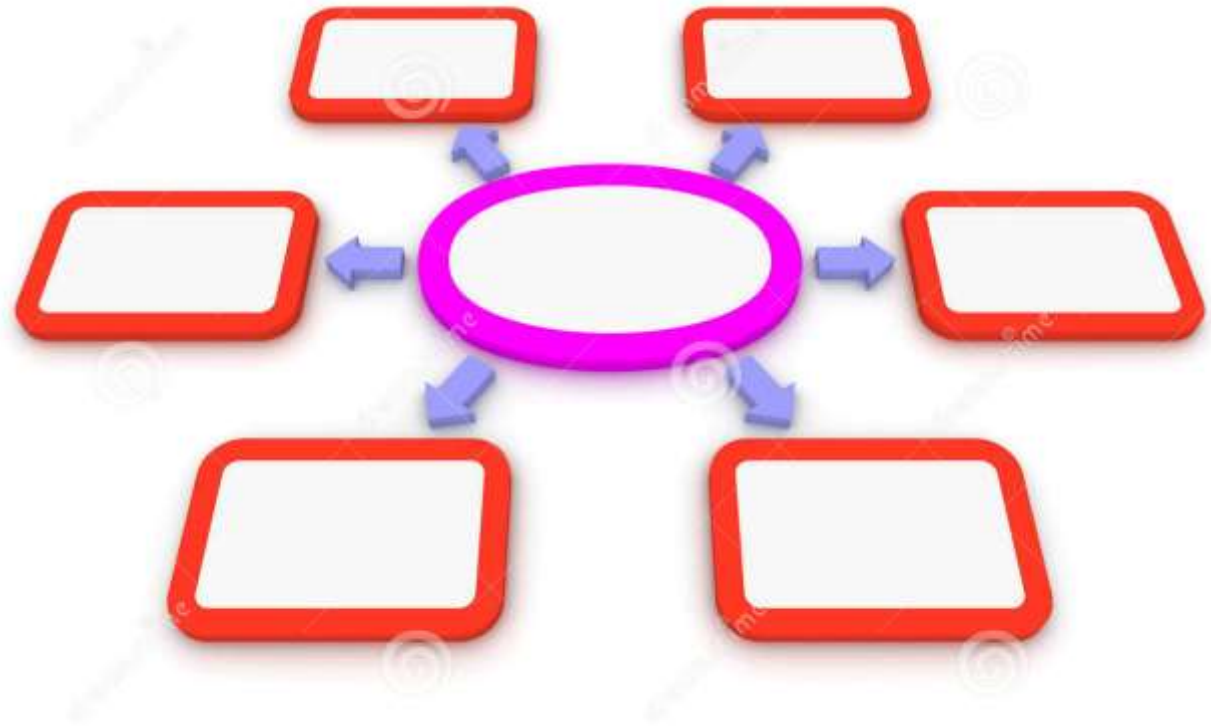
The Banks can not give loans to a firm in which HUF is a partner since as per the Hon'ble Supreme Court ruling (AIR-1930-PC-300 and AIR 1956-SC-854)

“ HUF is an association of persons and not a person within the meaning of expression of the Partnership Act and hence can not enter into contract of partnership with another person or persons”

This has been reconfirmed in another case M/s Rasiklal & Co Vs Commissioner of Income Tax as

“ In law, an HUF can never be a partner of a partnership firm.”

CLASSIFICATION OF ADVANCES



SECTOR WISE CLASSIFICATION

Priority

- Agriculture
- Education
- Housing
- Export credits
- MSME
- Social Infrastructure
- Renewable energy
- Others

Non Priority

- Sectors other than priority are covered under non priority sector

- Priority Sector Housing Loan :In Metropolitan Centres (Population 10 lacs and above)- Loans upto Rs. 28 lacs provided overall cost of dwelling unit not to exceed Rs. 35 lacs In case of repairs, amount restricted to Rs. 5 lacs
In Other Centres - Loans upto Rs. 20 lacs provided overall cost of dwelling unit not to exceed Rs. 25 lacs In case of repairs, amount restricted to Rs. 2 lacs
- Priority Sector Education Loans – Upto Rs 10 lacs
- Present target for priority sector lending – 40%
- Agriculture Loan : 18%

DEFINITION OF MSME

As defined under MSME Act 2006:

Sector	Micro	Small	Medium
Manufacturing Sector (investment in plant and machinery)	Upto Rs 25 lacs	Over Rs 25 lacs upto Rs 5 crore	Over Rs 5 crore upto Rs 10 crore
Service Sector (investment in equipment)	Upto Rs 10 lacs	Over Rs 10 lacs upto Rs 2 crore	Over Rs 2 crore upto Rs 5 crore

AMENDED DEFINITION OF MSME

Based on turnover instead of investment in plant & machinery

Approved by Union cabinet on 8th February 2018. However, notification is awaited.

Sector	Total Turnover
Micro Enterprises	Upto Rs 5 crore
Small Enterprises	Between Rs 5 crore to Rs. 75 crore
Medium Enterprises	Between Rs 75 crore to Rs 250 crore

SPECIAL RELIEF FOR MSME SECTOR

(RBI circular No BP>BC>100/21.04.048/2017-18 dated 7th February 2018)

Period

Period for classification as NPA increased from 90 days to 180 days for MSME entities for amount overdue as on 1st September 2017 and for payments due from 1st September 2017 to 31st January 2018.

Conditions

-Borrower is registered under GST as on 31st January 2018

-Aggregate exposure (fund based and non fund based) to Banks and NBFCs for the borrower not to exceed Rs 25 crore as on 31st January 2018. The sanctioned limit or outstanding , which ever is higher, shall be reckoned for arriving as exposure limit.

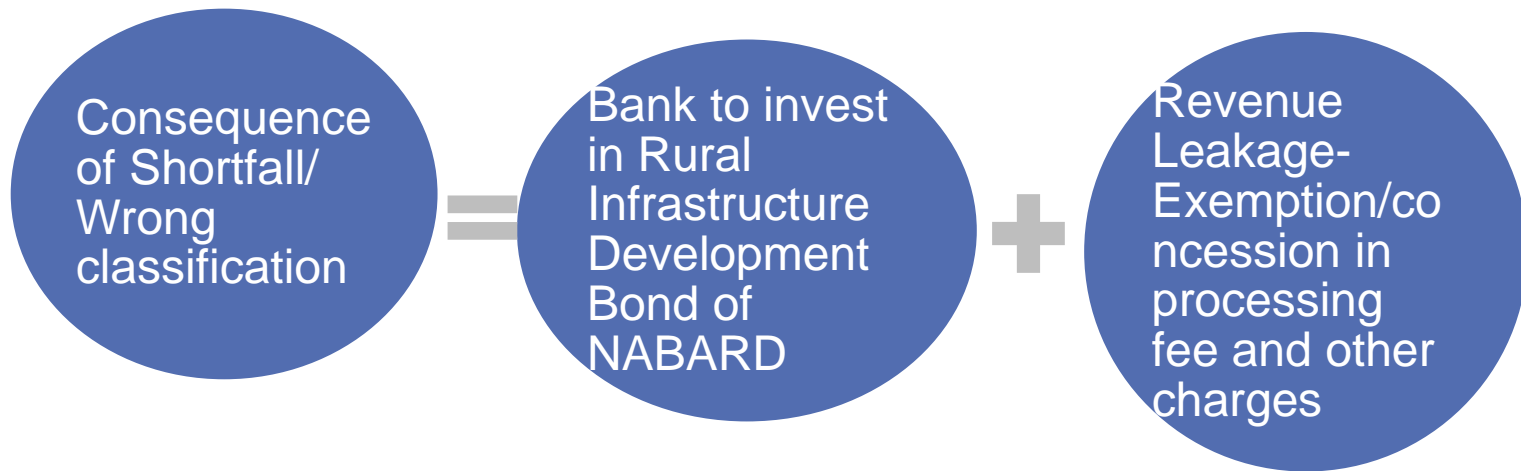
Account is standard as on 31st August 2017.

Provision

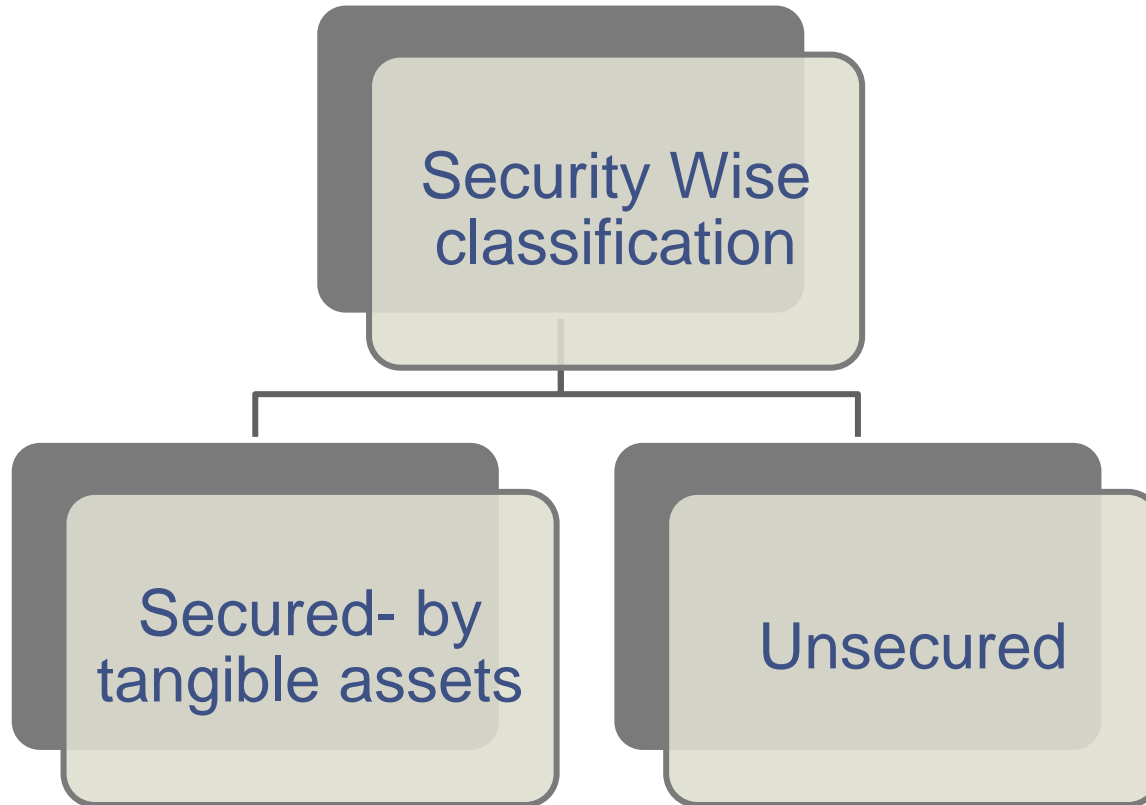
5% against such exposure which is not classified as NPA

Interest recognition

Additional time is only for asset classification and not for income recognition. If interest is overdue for over 90 days, the same shall not be booked in income.



SECURITY WISE CLASSIFICATION



TYPES OF SECURITIES

PRIMARY SECURITY

The security against which credit is extended by the Bank such as Stocks, Book debts , Machineries

COLLETRAL SECURITY

An additional security which provides a cushion to the bank in case of needs such as immovable property

SECURED BY GUARANTEE

- Personal guarantee of an individual :

To ensure that the guarantor has the capacity and is eligible to give guarantee. Payment of commission to give guarantee is prohibited.



- Corporate Guarantee :

Guarantee given by a company in respect of loan taken by another person.

- **CGTMSE SCHEME**

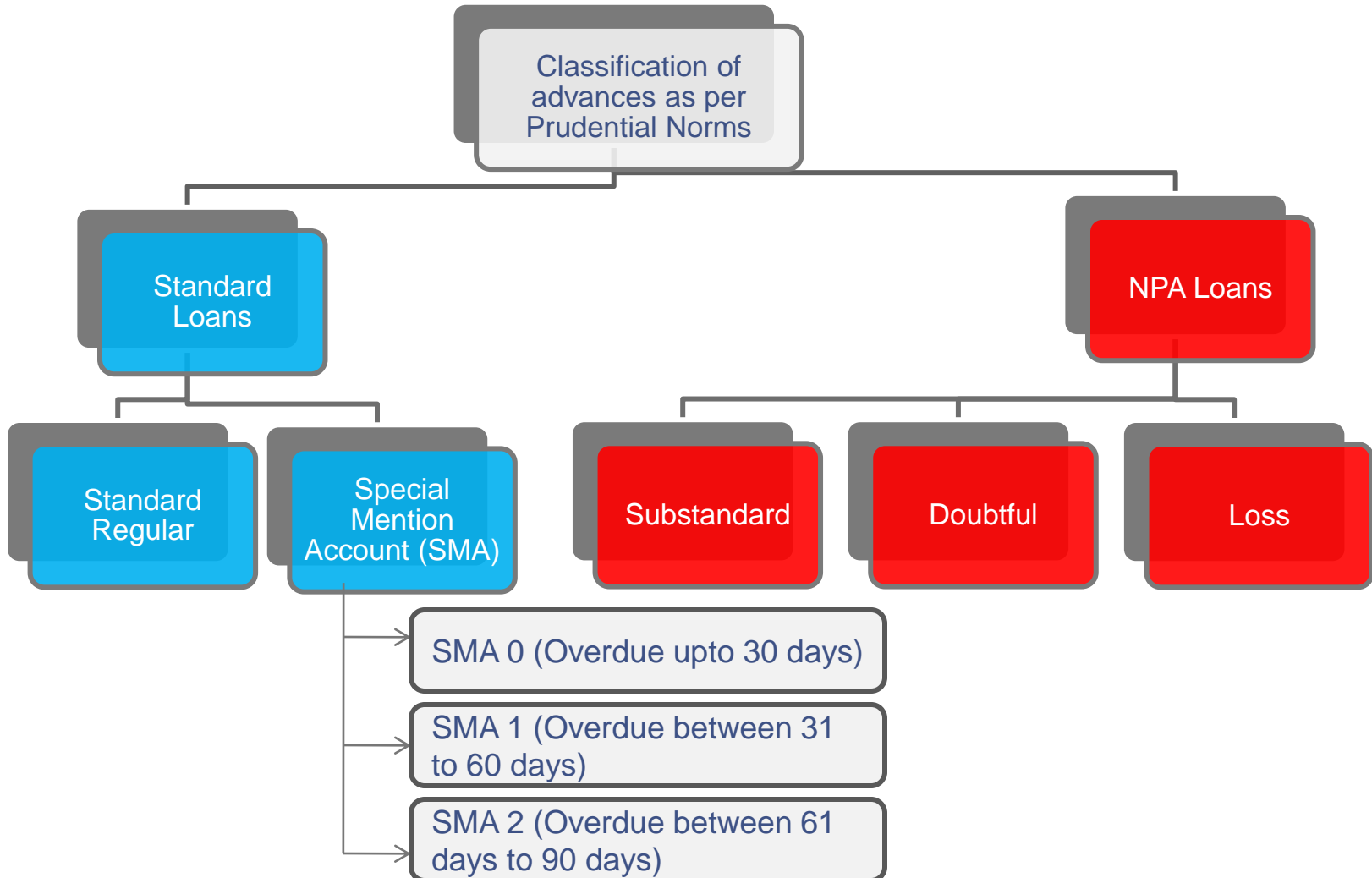
Accounts covered under CGTMSE (Credit Guarantee Fund Trust for Micro and Small Enterprises) scheme

- a) Eligible accounts- only micro and small enterprises
- b) No collateral and third party guarantee
- c) Maximum finance Rs 2 crore
- d) Payment of annual guarantee fee

ECGC (EXPORT CREDIT GUARANTEE CORPORATION):

- Coverage of export loans
- Premium to be paid on monthly basis (In case of pre-shipment, to be borne by the borrower, in case of post shipment, to be borne by the Bank)
- Prior Permission to extend loan to an NPA account
- Satisfactory credit report of overseas buyer not older than one year

PRUDENTIAL NORMS CLASSIFICATION



SMA- 0

RBI Circular No DBOD.BP.BC.No.97/21.04.132/2013-14 dated February 26, 2014

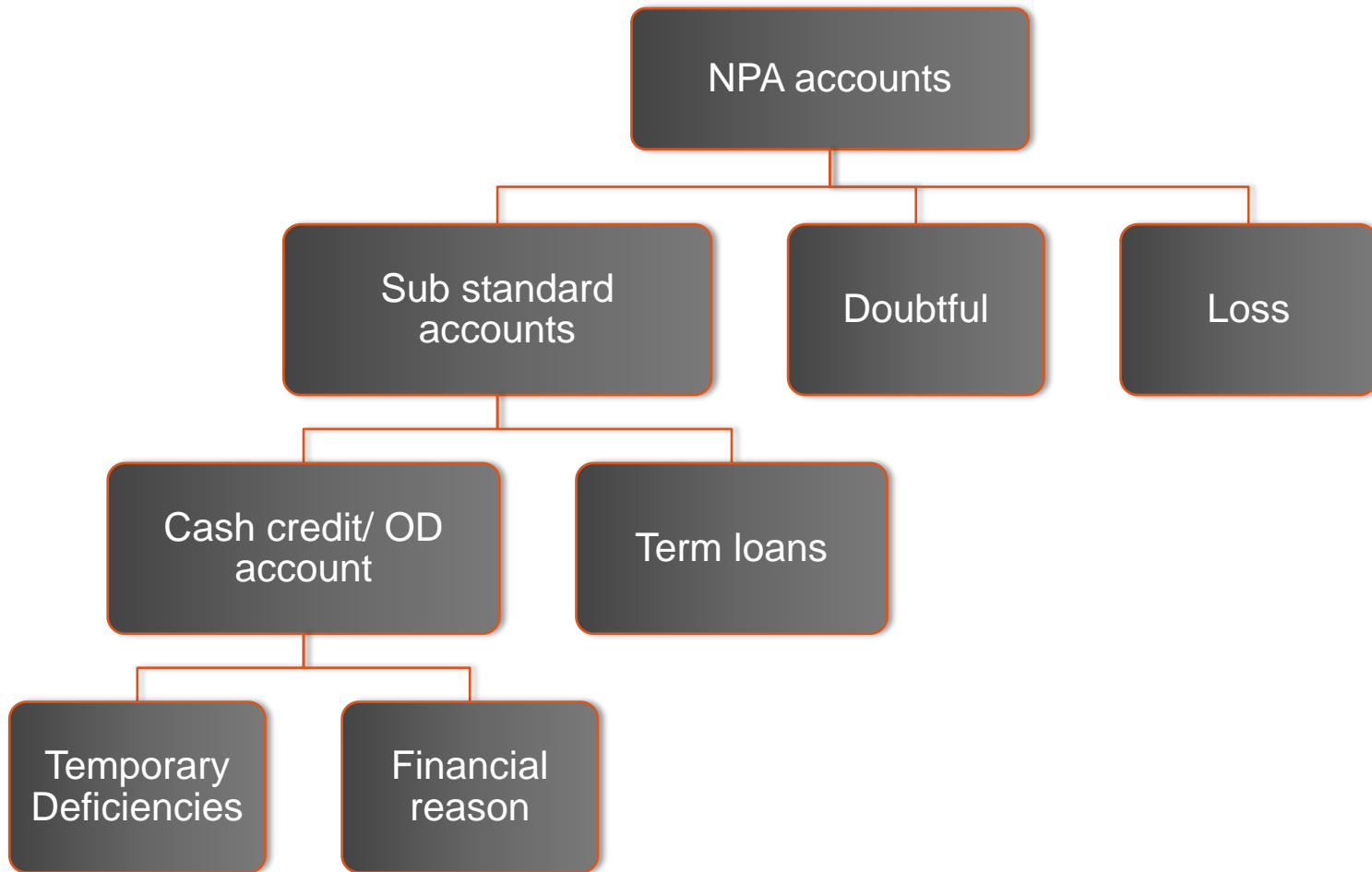
Few illustrative sign of stress in the account for classification as SMA 0 are :

- Returning of 3 or more cheques issued by borrower in 30 days
- Actual sales or profit falling short by 40% or more as compared to projections at the time of sanction
- Non payment of devolved LC/Invoked Bank Guarantee within 30 days
- Third request for extension of time for creation of securities against time specified in the sanction

RBI Circular No BP.BC.101/21.04.048/2017-18 dated February 12, 2018

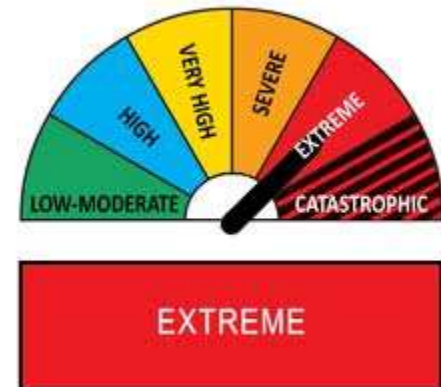
SMA-0 : Overdue between 1-30 days

SUB CLASSIFICATION OF NPA ACCOUNTS



PRESENT SCENARIO

- AQR (Asset Quality Review) undertaken by the Banks on the directives of RBI during the year 2015-16. The exercise is undertaken to clean the Bank's Balance Sheet as on March 31, 2017 and taken legal action against defaulting borrowers.
- India with 10.20% has the 5th highest NPA in the world behind Greece (36.37%), Italy (16.35%), Portugal (15.52%) and Ireland (11.85%)
- Most of the Banks under Prompt Corrective Action mechanism (PCA) of RBI involving restrictions on branch expansion, granting loans to borrowers above investment grade etc. PCA based on criteria's like Net NPA exceeding 6%, , return on assets etc.
- Gross NPA likely to increase from 9.60% as on March 2017 to 10.20% by March 2018 as compared to 5.10% as on Sept 15.



CONSEQUENCES OF NPAS ON ECONOMY

Lower Government revenues due to

- Lower taxes and dividends from Banks
- Higher interest rate on sovereign bonds . Present rating by Moody's is Baa2 (the second lowest rating amongst investment grade) due to low government's revenue base (21% of GDP) and huge NPAs. Interest payments absorb more than 20% of government revenues.
- Loss of revenue and high interest burden met through higher taxes resulting in lower income in the hands of consumers effecting demand and consumption pattern effecting profitability of companies and ultimately the revenue base of the Government.

Higher NPA → Lower Government Revenue → Higher Taxes → Burdened Consumers

MAJOR REASONS FOR NPAS

- No bar on borrowers.
- Sector specific problems
- Downsizing and lack of independence of Audit and Inspection Department
- Administrative weakness
- Lack of due diligence
- Delay in legal remedies
- Lending nature of banks

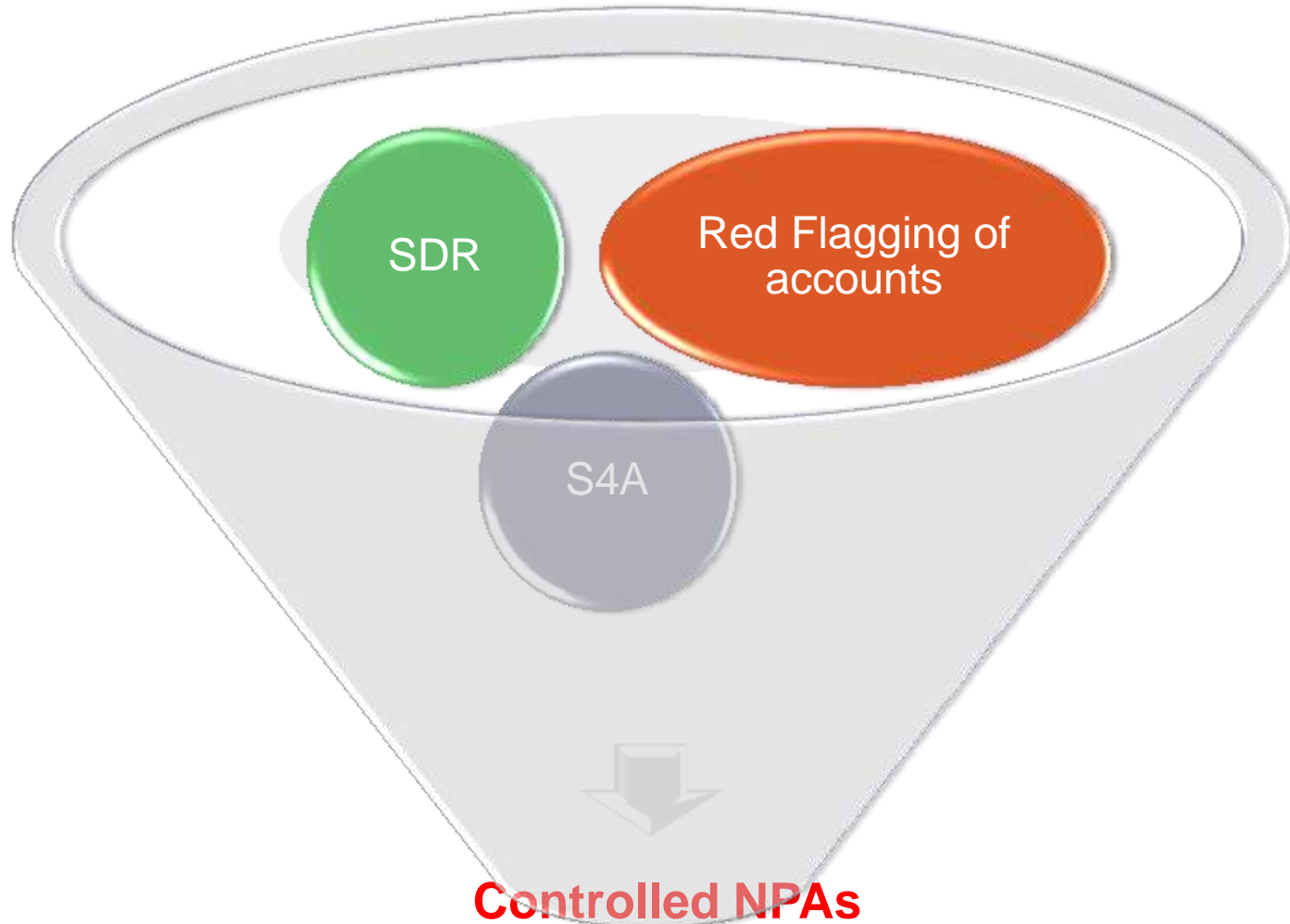


CONSEQUENCE OF IMPROPER ASSET CLASSIFICATION

- Affects true and fair view of the financial statements
- Booking interest and other income in the account whose realizability is doubtful.
- No recovery proceedings are undertaken
- Income tax is paid on unrealized income.

Special Benefits of claiming provision for bad and doubtful debts (section 36(i)(viii)) and paying tax on receipt basis (section 43D) not availed .

STEPS TAKEN FOR CONTROLLING NPAS



RED FLAGGED ACCOUNTS

- Came into existence w.e.f.7/5/2015 due to RBI's concern in delay in detection and reporting of loan related frauds by the Banks.
- A Red Flagged account is one where suspicion of fraudulent activity is thrown up by presence of one or more early warning signals.
- Total 45 EWS identified by RBI including – Heavy cash withdrawal, non routing of sales proceeds through bank account, LC devolvement, foreign bills remaining overdue, increasing in age of book debts, large transactions with related firms and large outstanding from them, non submission of bill of entry

i) Restructuring

- Granting concession in rate of interest in the stressed assets
- Granting extension of repayment period

Any account restructured w.e.f.1st April 2015 to be classified as NPA

ii) SDR- Discontinued w.e.f.12th February 2018

iii) S4A- Discontinued w.e.f.12th February 2018

INSOLVENCY AND BANKRUPTCY CODE



- Effective from November 1, 2016
- Ensures a time bound mechanism to either put a distressed entity to revival path or timely liquidation of its assets
- Dedicated authorities – NCLT (National Company Law Tribunal) for corporate and DRT (Debt Recovery Tribunal) for others.
- Time bound process- Insolvency resolution to be completed within 180 days (a maximum 90 days extension allowed) once application for insolvency resolution admitted.

If no resolution reached within prescribed time, code provides for automatic liquidation.

NEW GUIDELINE ON STRESSED ASSETS

RBI Circular No RBI/2017-18/131/DBR No. BP BC.101/21.4.048/2017-18 dated 12th February 2018



SALIENT FEATURES

Withdrawal of extant guidelines

All existing guidelines (SDR, S4A, 5:25 , JLF etc) stand withdrawn.

Early identification

Classification of assets into SMA-0, SMA 1 and SMA 2 immediately on default.

Reporting to CRILC (Central repository on Large Credits)

All borrowers with aggregate fund based and non fund based exposure of Rs. 5 crore and above

Implementation of Resolution Plan

Resolution plan to be initiated by all the lenders as soon as a default occurs in any of the account of the borrower with any bank.

Resolution plan may include

- i) Regularization of account by payment of all overdues
- ii) Sale of exposure to other investors
- iii) Change in ownership or restructuring.
- iv) Restructuring

If Resolution plan involves restructuring :

-Perfection of securities with all lenders

-New capital structure and change in terms and conditions of existing loans get reflected in the books of all lenders and borrower

- Rating of residual debts by Credit Rating agencies (Exposure Rs 100 crore and above – 1 CRA, Exposure Rs. 500 crore and above- 2 CRA , minimum credit rating RP 4)

Reference to IBC for accounts with aggregate exposure of Rs. 2000 crore and above

Resolution plan to be implemented :

- 1) For existing defaulters- within 180 days from the reference date i.e. March 1, 2018
- 2) For other accounts- within 180 days from the date of first default.

If not implemented, lenders shall file insolvency application within the expiry of 15 days from the above time line.

RBI to issue separate guidelines for accounts with aggregate exposure between Rs 100 crore to Rs. 2000 crore.

Upgradation of restructured account

Only if :

- i) No default at any time during the specified period (one year from the end of moratorium period or date by which 20% of principal and interest is repaid which ever is earlier)
- ii) For accounts with aggregate exposure of Rs 100 crore and above, besides satisfactory performance, the credit facilities of the borrower to be rated as Investment grade (BBB- or better)

PRUDENTIAL NORMS



ESSENCE OF PRUDENTIAL NORMS

- NPA norms are guided by RBI master circular relating to Prudential norms on **Income Recognition, Asset classification and provisioning (IRAC)**
- As per RBI Circular No DBR No .BP.BC.2/21.4.048/2015-16 dated 1.7.2015, an asset becomes non performing when it ceases to generate income for the Bank.
- While assessing an account as NPA, the availability of **security or net worth of the borrower/guarantor is irrelevant. The only relevant factor is recovery** . Hence, an account may be NPA in spite being fully secured.

STAGES OF ASSET CLASSIFICATION

SUBSTANDARD

NPA UPTO 1 YEAR

DOUBTFUL

OVER 1 YEAR

LOSS

DECLARED AS A LOSS BY THE AUDITORS

INSTANCE WHEN A SUB STANDARD ACCOUNT (AS PER THE PERIOD) MAY BE DIRECTLY CLASSIED AS DOUBTFUL OR LOSS

- **IF THERE IS AN EROSION IN THE VALUE OF ASSETS**

BETWEEN 50% TO 90%

DOUBTFUL

OVER 90%

LOSS

NPA NORMS

- **SUB STANDARD ACCOUNTS- CASH CREDIT/ OD ACCOUNTS - FINANCIAL REASONS**

- ❖ Account overdrawn > Lesser of (Sanctioned limit or drawing power)



90 days or more

- ❖ No credits or credits insufficient to cover the interest during the previous quarter.

- **SUB STANDARD ACCOUNTS- CASH CREDIT/ OD ACCOUNTS – TEMPORARY DEFICIENCIES**

- ❖ Renewal pending



More than 180 days

- ❖ DP calculated from stock statement older than 3 months and continuance of such irregularity for



More than 90 days

• **SUB STANDARD ACCOUNTS- TERM LOANS**

- ❖ Interest and /or principal remain overdue

More than 90 days

EXEMPTIONS

- × Central Government guaranteed advances. However, no exemption in income recognition.
- × Loans against LIC, NSC, FDRs KVP if adequate margin available
- × Loan to staff members where interest is payable after recovery of principle amount.
- × Loan where there is moratorium period for payment of interest

SUB STANDARD ACCOUNTS- BILLS DISCOUNTED

Remain overdue

More than 90 days

Asset Classification on non repayment of interest within 90 days **(RBI Guidelines)**

Extract from the RBI Circular No BP.BC.2/21.04.048/2015-16 dated July 1, 2015 :

“ In case of interest payments, 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”

Sub Standard Advances- Agriculture Loans

- Short Duration Crops : If principal or interest remains overdue for 2 crop seasons
- Long Duration Crops : If principal or interest remains overdue for 1 crop season.

The crop season is decided by the State Level Bankers' Committee in each state.



OTHER IMPORTANT ASPECTS

- Asset classification is borrower wise and not account wise
- Exemption : Bills discounted under LC provided documents under LC are accepted on presentation or payment under LC is made on due date
- Classification with other member banks are not relevant in consortium advances
- No restriction on number of times the account can be downgraded or upgraded during a year.
- No system of upgradation of NPAs within various sub categories .such as from doubtful to substandard or from loss to doubtful or substandard.

Accounts regularised near about the balance sheet date

RBI Circular No DBR.No.BP.BC.2/21.04.048/2015-16

Dated July 1, 2015

Para 4.2.6

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.

PROVISIONING

STANDARD

GENERAL	0.40%
AGRICULTURE & MSME	0.25%
REAL ESTATE	0.75%

SUBSTANDARD

SECURED PORTION	15%
UNSECURED	25%

DOUBTFUL

D-1 (UPTO 1 YEAR)	25%
D-2 (1 TO 3 YEARS)	40%
D-3 (OVER 3 YEARS)	100%
UNSECURED PORTION	100%

PROVISIONING IN RESPECT OF ADVANCES COVERED UNDER ECGC/CGTMSE

Provision to be made only for the excess of the amount covered under the guarantee. Hence , no provision is required to the extent balance is covered under the aforesaid guarantees.

PROVISIONING IN RESPECT OF FRAUDS

100% Provisioning is required irrespective of security available in the account



DISCLOSURE IN THE “ NOTES TO ACCOUNTS” TO THE FINANCIAL STATEMENTS- DIVERGENCE IN THE ASSET CLASSIFICATION AND PROVISIONING

RBI notification No RBI/2016-17 /283 dated 18th April 2017 requires Banks to make disclosure in their Financial Statements of the amount of additional Gross NPAs identified by RBI where it exceeds 15% of the published NPA of the Bank for the specified period. The first disclosure for divergences observed by RBI for the financial year 2015-16 shall be made in the Notes to Accounts of Financial Statements for the year ended March 2017.

Few Instances when accounts become NPA inspite of not being overdue :

- Loans where there is an increase in rate of interest without corresponding increase in EMI or period of repayment.
- Any other loan account of the borrower is NPA.
- Project Loans for non commencement of operations within DCCO.
- Restructuring of loans extending the period of repayment.

Few Instances where accounts remain standard inspite of being out of order for over 90 days

- Loans against FDR, NSC, KVP, LIC if value of securities fully cover the loans
- Central Govt guaranteed loans
- Bills discounted under LC
- Restructured loans before 1st April 2015
- Loans under SDR/S4A

A Few undesirable practices

- Granting TOD in other sister concern account
- Granting new loan to adjust old overdue loan
- Increasing days of eligible debtors for calculating DP
- Unauthorized opening of new loan account by transferring irregular portion of existing loan
- Unauthorized releasing of margin of non fund limits to adjust irregular portion of fund based facilities.
- Year end purchase of cheques
- Manual intervention through MEAC command
- Cash Deposit without actual cash receipt
- Discounting a fresh export bill to adjust old overdue bill
- Extension of period under DCCO

TYPE OF ADVANCES



- Fund based advances are those where there is an actual transfer of funds from the bank to the borrower. Examples : Cash credit, term loans, overdraft, bill discounting, export loans etc.
- Non fund based advances are those where there is no immediate involvement of transfer of funds from the bank to the borrower. Examples: Letter of credit , bank guarantees, co-acceptance of bill.

FUND BASED FACILITIES

- Cash Credit
- Term Loan
- Overdraft
- Bill Discounting
- Export Loan

FUND BASED FACILITIES



Cash Credit

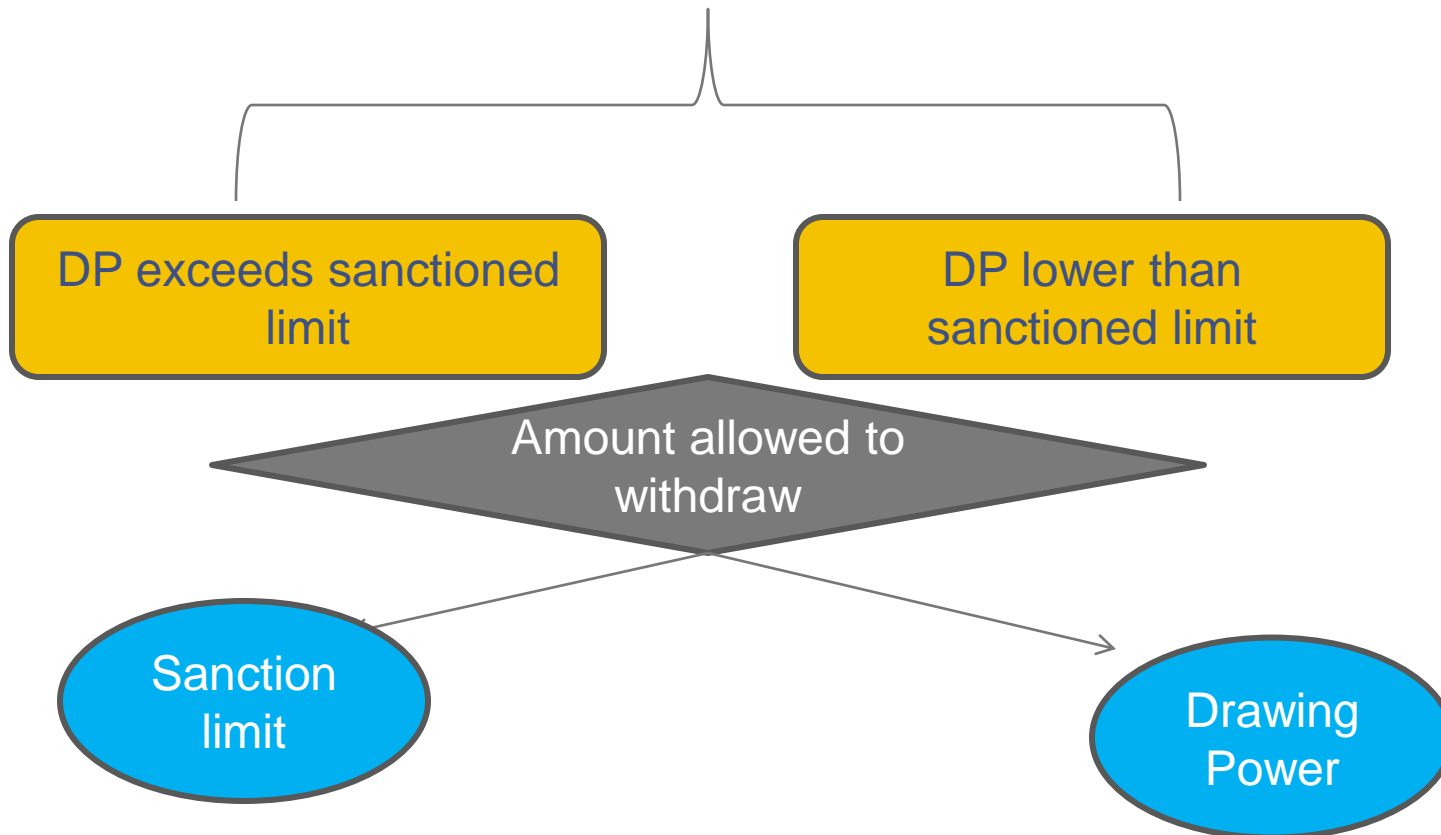
- To finance working capital requirements
- Requires periodic renewal (usually yearly)
- Requires monthly stock statement for calculation of drawing power
- Requires monitoring of end use of funds

VERIFICATION OF DRAWING POWER

DP is the amount of working capital funds allowed to borrower to draw from the working capital limit allotted to him

Calculated on basis of stock statements submitted by the borrower

There can be 2 situations:



General formula for calculation of DP:

$$\text{Paid Stocks} + \text{Debtors} - \text{Margin} = \text{Drawing Power}$$

Paid Stocks is Stocks less trade payables

Method of calculation differs from Bank to bank and governed by loan policy of each bank

Some Important Points in calculation of Drawing Power :

Creditors more than stocks . DP against stocks will be Nil. Whether excess creditors will be adjusted against debtors for calculation of DP against debtors

Method varies from Bank to Bank Refer Credit Policy of the Bank

Allowing set off of Sundry Creditors with Sundry Debtors (above the eligible debtors) and consider only the balance creditors while calculating DP against stocks

Method varies from Bank to Bank. Refer Credit Policy of the Bank

Ignoring sundry creditors upto the level of creditors fixed at the time of initial assessment of limit	Refer Banks credit policy
Allowing DP against advance to Creditors	To be allowed if terms of sanction /Credit policy permit. Moreover , nature of advance needs to be verified with supporting documents such as Purchase order to ascertain its genuineness.
Treatment of advance payment received from debtors	Generally no specific guidelines provided.
Inclusion of foreign debtors in stock statement	Difference of opinion

IMPORTANT POINTS FOR VERIFICATION OF STOCK STATEMENTS

- Stock statements to be in the Bank's prescribed format
- Submission of Stock Statement at prescribed interval
- Stock statement as on last date of the month.
- Agewise classification of Sundry Debtors
- No DP on book debts against associate concerns if stipulated in sanction
- Quarterly certification of book debts by the Statutory Auditors of the borrower.
- Detail of Sundry Creditors provided
- Stocks purchased under LC to be shown separately
- Margin calculated correctly
- Correct entry in system. Penal interest flag for non submission is " Y"

INSURANCE:

- **Stocks should be fully insured for all risks including fire, earthquake, burglary, terrorism etc.**
- **Stocks at all locations including stocks with processors need to be covered under insurance**
- **Bank's clause in insurance policy**
- **Validity period to be alive**
- **Insurance policy to cover theft in addition to burglary risk in view of Supreme Court decision on Industrial Promotion Investment Corporation of Orrisa Ltd (IPCOL) V/s New India Assurance Co Ltd.**

FUND BASED FACILITIES



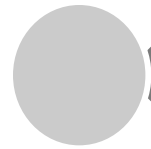
Overdraft

- Normally against FDR or immovable property
- Annual renewal if allowed against property
- No requirement for submission of stock statements

DIFFERENCE BETWEEN CASH CREDIT AND OVERDRAFT

- End use of funds needs close monitoring in Cash Credit
- Monthly stock statements need to be submitted in case of cash credit accounts.
- Difference in method of appraisal
- Interest in Cash Credit accounts effected by Internal/External ratings.
- Difference in nature of primary securities.
- In OD , pre existence of security is must. In CC, assets are created out of Bank's funds at subsequent stage.

FUND BASED FACILITIES



Term Loan

- Availed for acquiring fixed assets
- Repayment in a fixed period

DIFFERENCE BETWEEN CASH CREDIT AND TERM LOAN

- Term loan is for acquiring fixed assets while CC is for financing working capital requirement.
- The balance in CC accounts keeps fluctuating on day to day basis while in case of term loan , the balance goes reducing as per the repayment schedule and in the end becomes Nil.
- The balance in Cash credit account can be in credit unlike term loan which always remains in debit.

PROJECT TERM LOANS

- Granted for acquiring fixed assets like land and building, machinery
- TEV study wherever applicable done
- All project approval obtained and held in records
- Satisfactory credit report of suppliers of machineries from the approved rating agency available
- Funds released on basis of quotations available after keeping prescribed margin
- Bills in support of assets acquired available in records
- Insurance of machineries done
- Post disbursement inspection made
- DER (Debt Equity Ratio) and DSCR (Debt Service coverage Ratio) to be within acceptable norms as per Bank's credit policy. Any deviation to be approved by the competent authorities.

RETAIL LOANS

Some of the common retail loans advanced by banks now a days are:

- Housing Loan
- Car Loan
- Education Loan
- Loan against FDR's
- Loan against LIC Policies

HOUSING LOAN:

- Agreement to sell between buyer and seller
- Non Encumbrance Certificate (NEC) from panel advocate
- Valuation by approved valuer
- Creation of valid mortgage
- CERSAI registration
- Insurance of house property

Construction of House :

As per RBI circular No DIR.BC.13/08.12.001/2015-16 dated 1/7/2015 , compliance of following guidelines :

Availability of sanction plan from the competent authority in the name of the applicant

Submission of completion certificate within 3 months from the date of completion.

Failure leads to giving right to the Bank to recall the loan.

Builders Flat under construction:

- Banks prohibited to extend loans to builders for buying land
- Financing by branches under projects approved by the higher authorities

Major documents :

- Tripartite agreement
- Builders Buyer's agreement
- Builder's letter confirmation marking of bank's lien on the subject property
- NOC from the builder for creation of mortgage
- Original receipts

Type of Mortgages

Registered Mortgage

Mortgage deed executed in favour of the Bank and registered with the appropriate authority

Equitable Mortgage

Created by simple deposit of title deed by the mortgagor with clear intention to create the mortgage in favour of the Bank

Refer next slide for verification process of equitable mortgage

VERIFICATION PROCESS OF EQUITABLE MORTGAGE:

- Search on CERSAI site by the branch official to confirm non encumbrance. Snap shot of the search to be kept as part of the documents.
- Complete search of property documents by the panel advocate for the prescribed period. Original search receipt to be kept as part of documents.
- Unqualified Legal Opinion certifying the genuiness of title deed of the property and the right of the seller to sell the property
- Valuation of property by the approved valuer. Valuation report to be accompanied by the photograph of the property. In case of properties above Rs. 50 crore, 2 independent valuation reports required as per RBI Guidelines.
- Site verification by the branch official.
- Creation of Equitable Mortgage on basis of complete chain of title deed as prescribed by the advocate
- Payment of stamp duty as per the applicable state laws.
- Laminated title deeds to be avoided
- Certified true copy of title deed on basis of which mortgage created to be obtained from the office of the Registering Authority and compared with the originals
- Registration with CERSAI within 30 days
- Mortgage on basis of certified copy to be done only in exceptional case and after following prescribed procedures
- In case of a mortgage of property of a third party (other than borrower) , he/she to be made a guarantor of the loan..

CAR LOAN:

- Proper KYC and due diligence
- Proper appraisal of limit
- Release of loan on basis of quotation of car
- Branch to confirm the authenticity of the quotation
- Release of funds to the account of the dealer after keeping prescribed margin
- Bill and insurance of car to be obtained
- Joint RC to be submitted by the borrower
- Post disbursement inspection of the car

EDUCATION LOAN:

- Proper KYC and due diligence
- Education from accredited Institution/University
- Original payment receipts of fee paid
- Periodic progress report of student borrower
- Interest on interest collection flag to be marked as 'Y' after the start of EMIs.
- Repayment period: Course period + 1 year or 6 months after getting job, whichever is earlier.
- Maximum quantum of finance in India Rs. 10 lakhs and abroad Rs. 20 lakhs
- 1% int. concession if interest is serviced during moratorium period (concession available for moratorium period only)
- Security and Margin -

Particulars	Margin	Security
Upto ₹ 4 lakhs	Nil	Parents to be joint borrower(s). Banks have a discretion to waive this.
Above ₹ 4 lakhs and upto ₹ 7.5 lakhs	In India – 5% Abroad – 15%	Parents to be joint borrower(s). Plus third party guarantee.
Above ₹ 7.5 lakhs	In India – 5% Abroad – 15%	Parents to be joint borrower(s). Plus tangible collateral security.

LOAN AGAINST FDR:

- No loans against other bank's deposits as per RBI's guidelines
- No loan against third party deposits if prohibited by Bank's loan policy
- Loan against FDR if in joint name- to be applied and documents to be executed by joint holders
- Prescribed margin maintained
- FDR discharged and bank's lien marked on FDR as well in system
- Correct rate of interest charged

LOAN AGAINST LIC POLICIES:

- LIC Policy to be in the name of the applicant and it is alive
- Surrender value obtained and advance granted on basis of surrender value after keeping prescribed margin
- Up-to-date premium paid
- Policy is assigned in favour of the Bank

FUND BASED FACILITIES

Financing against Bills

- LC (Letter of Credit) or Non LC bills
- Accompanied by bills of exchange. Transporter's GR
- The bills are purchased if these are payable on demand.
- The bills are discounted if these are usance bills.
- Normally 3 parties are involved i e Seller of goods (drawer) , buyer of goods (drawee) and the banker of seller of goods discounting the bill.

FUND BASED FACILITIES

Export Loans (Pre Shipment)

- Granted to acquire goods
- Granted against LC or confirmed orders from overseas buyer
- Liquidated against discounting of export bills or foreign remittances

FUND BASED FACILITIES

Post shipment (Export bill discounting)

Exports bills drawn on overseas buyer discounted and Packing Credit (if availed) liquidated. Otherwise transferred to Current account.

Realization on due date. If not realized on due date, bills crystallized .

NON FUND BASED FACILITIES

- Letter of Credit (LC)
- Bank Guarantee (BG)
- Letter of Undertakings (LOU)

NON FUND BASED FACILITIES

Letter of Credit

An undertaking from the Bank on behalf of the customer (buyer) to the seller of the goods to pay the contracted amount in case the buyer fails to pay on the stipulated date. Known as LC devolvement In case of default by the customer. Essential movement of goods under LC supported by documents like Bill of Entry (in case of imports), Lorry Receipts.

- > Fraudulent LOU/LC : The issuing bank can not deny its liability to honour LC/LOU on the ground of fraudulent issue of LC/LOU in view of RBI Master Circular No RBI/2015-16/6 DCBR.BPD. (PCB) MC No.8/09.27.000/2015-16 dated July 1st, 2015

A graphic consisting of a grey circle on the left and a grey arrow-shaped box pointing to the right, containing the text 'Bank Guarantee' in white.

Bank Guarantee

Financial : to meet financial obligations (like security deposits)

Performance : To meet contractual obligations (like satisfactory project completion)

Deferred payment guarantee: To ensure timely payment to supplier of capital goods at a specified time

Binding on the issuing Bank to pay to the beneficiary the guarantee amount in case of default by the customer.

Exercise of the right by the beneficiary known as Invocation of guarantee.



Letter of undertaking

Banned w.e.f March 13, 2018

Parties involved in the transactions

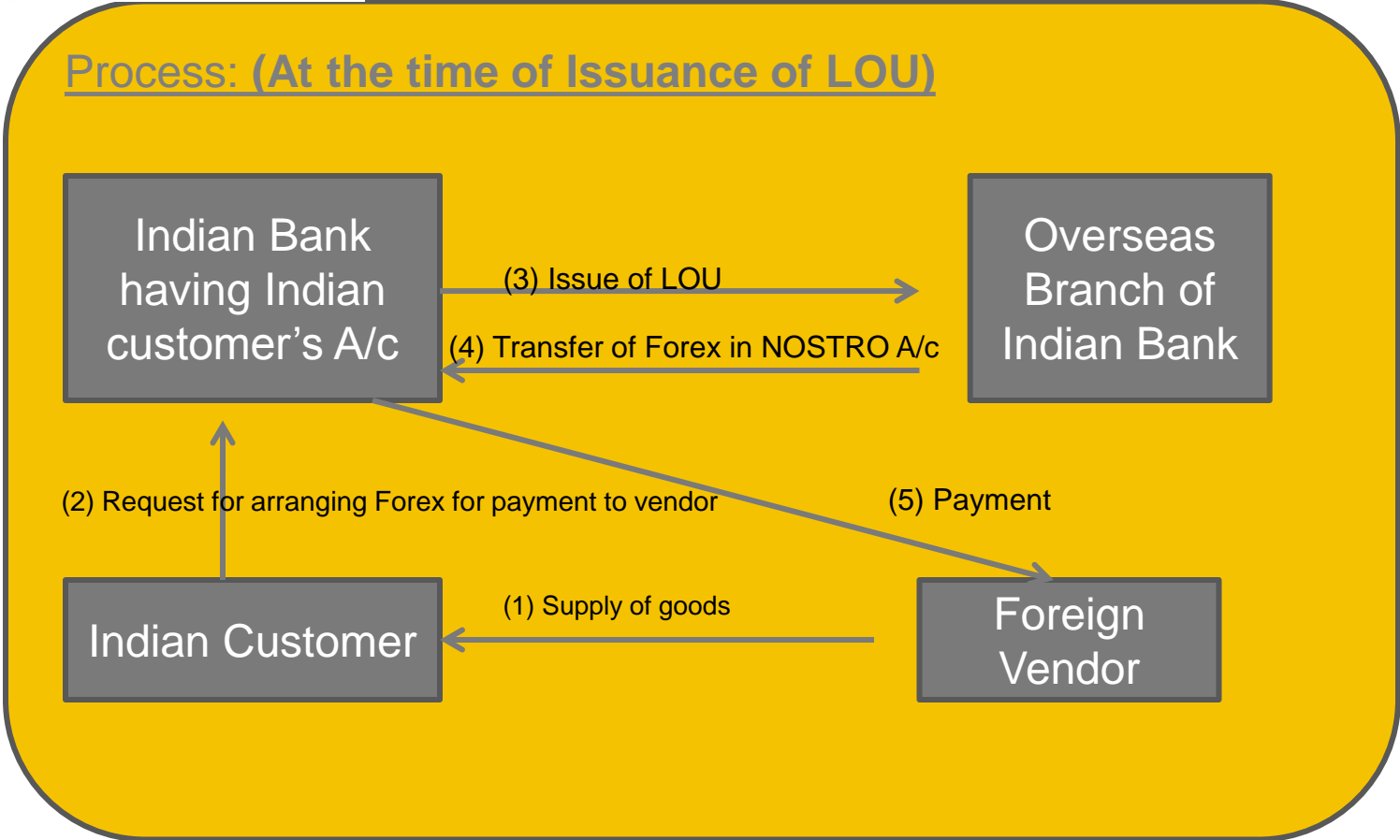
- A - Customer of an Indian Bank
- B- An Indian Bank which is issuing LOU at the request of the customer
- C- Overseas supplier of the customer
- D- A Foreign Bank or overseas branch of an Indian Bank which is releasing funds on the basis of LOU

Need for LOU :

Availability of cheaper foreign funds to the customer



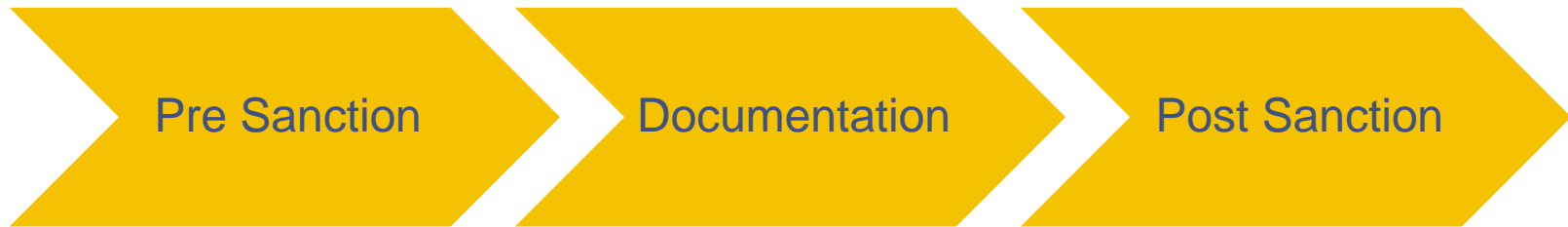
Letter of undertaking
Banned w.e.f March 13, 2018



LOANS AND ADVANCES- GENERAL VERIFICATION PROCEDURE



STAGES OF LOAN



PRE-SANCTION



- Proper application and other relevant papers – ITR, Balance Sheet, License, Address Proof, Partnership Deed, proprietorship proof, IEC Registration, SSI registration, Memorandum and Articles of Association, Certificate of incorporation.
- Due diligence for identification of the borrower including pre sanction visit
- Verification of KYC documents with the originals
- Direct third party verification of documents
- Generation of CIBIL reports, reference to RBI defaulters list, ECGC caution list
- Satisfactory status report from the existing bankers
- Credit risk rating done
- Site verification and valuation of immovable properties by approved valuer and branch official
- CERSAI Verification for any existing charge on immovable property.
- ROC search
- Assessment of limit as per the guidelines
- Loan granted within the delegated power of the sanctioning authority
- Compliance of Bank's lending policy stipulations
- Compliance of take over norms
- Issuance of sanction letter

Direct verification with third parties – RBI Guidelines

As per RBI circular dated 30.6.11 :

Wherever a Chartered Accountant certificate, property valuation certificate, legal certificate, guarantee/line of credit or any other third party certification is submitted by the borrower, the bank should independently verify the authenticity of such certification by directly communicating with the concerned authority issuing the certificate; indirect confirmation may also be resorted to, ie. indicating to the issuer that in case there is no response by a certain deadline, it would be assumed that the certificate is genuine.

In cases where it is established that the certification given by a chartered accountant, lawyer, registered property valuer or such third party is wrong, IBA should put in place a process to issue a 'Caution List' regarding the certifier to all banks.

DOCUMENTATION



IMPORTANT ASPECTS OF DOCUMENTATION:

- Properly filled, duly stamped and signed by the borrower and guarantor
- Proper value of stamp or stamp paper to be used. Stamp duty of documents varies from state to state except Bill of Exchange.
- Date of stamp paper to be before the date of execution
- Stamp Paper to be in the name of the borrower or the Bank
- Overwriting/Cuttings to be duly authenticated
- Execution of documents by the legally competent persons
- Documents to be alive
- Documents on the printed format of the Bank. No computer generated documents except through LAPS (Loan Application Processing System)
- The banks are required to give a copy of the loan agreements to the borrower.

↓

Persons not legally competent to execute the documents: Minor, Insolvent, Insane, Person of unsound mind, Heavily drunk person

LIMITATION PERIOD:

- Normally 3 years.
- In case of term loans, 3 years to be reckoned from the date of default
- Limitation period can be extended through
 - Obtaining fresh documents
 - Obtaining Balance confirmation
 - Part payment in the account

Important aspects of ROC charge registration

- Covered under Section 77 of the Companies Act 2013
- Charge is required to be registered within 30 days . However, additional 270 days are allowed to file charge with additional fee.
- Charge is required to be created for all assets (tangible as well as intangible) whether in India or outside.
- In case of non filing , the charge of bank does not become invalid in case of a going concern. However, in case of winding up of company, the Bank is considered as an unsecured creditor. Under the new Act, no charge created shall be taken into account by the liquidator unless a certificate of registration of charge is given by the Registrar of Companies.
- Primary responsibility of registration of charge with the borrower. In case of failure of the company, the Bank may after the expiry of 30 days , directly apply to ROC for registration (Section 78)
- Satisfaction of charge is to be reported to ROC within 30 days from the date of full payment.

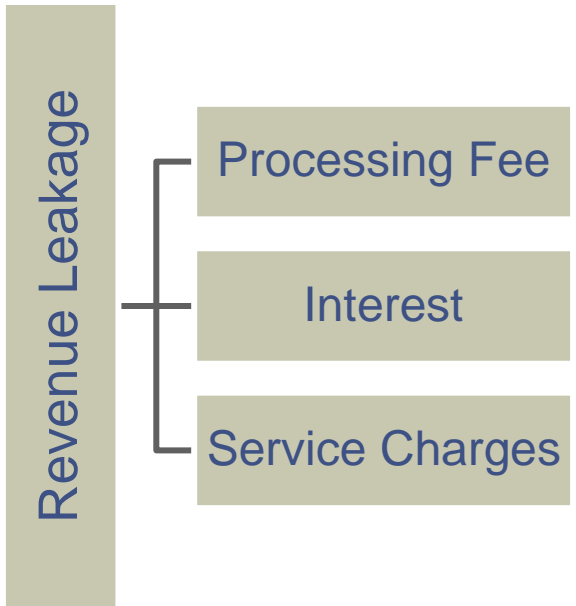
POST SANCTION



- All terms of sanction duly complied with
- Disbursement as per the terms of sanction. Precautions against disbursements through shell companies.
- Prescribed margin obtained. Rate of interest correctly fed in system
- Applicable charges recovered
- Over-drawings in the account need based, properly reported, within discretionary power, adjusted in time
- Primary securities created and necessary bills held as proof of purchase
- Post disbursement inspection made
- Submission of stock statement at prescribed interval, calculation of DP as per lending policy
- Stock audit in applicable cases
- Balance confirmation letter at periodic intervals
- Monitoring of operations in account . Prompt action in case of early warning signals including low turnover, frequent excess, frequent returning of cheques, huge cash deposits and withdrawals, frequent LC devolvement
- Submission of statements of financial performance (QIS etc.)
- Renewal of working capital limits on annual basis

REVENUE LEAKAGE EXERCISE





Processing Fee:

- Non charging of Processing fee
- Non Charging of Processing fee for broken period
- Non Charging of Processing fee on non fund based limits

Service Charges:

- Non charging of commitment charges
- Non Charging of annual lead bank charges
- Bank Guarantee Commission : Improper classification of Bank Guarantee, Non charging of commission in subsequent years when the same to be charged on annual basis.

Interest:

- Non Charging of interest in the account
- Wrong periodicity – Interest charged on quarterly instead of monthly basis.
- Reversal of penal interest for non renewal due to back dated history change
- Loan against FDR- Increase in rate of interest of FDR without corresponding change in the rate of interest of the Loan account
- Loan against FDR- Loan exceeding security value . Balance over security value to be treated as clean loan attracting higher ROI
- Non charging of penal interest for non submission of stock statement, non renewal of account
- Non charging for penal interest for non compliance of terms of sanction like failure to obtain external rating
- Continuation of charging concessional rate of interest/applicable charges even after the lapse of sanction
- Non charging commercial rate of interest from the date of release in export limits where export has not taken place
- Charging of rate of interest lower than applicable rate of interest
- Continuation of charging simple interest instead of compounded interest in case of education loans where repayment has started

Governed under Securitization and Reconstruction of Financial Assets and enforcement of Security Interest Act 2002 grants significant power to banks to possess the securities of the defaulting borrower and recover the dues. The act is applicable to whole of India.

Applicability on Loans-

- Classified as NPA
- Dues exceeding Rs 1 lac
- In case of consortium loans, Secured Creditors representing at least 60% of the value of outstanding amount agree
- The act is applicable on both movable as well as immovable assets.

WILFUL DEFAULTER

- Defined under RBI CIRCULAR NO CID.BC.22/20.16.003/2015-16 dated July 1, 2015
- Any borrower with sanctioned limit above Rs 25 lacs on the occurrence of following events :
 - 1) Default in repayment of dues even when it has the capacity to honour the obligations
 - 2) Diversion of funds
 - 3) Siphoned off the funds
 - 4) Removal of movable or immovable property without the knowledge of the Bank

Diversion of funds:

- Transfer of funds to subsidiaries / group companies
- Use of short term funds for long term purposes
- Use of funds for purpose other than purpose for which granted
- Routing of funds through other Banks
- Investment in other companies through Shares/debt instruments

Siphoning of Funds:

Utilization of funds for purpose unrelated to operations of the borrower

Consequence of Wilful Default:

- No further lending by any Bank/Financial Institution
- Legal process to recover due start immediately
- Bank get the power to change the management
- Barred by SEBI from becoming director in any
- Other listed company



Auditors liability

As per the RBI's circular on wilful defaulters , in case if any falsification of accounts on part of the borrowers is observed by the Banks and if it is observed that the auditors were negligent or deficient in conducting the audit ,

- a) The Banks should lodge a formal complaint against the auditors of the borrower with ICAI
- b) Pending disciplinary action by ICAI, the complaint may be forwarded to RBI and IBA.

Major Wilful defaulters in Indian Banks

Nirav Modi Group, Kingfisher Airlines Ltd, Zoom Developers Pvt Ltd, Winsome Diamond & Jewellery Ltd, Forever Precious Jewellery and Diamond Ltd, Deccan Chronical Holdings Ltd.

Total wilful defaulters as on Dec 17 - 9063 with total loan amount of Rs. 110050 crore

Amount written off during last 5 years for the period ended March 2016- Rs. 230287 crore

Total loan frauds during the last financial years upto March 2017- 8670 amounting to Rs. 61260 crore.

Recent steps taken by Government of India

Passport detail of all borrowers with exposure of above Rs. 50 crore.

Restriction on overseas travel of 91 borrowers considered wilful defaulters

ANY QUESTIONS?



CONTACT DETAILS

CA AKESH VYAS

Email ID: avyasca@gmail.com

Mobile: +91 9818860081