

Seminar on Statutory Audit of Bank Branches

Recent Regulatory Developments &
IRAC Norms- Practical issues

Vasai Branch of WIRC of ICAI

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Challenges for Bank Audit -FY 2024-25:

- ❑ **RAM portfolio-** increase in loan portfolio and increasing defaults rates which may lead to **possible evergreening- End use monitoring**
- ❑ **Building up stress - Unsecured loan portfolio- PL, Credit cards etc.**
- ❑ **Quick Loans-** increased focus of RBI on loans which are given over the counter by the Branches- Gold Loans- several lapses highlighted by RBI- Quality of portfolio- **LFAR reporting/MOC**
- ❑ **IRAC Norms 2.0-** reporting on implementation issues in - daily NPA **classification through system** with minimum or no manual intervention, out of order in CC a/c etc. as per new norms
- ❑ Ensuring **compliance of various RBI guidelines issued during CY** relating to operational and other matters of consumer service- **LFAR reporting**
- ❑ **Reliance on effective functioning of automated systems in Banks-** interest rate re-set, interest paid on deposit account etc.- **independent testing by the auditor- Test of 1**

*From Reserve Bank of
India Desk*

Relevant Circulars applicable for FY 2024-25:

❑ Important Circular/Notifications:

- Reset of Floating Interest Rate on Equated Monthly Instalments (EMI) based Personal Loans- August 18, 2023- effective 1st January 2024- **LFAR reporting**
- Inoperative Accounts /Unclaimed Deposits in Banks- Revised Instructions- January 1, 2024- w.e.f. April1,2024- **LFAR Reporting**
- Fair Practices Code for Lenders – Charging of Interest- April 29,2024 – **MOC/LFAR reporting**
- Gold loans - Irregular practices observed in grant of loans against pledge of gold ornaments and jewellery- September 30,2024- **LFAR reporting/MOC- Potential NPA**
- Key Facts Statement (KFS) for Loans & Advances- April 15,2024 – effective from October 1,2024- **LFAR Reporting**

Relevant Circulars applicable for FY 2024-25:

❑ Master Circular/Master Directions:

- Master Circular Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances 2nd April 2024– **[Consolidated Circular]**
- Master Circular - Guarantees and Co-acceptances- 1st April 2024
- Master Directions on Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions- **updated RFA & EWS mechanism**
- Master Direction-Priority Sector Lending-Targets and Classification (amended from time to time)- **Certificate from SBA's**
- Master Direction - Know Your Customer (KYC) Direction, 2016- **LFAR clauses**

Fair Practices Code for Lenders – Charging of Interest-

□ RBI Circular dated April 29, 2024 :

2. During the course of the onsite examination of REs for the period ended March 31, 2023, the Reserve Bank came across instances of lenders resorting to certain unfair practices in charging of interest. Some of the unfair practices observed are briefly explained below:

- a) Charging of interest from the date of sanction of loan or date of execution of loan agreement and not from the date of actual disbursement of the funds to the customer. Similarly, in the case of loans being disbursed by cheque, instances were observed where interest was charged from the date of the cheque whereas the cheque was handed over to the customer several days later.
- b) In the case of disbursement or repayment of loans during the course of the month, some REs were charging interest for the entire month, rather than charging interest only for the period for which the loan was outstanding.
- c) In some cases, it was observed that REs were collecting one or more instalments in advance but reckoning the full loan amount for charging interest.

Audit Procedures by SBAs on FLP:

- ❑ Inquire with the Branch about **different mode of disbursement-** RTGS/NEFT/Cheque/DD etc.
- ❑ Inquire with the Branch about the **nature of products** where disbursement are made through DD/Cheques
- ❑ Verify the **existing process of the Bank on charging interest** on Loan in the system i.e. interest start date- cheque date or disbursement date
- ❑ **Re-computation of one sample** for each product to verify the system logic – Hl, Vehicle etc.
- ❑ **Discuss the issue identified** based on inquiry and re-computation with Branch Manager
- ❑ **Report the observation in LFAR** – all clauses in LFAR related to interest on loan should be “*subject to the above observation*” MOC will not be possible.
- ❑ **Highlight the above in main Audit report** as well- since the same is non-compliance with RBI circular

Gold loans - Irregular practices- 30th September 2024:

	RBI Observations
1	Loans granted through BC- Complete reliance placed on BC for valuation, KYC, appraisal process, storage of Gold etc.
2	Instances of breach of regulatory LTV ceilings- 75%
3	End use of funds was usually not verified for non-agriculture loans
4	Lack of proof or proper documentation obtained and retained in respect of agriculture gold loans .
5	No fresh appraisal was done at the time of sanctioning these top up loans - only given based on value of Gold
6	Average realisation from auction of gold on default by the customer was low
7	Share of gold loans disbursed in cash to total gold loans disbursed was high

Gold loans - Irregular practices- 30th September 2024:

	RBI Observations
8	Practice of rolling over loans at the end of tenor, with only part payment
9	Non-categorisation of gold loans as NPA in the system,
10	Evergreening by renewing overdue loans/issuing a fresh loan
11	Application of risk weights were at variance with the prudential regulations

Statement referred to in reply to parts (a) to (e) in respect of Lok Sabha Starred Question No. *82 for reply on 10.02.2025 regarding Gold Loan NPAs in Banks and NBFCs asked by Shri Anand Bhadauria and Smt Kanimozhi Karunanidhi.

(a) to (e): The gross non-performing assets (GNPAs) pertaining to gold loan in Scheduled Commercial Banks (SCBs) and Upper and Middle-Layer Non-Banking Financial Companies (NBFCs) have increased by 18.14% from March 2024 to June 2024, and the gross GNPAs pertaining to gold loan in SCBs have increased by 21.03% during the same period. Further, as on 30.6.2024, gross NPA ratio pertaining to gold loans in SCBs was 0.22 % and that of upper layer and middle layer NBFCs was 2.58 %.

Gold loans - Steps to be performed by SBAs :

- Understand **types of Gold loans** offered to the customers (OD, TL etc.)
- Select **additional loans samples** from Gold loan portfolio to understand the process of sanction & disbursements- **Cash payout**
- Verify the process of **determining the value of gold** by the independent valuer appointed by the Bank
- Verify the process of **determining the eligible loan amount**, interest rate and fees charged to the customer – waiver within authority
- Verify the process of **LTV monitoring by the Bank** and process of reaching out to customer in event of breach of LTV ratio
- Review the **process of verification of quality of gold**, existence of gold packets etc. implemented by the bank – surprise verification?
- **Independent counting of Gold loan packets** by SBA on last day of audit

Key Areas of penalties by RBI:

❑ PSB/Private Banks:

- Offered interest rate applicable to normal term deposits on certain senior citizen term deposits **instead of higher rate of interest applicable to such deposits**
- sanctioned loans to certain borrowers against pledge of gold ornaments and jewellery for non-agricultural purposes **exceeding 75 per cent of the value of gold ornaments and jewellery,**
- **Allotted multiple Customer Identification Code** to certain individual customers instead of a Unique Customer Identification Code (UCIC) to each customer.
- did not pay **interest rates strictly as per the schedule of interest rates** disclosed in advance in several term deposit accounts,
- **levied interest from disbursement due date** instead of the actual date of disbursement, contrary to the terms & conditions of sanction,
- **failed to benchmark the interest rate** of certain floating rate retail loans and floating rate loans to MSMEs to an external benchmark lending rate.
- **failed to credit eligible amount to DEAF** within the period prescribed in the BR Act

ICAI Materials:

Guidance Note on Audit of Banks (2025 Edition)

Attention

Members' attention is invited to relevant directions/circulars issued by the Reserve Bank of India up to January 31, 2025, available at ICAI website for ease of use and reference. Members are advised to keep track of legislative/regulatory developments, for example, circulars of the Reserve Bank of India, issued subsequent to the aforementioned date and having a bearing on the statutory audit of banks/bank branches for the year ended March 31, 2025.

Members are also advised to read this Guidance Note along with other three publications (Technical Guide on Audit of Internal Financial Controls in Case of Public Sector Banks, Technical Guide on Revised Formats of Long Form Audit Report and Guidance Note on Reports or Certificates for Special Purposes (Revised 2016)) of AASB.



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

Technical Guide on Revised Formats of Long Form Audit Report



The Institute of Chartered Accountants of India
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Technical Guide on Audit of Internal Financial Controls in Case of Public Sector Banks

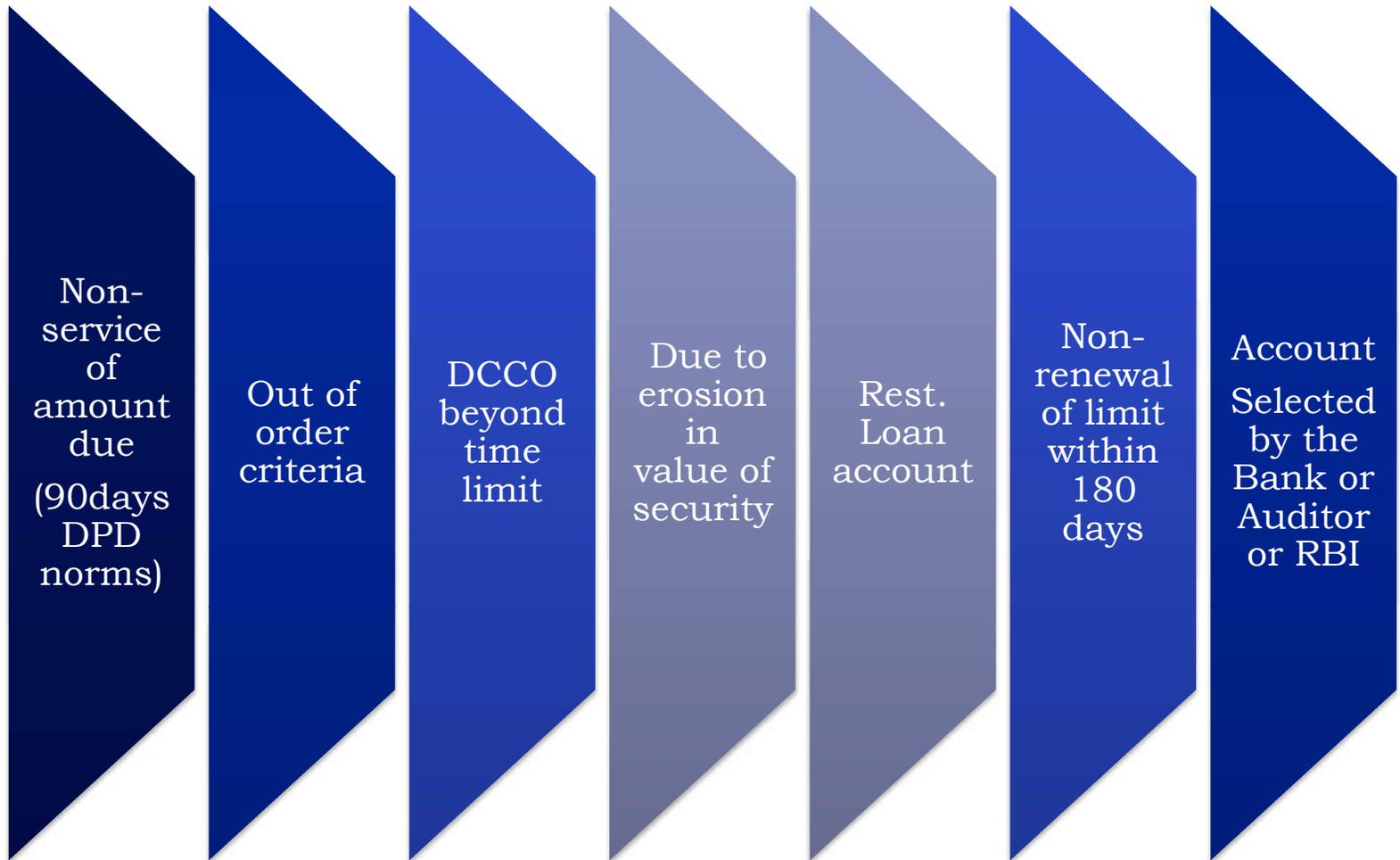


The Institute of Chartered Accountants of India
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New Delhi

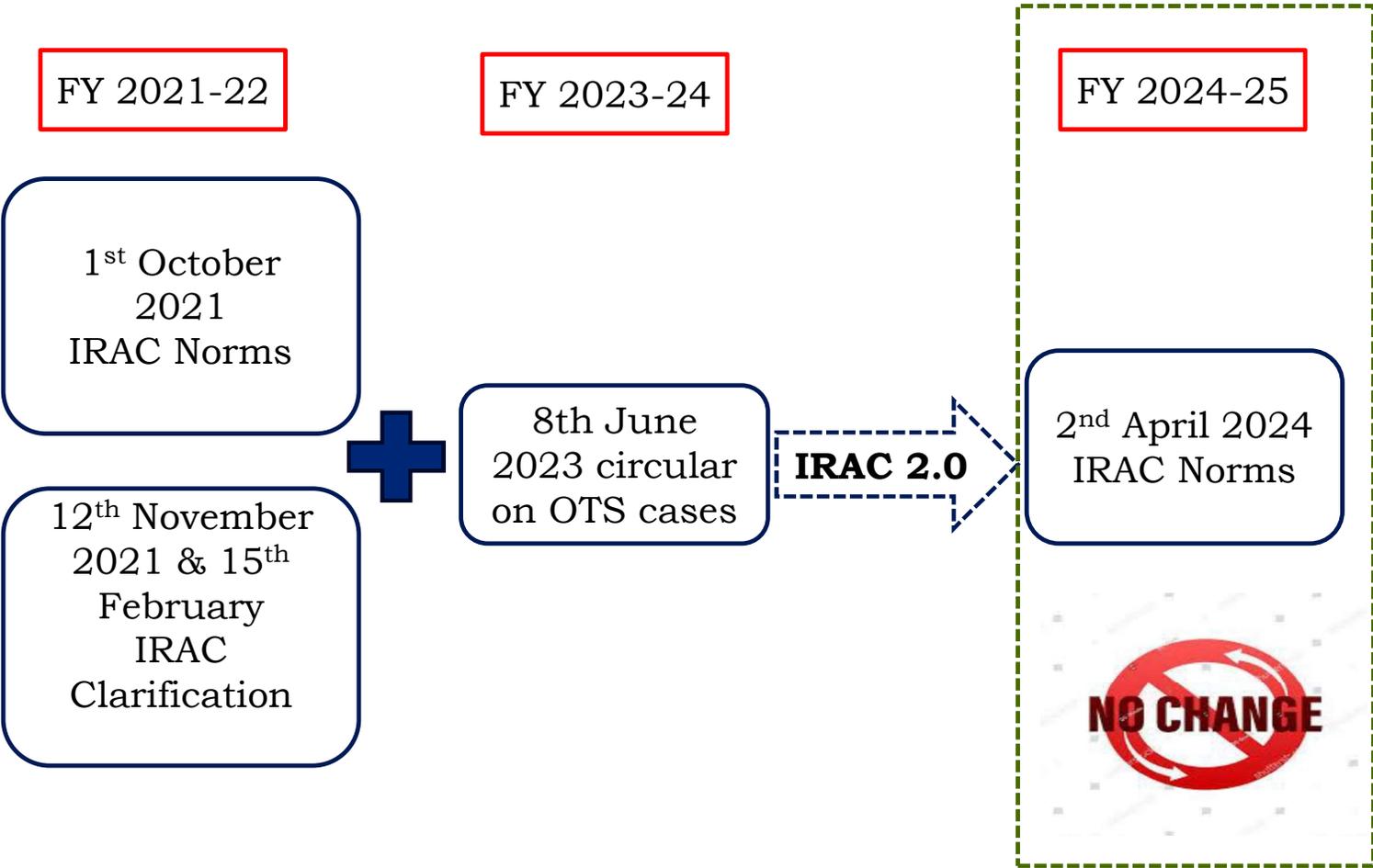
Referencer issued by WIRC/ Vasai Branch
provides practical guidance to members

IRAC Norms 2.0

NPA as per IRAC Norms:



Journey of IRAC 2.0:

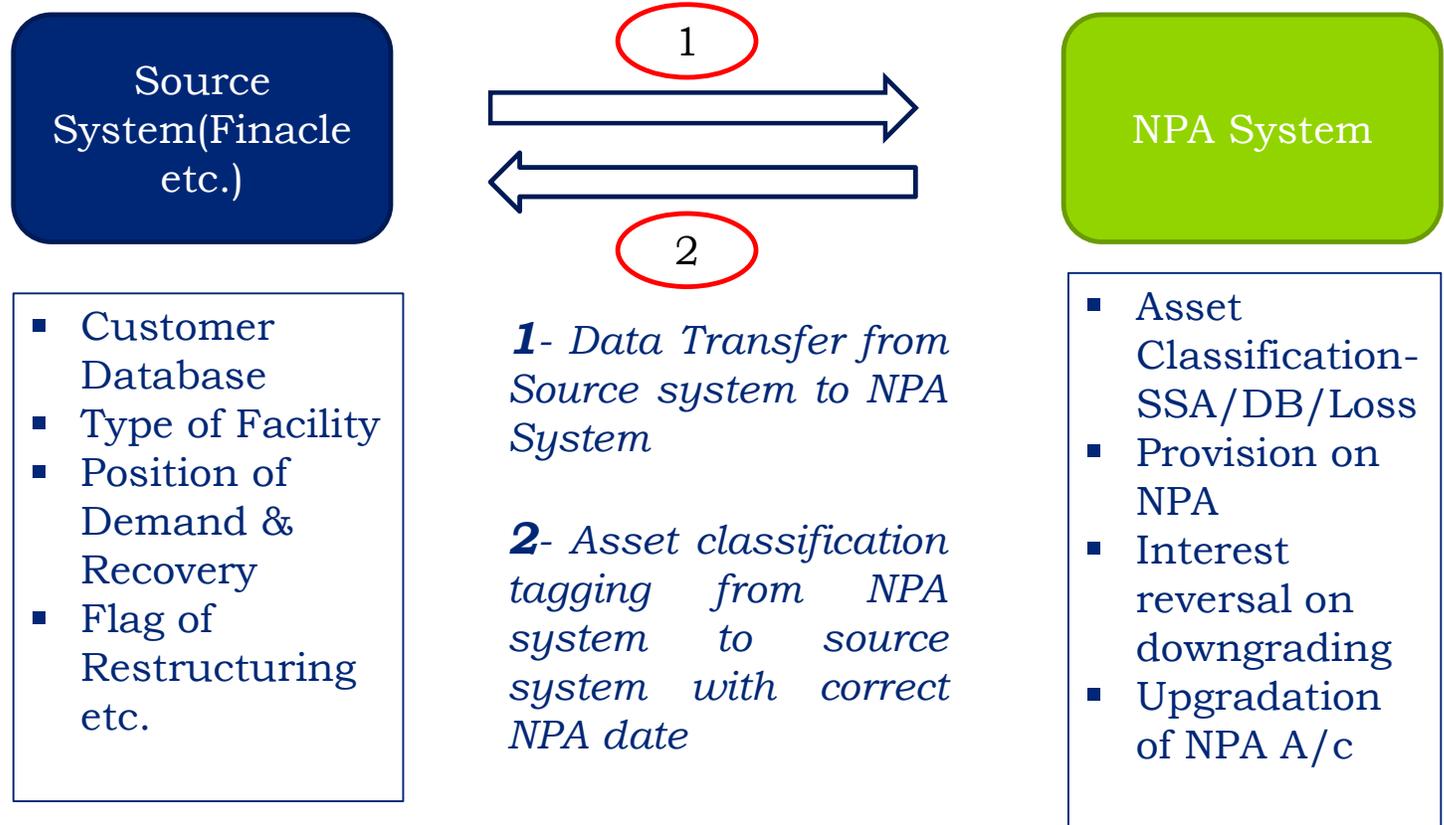


Reporting by SBA-on IRAC 2.0- Recap:

- **Compliance of IRAC norms** to avoid any observations from RBI- impact in LFAR reporting- **same day vs. next day & Daily NPA**
- Reporting on **different practice** followed by the banks- **CC/OD classification**- LFAR reporting – compliance of IRAC norms- **previous 90 days recovery**
- Linked account classification on recovery of dues- **zero DPD vs. recovery of dues in NPA account**
- Manual Intervention on asset classification-need to highlight the instances if any either in changing the date of NPA/class of assets- **should be rare instances**
- Extent of automation in NPA system- updation of security value & impact of **expired security valuation** (more than 3 years)

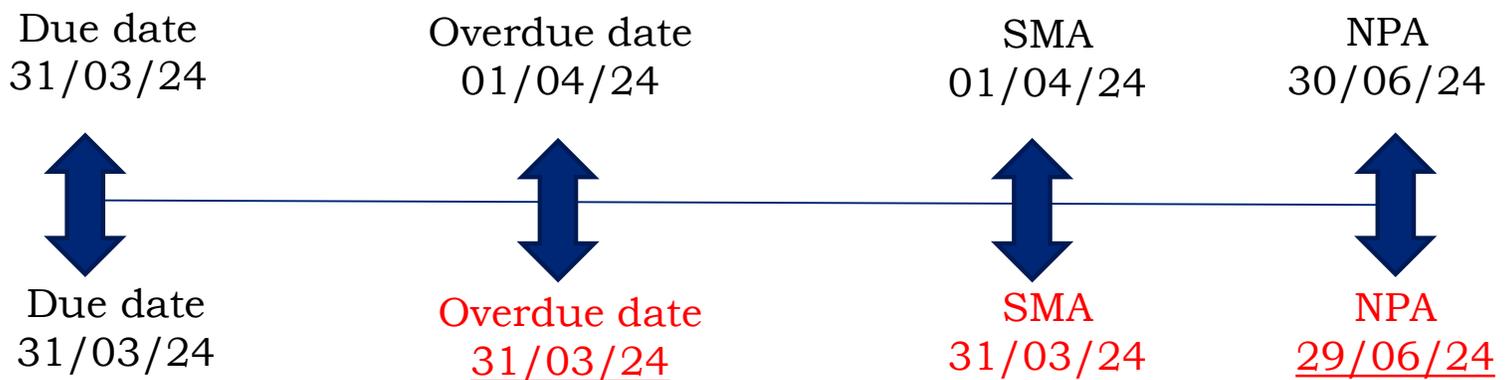
IRAC Norms – Clarifications/changes for Banks:

Usual **day-end** process in case independent system used for NPA:



IRAC Norms – Clarifications/changes for Banks:

Classification of SMA & NPA –part of day-end process:



- ❑ Different banks were following different practice of identification of account as NPA- monthly/quarterly/daily/3EMI due
- ❑ September 2020 circular and November 2021 circulars now requires SCB to identify the NPA on daily basis through system- **June 2021**
- ❑ No exceptions are given for Saturday/Sunday/Holidays- NPA process need to run to identify any account as NPA- **LFAR point**
- ❑ Major impact- total overdue recovery for NPA vs. Partial recovery in Standard accounts

IRAC Norms – Clarifications/changes for Banks:

Clarification regarding definition of 'out of order':

Changes in the wording of definition:

An account should be treated as '**out of order**'

if the outstanding balance in the CC/OD accounts remains continuously in excess of the sanctioned limit/drawing power for 90 days or 1

~~In cases where~~ the outstanding balance in the CC/OD accounts ~~in the principal operating account~~ is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days, ~~as on the date of Balance Sheet~~ or 2

the outstanding balance in CC/OD account is less than the sanctioned limit/drawing power but credits are not enough to cover the interest debited during the same previous 90 days -period, ~~these accounts should be treated as 'out of order'~~. 3

OTS cases :

Major points as per 8th June 2023 circular for SBAs:

- Board approved policy – on process to be followed for all compromise settlements and technical write-offs – permissible sacrifice etc.- **verification by SCAs/Review of policy by SBAs**
- Time for payment of Agreed settlement amount exceeds three months- treated as restructuring and tagged as NPA – **important area in CY**
- Cooling period before giving fresh exposure to such borrowers- minimum 12 months as per RBI circular (except farm credit)- **important area for verification of new sanctions**
- Status of cases - settlement agreed between the bank and borrower on 29th/30th /31st March 2025? – **Potential NPA miss out cases- MOC-system delink**
- Annual Restructuring disclosure should include these accounts as well+ **LFAR reporting** on restructured accounts

Commonly asked Questions on 8th June circular :

- What will be the date of restructuring and the date of NPA in the cases having settlement period more than 3 months?
- What if the borrower is having more than one credit facility and only one facility has been accepted and approved for OTS with settlement period more than 3 months?- Borrower wise classification
- Whether the restriction on granting the new facility for minimum period of 12 months is only from the respective bank or the entire banking industry? Can the bank decide less than 12 months period for such restrictions?
- As an auditor what we should do if the Branch is saying that these processes are handled centrally at Head Office?

LFAR Clause of Restructuring:

<p>(ii)</p>	<p>a) Whether the branch has reported accounts restructured or rephased during the year to Controlling Authority of the bank?</p> <p>b) Whether the RBI Guidelines for restructuring on all such cases have been followed.</p> <p>c) Whether the branch complies with the regulatory stance for resolution of stressed assets, including the compliance with board approved policies in this regard, tracking/reporting of defaults for resolution purposes among others?</p>	<p>:</p>
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IRAC Norms – Clarifications/changes for Banks:

Major points of clarifications –Upgradation of loan account: 1st October 2021 IRAC norms:

4.2.5 Upgradation of loan accounts classified as NPAs

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as nonperforming and may be classified as 'standard' accounts. With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of DCCO, etc., the instructions as specified for such cases shall be applicable.

1st April 2022- IRAC Norms: (added by 15/02 clarification)

4.2.5 Upgradation of loan accounts classified as NPAs

The loan accounts classified as NPAs may be upgraded as 'standard' asset only if entire arrears of interest and principal are paid by the borrower. In case of borrowers having more than one credit facility from a bank, loan accounts shall be upgraded from NPA to standard asset category only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities. With regard to upgradation of accounts classified as NPA due to

Classification of Co-borrower: [Industry Issue]

❑ Assessment of Joint Loans:

- Loans given after assessing and considering income of primary and co-borrower;
- Eligibility criteria tested considering the profile of both the borrowers;
- Borrower and Co-borrower – equal responsibility in regular service of EMI;
- Default in repayment by both would lead to account getting classified as overdue and then NPA.

❑ Current Industry practice:

- In absence of clear guidance- only Cust ID of primary borrower is classified/tagged as NPA- **Co-borrower only CIBIL**

Borrower	Housing Loan	Auto Loan	Credit Card
Primary	Rs.10 crore (Joint Loan)	Rs. 50 lakhs	
Co-borrower		-	Rs.5 lakhs
NPA Classification	Yes	Yes	???

Classification of Co-borrower:

❑ IRAC norm- 1st April 2024:

- No specific guidance on classification of co-borrower in case joint facility becomes an NPA;
- Joint responsibility of repayment - Default by one to be constituted as default by other;
- Term 'borrower' in IRAC norms would mean to include 'co-borrower' as there is no visible distinction between the two;
- Both the borrowers to be classified as NPA.

❑ Current Practice in some banks:

➤ ICICI Bank-

If a loan account of a borrower is classified as NPA, all other accounts of the same borrower/co-borrower are also classified as NPA, irrespective of overdue status in other accounts.

➤ Axis Bank-

Further, in case of NPA, if a loan account of a borrower is classified as NPA, all other accounts of the same borrower/ co – borrower(s) are also classified as NPA, irrespective of overdue status in other accounts.

RBI directions on Negative amortisation: :

RBI circular on Floating Interest rate to Fixed Interest- 18th August 2023:

loan. However, in respect of EMI based floating rate personal loans, in the wake of rising interest rates, several consumer grievances related to elongation of loan tenor and/or increase in EMI amount, without proper communication with and/or consent of the borrowers have been received. In order to address these concerns, the REs are advised to put in place an appropriate policy framework meeting the following requirements for implementation and compliance:

- (v) REs shall ensure that the elongation of tenor in case of floating rate loan does not result in negative amortisation.

LFAR Clause of Security Valuation:

(vii)	In respect of non-performing assets, has the branch obtained valuation reports from approved valuers for the immovables charged to the bank, once in three years, unless the circumstances warrant a shorter duration?	:
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LFAR Appropriation policy:

(f)	<i>Asset Classification, Provisioning of Advances and Resolution of Stressed Assets</i>		
(x)	Whether in the cases concluded the recoveries have been properly appropriated against the principal / interest as per the policy of the bank?	:	

Relevant LFAR Clause- IRAC 2.0:

(f)	<i>Asset Classification, Provisioning of Advances and Resolution of Stressed Assets</i>	
(i)	a) Has the branch identified and classified advances into standard / substandard / doubtful / loss assets through the computer system, without manual intervention? b) Is this identification & classification in line with the norms prescribed by the Reserve Bank of India	f) Whether RBI guidelines on income recognition and provisioning have been followed.
(iii)	a) Whether the upgradations in non-performing advances is in line with the norms of Reserve Bank of India b) Where the auditor disagrees with upgradation of accounts? If yes, give reasons thereof.	

Minimum Audit Procedures on NPA:

- Comparison of NPA of current year vs. Previous year [Name of Customer, Date of NPA, O/s Balance etc.]
- Verification of the any changes in the above and reasons for the same along with relevant supporting documents
- Increase in the O/s Balances- due to recovery charges etc. should be debited to P & L A/c- CRIP Cost in case of IBC cases
- Verification of the recovery in the NPA accounts- apportionment as per the recovery policy of the bank- adjustment of recoveries done through suspense a/c rather than direct NEFT/RTGS
- Verification of the security valuation for the cases shifted to Doubtful category in the current year from the date of NPA
- Verification of Fraud accounts – comparison of the same with the last year and new accounts identified in the CY

Key areas in NPA during Bank Audit-2024-25:

Area	Potential Issues	Potential Impact on Branch Audit
Identification of account as NPA	1. Time-gap between the approval and flagging OTS accounts in system	Non-identification of NPA- MOC and reporting in LFAR under Restructuring.
	2. Quality of credits in cash credits accounts	Non-identification of NPA- MOC and reporting in LFAR
	3. Classification of cases of Negative amortization	Non-identification of NPA- MOC and reporting in LFAR
	4. Classification of Co-Borrower as NPA	Non-identification of NPA- MOC and reporting in LFAR
	5. Possible evergreening through new facility	Non-identification of NPA- MOC and reporting in LFAR

Key areas in NPA during Bank Audit-2024-25:

Area	Potential Issues	Potential Impact on Branch Audit
Provision on NPA accounts	6. Value of security post multiple auction failure	Under provisioning-MOC
	7. Existence of security in system but not in possession	Under provisioning-MOC
	8. Value of Plant & Machinery based on valuation report without any impact of subsequent depreciation	Under provisioning-MOC

Key areas in NPA during Bank Audit-2023-24:

Area	Potential Issues	Potential Impact on Branch Audit
Upgradation of NPA accounts	9. Recoveries of guaranteed amount relating to ECLGS loans	Incorrect upgradation – MOC
	10. Upgradation with Linked facilities in overdue status	Incorrect upgradation – MOC
	11. Upgradation of written off accounts post recovery till date of w/off	Incorrect upgradation – MOC

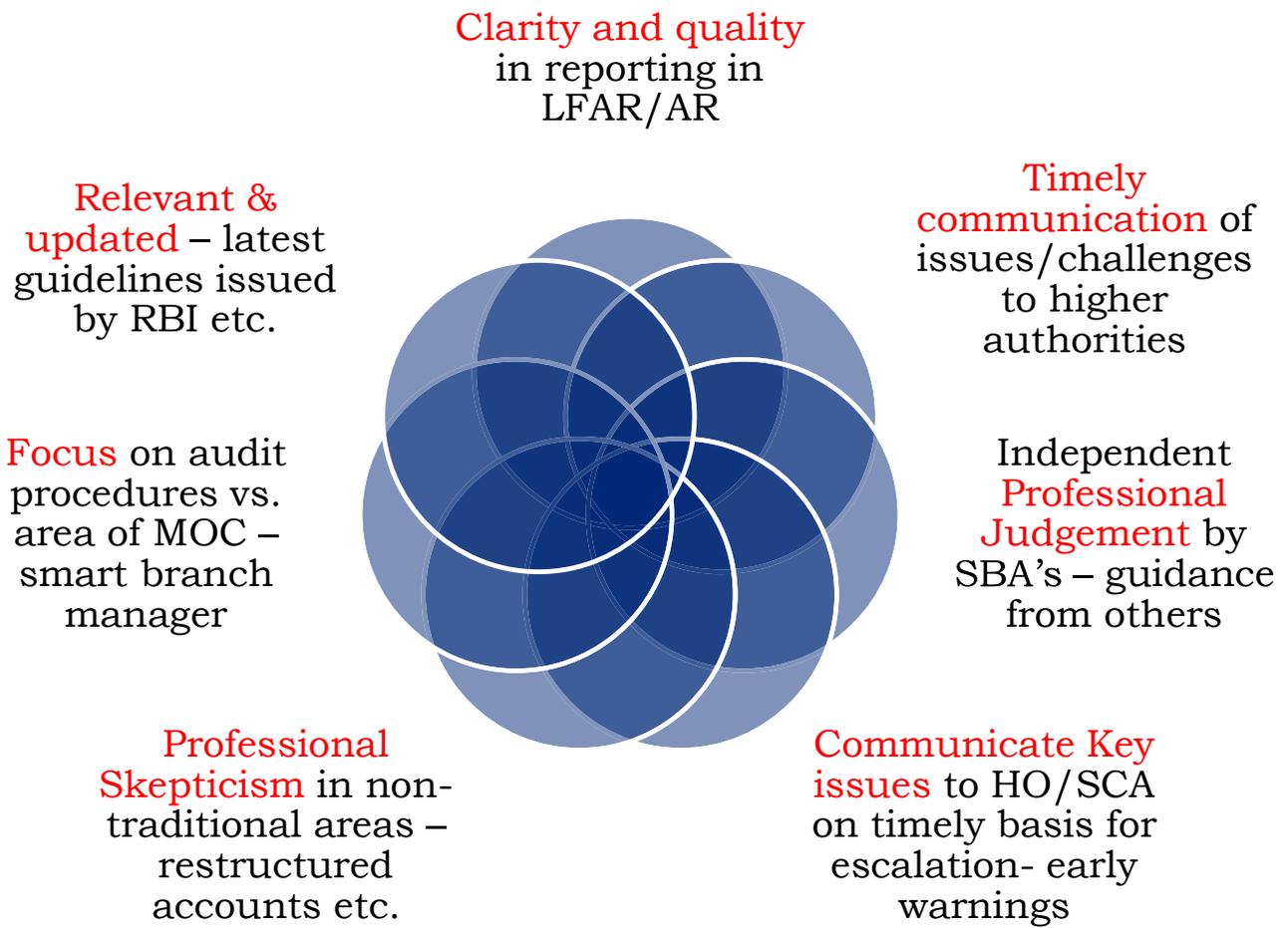
Top Focus area for Bank Audit in FY 24-25 :

- ❑ **Review of Gold loan portfolio-** identification of process lapses and reporting the same in LFAR/MOC for account with evergreening
- ❑ **Fair lending practice-** review of interest charging the system by the Banks- reporting on incorrect charging in LFAR and MOC if required- P&L would not give true and fair view
- ❑ **Mule Account-** inquiry with Bank to understand the process- review of inoperative account on sample basis to identify any suspicious transaction- Office accounts, Inoperative accounts, employee frauds
- ❑ **Loan with pending security creation-** Housing loans and other retail loan with long pending security creation- availability of these securities
- ❑ **Loans under various Government Schemes-** review of processes and system for disbursement of loans & review of eligibility criteria for the loans
- ❑ **System Controls/automated controls-** loan disbursement, fee accrual, NPA other areas

Other critical areas in Bank Audit-2024-25:

- ❑ Inclusion of GST in determining LTV ratio for Housing loans- RBI circular clearly prohibits Stamp duty, registration and other charges
- ❑ Refund of proportionate locker rent- rent collected in advances should be refunded to deposit in case of surrender of locker
- ❑ Exclusion of Government Deposit for Computation of DICGC premium- only Central and State government needs to be excluded- impact on DICGC premium amount
- ❑ Transfer to DEAF based on the transaction in respective account and not at the borrower level- current a/c less than 10 yrs. And hence deposit account not transferred- clarified in new RBI Direction
- ❑ Credit Rating to include- details of lender, nature of facilities and exposure amount- else unrated exposure- impact on CRAR- RBI focus-reporting in LFAR
- ❑ Process of De-dupe of new loans with Banks Buy-out portfolio from NBFCs- potential sanction ineligible cases

Do's in Bank Audit :



Thank You

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