Audit of NPA with Special Reference to Prudential Norms

Advances constitute greatest amount in the total assets of a bank's balance sheet and therefore, audit of advances becomes the most important component of bank audit. In case an advance account is classified as NPA (Non- Performing Asset), primary responsibility of making adequate provision for diminution in value of advance is that of the bank management and the statutory auditors. It is, therefore, imperative for the statutory auditors, to have thorough knowledge of the norms prescribed by the Reserve Bank of India (RBI) in Master Circular - "Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances" (IRAC Norms). The author in this article explains those aspects of the Master Circular regarding NPAs which are most relevant during the bank branch audit.

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Overview

The prudential norms are formulated on the basis of objective criteria rather than on any subjective consideration. This has brought in uniform and consistent application of the norms and greater transparency in published accounts of banks. The latest Master Circular No. DBOD.

No. BP.BC.9/21.04.048/2014-15 dated 1st July, 2014 issued by the RBI contains IRAC norms which are applicable for the statutory audit of banks for the year ending 31st March, 2015. For the first time, the RBI has introduced new frame work for revitalisation of distressed assets in the above circular.

Audit of NPA would basically involve identification of an account as NPA, its correct classification, income recognition, provisioning, if an account is restructured and compliance of various conditions as enumerated in the Master Circular, *etc.*

1.0 Types of Assets

Standard Asset: An account is considered as standard asset when it is not non-performing and does not carry more than normal risk attached to the business.

Non-Performing Asset (NPA): An asset becomes NPA when it ceases to generate income for the bank. This would mean that an account would be classified as NPA on the basis of record of recovery rather than security charged in favour of the bank in respect of such account. Thus, an account would become NPA if interest charged to that particular borrower is not realised within the prescribed time frame despite the account being fully secured.

2.0 Identification of Account as NPA

The RBI has laid down undermentioned criteria for classification of various types of advances as NPA which is based on record of recovery:

(i) **Term Loan:** Interest and/or instalment of principal remain overdue for a period of more than 90 days.

It is very important to note here that as per *para 2.1.3* of the Master Circular, an account would be classified 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. For example, interest is charged on 30th November, 2014 in a term loan account. Now, if it is not serviced within 90 days from 31st December, 2014, then term loan account would become NPA, not otherwise.

(ii) **Overdraft/Cash Credit:** If an account remains out of order, it would become NPA. For this purpose, an account would be treated as 'out of order', if:

a. The outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 90 days or more, or

b. Even if the outstanding balance in the account is less than the sanctioned limit/drawing power, there are no credits in the account continuously for 90 days as on the date of the balance sheet, or

c. Credits in the account are not sufficient to cover interest debited during the same period.

As on 31st March, 2015, if any of the above criteria is satisfied, the account would be classified as NPA. Auditor should verify stock statement to check the correctness of drawing power and whether the same is calculated in accordance with the approved policy of bank. Auditor should not assume sanctioned limit to be the drawing power. There may be instances where drawing power would be less than the sanctioned limit. For example, sanctioned limit of an account may be ₹25 lakh but the drawing power of the account may not necessarily be ₹25 lakh and it could less than that. A CC/OD account which is classified as standard may get classified as NPA because of an error in calculation of drawing power.

(iii) **Bills Purchased/Discounted:** If the bill purchased or discounted remains overdue for a period of more than 90 days from its due date.

(iv) **Agricultural Advances:** A loan granted for-

a. Short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons.

b. Long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.

For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one year and NPA date would depend on crop cycle, which is

A credit card account will be treated as NPA, 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.

decided by State Level Bankers' committee in each state.

(v) The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated 1st February, 2006.

(vi) In respect of 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.

(vii) A credit card account will be treated as NPA, 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.

(viii) Guidelines for classification of projects under implementation are as under:

Notes:

a) For all projects financed by the financial institutions (FIs)/banks after 28th May, 2002, the date of completion of the project should be clearly spelt out at the time of financial closure of the project.

b) 'Project Loan' would mean any term loan which has been extended for the purpose of setting up of an economic venture. Banks should fix a Date of Commencement of Commercial Operations (DCCO) for all project loans at the time of sanction of the loan/financial closure.

c) The above asset classification norms would apply to the project loans before commencement of commercial operations.

d) The above guidelines would not be applicable for restructuring of advances which are dealt with different sets of guidelines.

e) Any change in the repayment schedule

	Before commencement of commercial operation	Failure to commence commercial operation within two years (IS)/ one year (NIS) from DCCO	Restructuring due to court cases (refer note 'e')	Restructuring due to other reasons (Refer note 'e')
Infrastructure Sector (IS)	Classify as NPA if interest/instalment is 90 days' overdue.	Classify as NPA even if it is regular as per record of recovery unless restructured and eligible to be classified as Standard.	a) Can be retained as Standard if restructured within two years from original DCCO. b) DCCO can be extended up to 4 years beyond the original DCCO	a) Can be retained as Standard, if restructured within two years from original DCCO. b) DCCO can be extended up to 3 years beyond the original DCCO
Non Infrastructure Sector (NIS)	Classify as NPA if interest/instalment is 90 days' overdue.	Classify as NPA even if it is regular as per record of recovery unless restructured and eligible to be classified as Standard	Not applicable	a) Can be retained as Standard, if restructured within one year from original DCCO. b) DCCO can be extended up to another one year (beyond the existing extended period of 2 years, *i.e.*, total extension of 3 years)

of a project loan would not be treated as restructuring if :

i. The increase in scope and size of the project takes place before commencement of commercial operations of the existing project.
ii. The rise in cost excluding any cost-overrun in respect of the original project is 25% or more of the original outlay.
iii. The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCO.
iv. On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch.

3.0 Exceptions/ Clarifications

3.1 Accounts with temporary deficiencies:

An account should not be classified as NPA, if the deficiencies like non-submission of stock statement, non-renewal of facility in the account are temporary in nature, *etc.* RBI's guidelines in this regard are as under:

a) Drawing power is required to be arrived at based on the current stock statement.
However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding balance in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular. A CC/OD account would become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days. For example, if borrower is allowed drawing on the basis of stock statement of August 2014 for next three months, then it would be irregular from December 2014. If the borrower does not submit fresh stock statement then the account would become NPA in March 2015.

b) An account, where the regular/*adhoc* credit limits have not been reviewed/renewed within 180 days from the due date/date of *adhoc* sanction, will be treated 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 and not the particular facility/investment or part thereof which has become irregular. However, there are few exceptions to this guideline.

3.2 Asset Classification to be borrower-wise and not facility-wise

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 and not the particular facility/investment or part thereof which has become irregular. However, there are following exceptions to this guideline:

a) Under the on-lending system, only that particular credit facility granted to PACS/FSS which is in default will be classified as NPA and not all the credit facilities sanctioned to a PACS/FSS.

b) Any amount, representing positive mark-to-market value of the foreign exchange derivative contracts (other than forward contract and plain vanilla swaps and options) that were entered into during the period April 2007 to June 2008, which has already crystallised or might crystallise in future and is/becomes receivable from the client, even if overdue for a period of 90 days or more, will not make other funded facilities provided to the client, NPA on account of the principle of borrower-wise asset classification, though such receivable overdue for 90 days or more shall itself be classified as NPA, as per the extant IRAC norms.

c) In respect of additional facilities sanctioned under the rehabilitation package approved by BIFR, classification norms will become applicable after a period of one year from the date of disbursement, *i.e.*, additional facility can be treated as standard upto one year from the date of disbursement.

3.3 Advances under consortium arrangements

Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with lead bank and the lead bank is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA. If the bank is able to arrange to get their share of recovery transferred from the lead bank or get an express consent from the

An account which is generally irregular, where a solitary or a few credits are recorded before the balance sheet date, should be carefully checked.

lead bank for the transfer of their share of recovery, they may be able to make proper classification in their books.

3.4 Advances against Term Deposits, NSCs and KVP/IVP, *etc.*

Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

3.5 Government guaranteed advances

The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the government repudiates its guarantee when invoked.

3.6 Up gradation 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'.

3.7 Accounts regularised near about the balance sheet date

An account which is generally irregular, where a solitary or a few credits are recorded before the balance sheet date, should be carefully checked. 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 auditors must obtain satisfactory evidence about the manner of regularisation of the account to eliminate doubts on their performing status.

4.1 Income Recognition

i) As per Accounting Standard 9 on Revenue Recognition and as per the Master Circular of the RBI, income should be recognised when there is a reasonable certainty about its realisability. In respect of NPA, there is no reasonable certainty about realisability of interest, therefore it is booked as income only when it is actually realised. If bank follows policy of charging interest in NPA account then same should not be taken to income but to unrealised interest or interest suspense account.
However, 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. For example: A borrower has taken loan of ₹1 lakh against term deposit of ₹1.25 lakh. Balance in the account as on 31st March, 2015 is ₹1.10 lakh. Even though account is over drawn, income would be recognised since value of deposit is more than the balance outstanding.

ii) Income on standard advances is recognised on accrual basis except in case of income on Central Government guaranteed advances, which would have otherwise become NPA, income is recognised on realisation.

iii) 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.

iv) In project loans, any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.

v) If the amount of interest dues is converted into equity or any other instrument, and income is recognised in consequence, full provision should be made for the amount of income so recognised. However, if the conversion of interest is into equity which is quoted, interest income can be recognised at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity.

vi) The income in respect of unrealised interest which is converted into debentures or any other fixed maturity instrument should be recognised only on redemption of such instrument.

vii) Fees and commissions earned by the banks as a result of re-negotiations or re-scheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or re-scheduled extension of credit.

4.2 Reversal of Income

i) If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised during the year under audit. This will apply to government guaranteed accounts also.

ii) In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

iii) The 'finance charge' component of finance income [as defined in 'AS 19–Leases' issued by 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 non-performing, and remaining unrealised, should be reversed or provided for in the current accounting period.

4.3 Appropriation of Recovery in NPAs

In case of any recovery in the NPA, the application of recovery towards interest/principal should be based on the agreement with the borrower. In the absence of a clear agreement, banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner. Thus, as per the consistent policy of the bank, recovery may be appropriated towards interest or principal.

5.0 Asset Classification

Having identified an account as NPA, it is further required to be classified into -

a) Sub-standard Assets
b) Doubtful Assets
c) Loss Assets

Sub-standard Assets:

An account which is classified as NPA for the first time, is categorised as sub-standard for a period of less than or equal to twelve months from the date of advance becoming NPA. However in following circumstances, the NPA should be straightaway classified as doubtful/loss asset-

(i) Where there are potential threats for 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

(ii) When erosion in the realisable value of the security is more than 50% of the value assessed by the bank or accepted by the RBI at the time of last inspection, NPAs should be straightaway classified under doubtful category.

(iii) If the realisable value of the security, as assessed by the bank/approved valuers/RBI is less than 10% of the outstanding in the borrowal accounts, the NPA should be straightaway classified as loss asset.

Doubtful Assets:

An account is classified as doubtful if it has remained in the sub-standard category for a period of 12 months.

Loss Assets:

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 recovery value (less than 10% of balance outstanding).

6.0 Prudential Guidelines on Restructuring of Advances by Banks

There is a different set of guidelines for classification of advances under restructuring in Part-B of the Master Circular of Reserve Bank of India

6.1 Guidelines are extended to following four category of advances:

(i) Advances to industrial units
(ii) Industrial units under the Corporate Debt Restructuring (CDR) mechanism
(iii) Advances extended to Small and Medium Enterprises (SME)
(iv) Restructuring of all other advances.

6.2 Eligibility Criteria:

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

If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised during the year under audit.

b) 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.
c) The process of restructuring can be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.
d) 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.
e) The borrowers indulging in frauds and malfeasance are ineligible for restructuring. However, in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and bank satisfies 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 and for accounts the restructuring under the CDR Mechanism may be carried out with the approval of the Core Group
f) BIFR cases are eligible for restructuring after their express approval and ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.

6.3 Asset Classification Norms

a) The restructuring/rescheduling/renegotiation of the terms of loan agreement could take place:
   (i) before commencement of commercial operations;
   (ii) after commencement of commercial operations but before the asset has been classified as sub standard;
   (iii) after commencement of commercial operations and after the asset has been classified as substandard.
b) Upon restructuring, the accounts classified as 'standard assets' would get reclassified as 'substandard assets' and account which is already NPA would continue to have the same classification and slip in to further lower asset classification as per the extant asset classification norms.
c) Any additional finance may be treated as 'standard asset', up to a period of one year after the first interest/principal payment, whichever is earlier, falls due under the approved restructuring package.

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.

All restructured accounts which have been classified as NPA upon restructuring, would be eligible for up-gradation to the 'standard' category after observation of 'satisfactory performance' during the specified period. Specified period means a period of one year from the commencement of the first payment of interest or principal whichever is later, on the credit facility with longest period of moratorium under the terms of restructuring package.

d) However, accounts of the borrower can continue to be classified in existing asset classification category subject to fulfilment of conditions enumerated in para 7 below.

6.4. Provisioning Norms:

a) The total provisions required against an account under restructuring would be normal provisions plus provisions in lieu of diminution in the fair value of the advances.
b) Normal provision is discussed in para 8.
c) Diminution in fair value of the advance is difference between fair value of advance before and after restructuring. Fair value of advance before/after restructuring is computed as the present value of cash flows representing the interest at the existing rate/revised rate charged on the advance before/after restructuring and discounted at an appropriate rate. The difference between two fair values would be the diminution in value of advance which would be provided for.
d) The diminution in the fair value would be required to be re-computed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account. Consequently, banks would be required to provide for the shortfall in provision or reverse the amount of excess provision.
e) 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 therefore, at five percent of the total exposure, in respect of all restructured accounts where the total dues to bank are less than ₹ 1 crore.

f) Restructured advances classified as standard or classified as NPA but subsequently upgraded would attract higher provision.

7.0 Special Regulatory Treatment for Asset Classification

Reserve Bank of India has stipulated special regulatory frame work for asset classification, in modification to guidelines as enumerated in para 6 above. This special treatment will be available to the borrowers engaged in important business activities, subject to compliance with certain conditions as enumerated herein and is not extended to the following categories of advances:

i. Consumer and personal advances;
ii. Advances classified as capital market exposures;
iii. Advances classified as commercial real estate exposures

Thus benefit of special regulatory frame work would be available subject to compliance of conditions stipulated in the paragraph 7.1 below. If these conditions are not complied then guidelines as discussed in para 6 would apply to restructured accounts.

7.1 Elements of special regulatory framework

The special regulatory treatment has the following two components:

(i) Incentive for quick implementation of the restructuring package.

As an incentive for quick implementation of the package, if the approved package is implemented by the bank as per the following time schedule, the asset classification status may be restored to the position which existed when the reference was made to the CDR Cell or when the restructuring application was received by the bank.

(a) Within 120 days from the date of approval under the CDR Mechanism.
(b) Within 120 days from the date of receipt of application by the bank in other cases.

(ii) Retention of the asset classification of the restructured account in the pre-restructuring asset classification category

Subject to the compliance with the undernoted conditions in addition to the adherence to the prudential framework laid down in para 6 above,

(a) An existing 'standard asset' will not be downgraded to the sub-standard category upon restructuring.
(b) During the specified period, the asset classification of the sub-standard/doubtful accounts will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period.

These benefits will be available subject to compliance of the following conditions:

i. The dues to the bank are 'fully secured' by tangible assets except in the following cases:
   a) SSI borrowers, where the outstanding is up to ₹ 25 lakh.
   b) Infrastructure projects, provided the cash flows generated from these projects are adequate for repayment of the advance, the financing bank(s) have in place an appropriate mechanism to escrow the cash flows, and also have a clear and legal first claim on these cash flows.
ii. The unit becomes viable in 8 years, if it is engaged in infrastructure activities, and in 5 years in the case of other units.
iii. The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances. The aforesaid ceiling of 10 years would not be applicable for restructured home loans; in these cases the Board of Directors of the banks should prescribe the maximum period for restructured advance keeping in view the safety and soundness of the advances.
iv. Promoters' sacrifice and additional funds

Promoter's personal guarantee should be obtained in all cases of restructuring. Corporate guarantee cannot be accepted as a substitute for personal guarantee. However, the same can be accepted in cases where promoters of a company are not individuals.

Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for.

brought by them should be a minimum of 20% of banks' sacrifice or 2% of restructured debt whichever is higher. The term 'bank's sacrifice' means the amount of "erosion in the fair value of the advance". The additional funds required to be brought in by the promoter should be brought up front and not be phased over a period of time.

v. Promoter's contribution need not necessarily be brought in cash and can be brought in the form of de-rating of equity, conversion of unsecured loan brought by the promoter into equity and interest free loans.

vi. The restructuring under consideration is not a 'repeated restructuring'

vii. Promoter's personal guarantee should be obtained in all cases of restructuring. Corporate guarantee cannot be accepted as a substitute for personal guarantee. However, the same can be accepted in cases where promoters of a company are not individuals.

8.0 Provisioning Norms

(i) Substandard assets

A general provision of 15% on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available.

The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10%, *i.e.*, a total of 25% on the outstanding balance'. However, in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 20% instead of the aforesaid prescription of 25%.

(ii) Doubtful assets

a) 100% of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis (unsecured portion).

b) In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25% to 100% of the secured portion depending upon the period for which the asset has remained doubtful:

Period for which the advance has remained in 'doubtful' category	Provision requirement (%)
Up to 1 year	25
1 to 3 years	40
More than 3 years	100

(iii) Loss assets

Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

(iv) Standard assets

a. Direct advances to agricultural and SME sectors at 0.25%;

b. Advances to Commercial Real Estate (CRE) Sector at 1%;

c. Advance to commercial Real Estate – Residential Housing Sector at 0.75%

d. Housing loan at teaser rates 2% and 0.40% after 1 year from the date on which the rates are reset at higher rates

e. All other loans and advances not included in (a), (b), (c) and (d) above at 0.40%

f. Restructured account classified as standard would attract higher provision. Para 4.2.15.3(iv) of Master Circular may be referred for the same.

(v) Valuation of security for provisioning purposes

a. There are specific guidelines in para 5.4(iii) of the Master Circular for consideration of security in respect of infrastructure projects. The same may be referred.

b. In cases of NPAs with balance of ₹5 crore and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the board of the bank would be mandatory. Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.

(vi) Provisions under Special Circumstances:

a. Provision on additional facilities sanctioned as per package finalised by BIFR and/or term lending institutions, need not be made for a period of one year from the date of disbursement

b. Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs, and life policies would attract provisioning requirements as applicable to their asset classification status.

c. Advances against gold ornaments, government securities and all other kinds of securities are not exempted from provisioning requirements.

d. Advances covered by ECGC/CGTSI guarantee: In the case of advances classified as doubtful and guaranteed by ECGC/ CGTSI, provision is required to be made only for the balance in excess of the amount guaranteed by the corporation. Further, while arriving at the provision required to be made for doubtful assets, realisable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by the corporation and then provision should be made.

e. Provisioning norms for sale of financial assets to securitisation company (SC)/ reconstruction company (RC)–

   i) If the sale of financial assets to SC/RC, is at a price below the net book value (NBV) (*i.e.,* book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

   ii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilised to meet the shortfall/loss on account of sale of other financial assets to SC/RC.

Banks are required to report SMA accounts as per prescribed limit of exposure to Central Repository of Information on Large Credits (CRILC) of RBI.

9.0 Framework for Revitalisation of Distressed Assets

The new frame work is given in part C of the Master Circular. The purpose of this frame work is to ensure that the banking system recognises financial distress timely, takes prompt steps to resolve it and ensures fair recovery for lenders and investors. Due to space constraints the same are not discussed in detail. However, some of the key aspects are discussed in brief hereunder:

i) Banks are required to identify incipient stress in the account by creating three sub-categories under the special mention account (SMA):

SMA sub-categories	Basis for classification
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

ii) Banks are required to report SMA accounts as per prescribed limit of exposure to Central Repository of Information on Large Credits (CRILC) of the RBI.

iii) As soon as an account is reported as SMA2, banks have to form a committee called Joint Lender's Forum (JLF). The JLF in turn would decide Corrective Action Plan (CAP) which would be either rectification or restructuring or recovery.

iv) While a restructuring proposal is under consideration by the JLF/CDR, the usual asset classification norm would continue to apply.

v) As a measure to impose disincentives on borrowers not maintaining credit discipline, accelerated provisioning norms are prescribed (Refer para 26 of the Master Circular).

vi) As per *para* 27 of the Master Circular, banks would be required to identify directors whose name appear more than once in the list of willful defaulters as also no cooperative borrowers. The provisioning for such cases will be at the rate of 5% if it is a standard account and accelerated provision as per para 27 if it is NPA.

Having discussed the Master Circular, audit steps for verification of NPA and some important issues are discussed here:

1) Generally, all the banks have a system driven process of identification of account as NPA in place. Verify the system and various parameters to ensure the accuracy of classification, reversal of unrealised interest/ income, categorisation of account into substandard or doubtful I, II, III, calculation of provision, carry forward of classification of NPA date, *etc.*
2) Some of the critical areas in CC/OD accounts which auditor need to verify are determination of correct drawing power, temporary deficiencies, fresh sanction to regularise an account, regularisation of account near about the balance sheet date through genuine sources, *etc.*
3) Reversal of unrealised interest on classification of an account as NPA and non-recognition of income subsequently.
4) Accounting and recognition of income in NPA accounts on recovery.
5) If an account is classified as NPA, all the facilities of the borrower to be classified as NPA.
6) Up gradation of accounts from NPA to Standard if any and whether the same is in accordance with the guidelines given in the Master Circular.
7) Verification of secured and unsecured portion and provisioning. Many a times, valuation report of securities are not available. In such cases, auditor will have to be careful in evaluating the value of securities and take an appropriate view.
8) 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 part of the borrower's principal operating account for the purpose of prudential norms on income recognition, asset classification and provisioning. (Para 4.2.7(ii) of Master Circular)
9) If an account is restructured, ensure that guidelines as prescribed in the Master Circular are followed.

Conclusion

Important aspects relevant for audit of NPAs have been discussed in this article. Needless to mention that auditor should refer Master circular dated 1st July, 2014 of RBI for better understanding of the subject. ■