

Restructuring & Relief to MSME borrower's- Auditor's perspective

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MSME plays an important role in our economy. This sector contributes significantly to the Indian Economy in terms of Gross Domestic Product (GDP), Exports and Employment generation.

Understanding its difficulties, RBI from time to time has come out with host of measures to provide relief to this sector. The key important RBI circulars are as below:

1. Circular No. RBI/2019-20/160 dated February 11,2020

The RBI has permitted one-time restructuring of MSME advances. Accordingly, a one-time restructuring of existing loans to MSMEs classified as 'Standard' without a downgrade in the asset classification is allowed , subject to the following conditions:

The aggregate exposure, of banks and NBFCs to the borrower does not exceed ₹25 crore as on January 1, 2020.

The borrower's account was in default but was a 'Standard Asset'as on January 1, 2020

The account continues to be classified as a 'Standard Asset'till the date of implementation of the restructuring.

The restructuring of the borrower account is implemented on or before December 31, 2020.

2. Circular No. RBI/2019-20/186 dated March 27,2020

RBI has announced COVID-19 –Regulatory measures to mitigate the burden of debt servicing brought about by disruptions on account of COVID-19 pandemic and to ensure the continuity of viable businesses. In this regard, the detailed instructions are as follows:

Rescheduling of Payments – Term Loans and Working Capital Facilities

- i. In respect of term loans all Commercial Banks, Financial Institutions, and NBFCs are permitted to grant a moratorium of three months on payment of all instalments falling due between March 1, 2020 and May 31, 2020.
- ii. The repayment schedule for such loans as also the residual tenor, will be shifted across the board by three months after the moratorium period.
- iii. Interest shall continue to accrue on the outstanding portion of the term loans during the moratorium period.
- iv. In respect of working capital facilities Banks are permitted to defer the recovery of interest applied during the period from March 1, 2020 upto May 31, 2020 .
- v. The accumulated accrued interest shall be recovered immediately after the completion of this period.

Easing of Working Capital Financing

- i. In respect of working capital facilities borrowers facing stress on account of the economic fallout of the pandemic, Banks may recalculate the 'drawing power' by reducing the margins and/or by reassessing the working capital cycle.
- ii. This relief shall be available in respect of all such changes effected up to May 31, 2020 and shall be contingent on the lending institutions satisfying themselves that the same is necessitated on account of the economic fallout from COVID-19.

Other Conditions

- i. Since the moratorium/deferment/recalculation of the 'drawing power' is being provided specifically to enable the borrowers to tide over economic fallout from COVID-19, the same will not be treated as concession or change in terms and conditions of loan agreements due to financial difficulty of the borrower.
- ii. Such a measure, by itself, shall not result in asset classification
- iii. The asset classification of term loans which are granted relief , shall be determined on the basis of revised due dates and the revised repayment schedule.

iv. Similarly, working capital facilities where relief is provided , the SMA and the out of order status shall be evaluated considering the application of accumulated interest immediately after the completion of the deferment period and as well as per the revised terms.

v. The rescheduling of payments, including interest, will not qualify as a default for the purposes of reporting to Credit Information Companies (CICs) by the lending institutions.

vi. CICs shall ensure that the actions taken by lending institutions pursuant to the above announcements do not adversely impact the credit history of the beneficiaries.

3. Circular No. RBI/201 9-20/220 dated April 17,2020

RBI has issued this circular which aims at alleviating the lingering impact of Covid19 pandemic on the businesses and financial institutions in India, consistent with the globally coordinated action committed by the Basel Committee on Banking Supervision. In this regard, the instructions with regard to asset classification and provisioning are as follow :

- In view of circular mentioned in pt. no. 2 above, the lending institutions are permitted to grant a moratorium of three months on payment of all term loan instalments falling due between March 1, 2020 and May 31, 2020 . RBI has stated that these three months , the moratorium period, wherever granted, shall be excluded for the purpose of asset classification under the IRAC norms.
- Similarly in respect of working capital facilities ("CC/OD"), where the circular dated March 27,2020 has permitted the recovery of interest applied during the period from March 1, 2020 upto May 31, 2020 to be deferred . This deferment period, shall be excluded for the determination of out of order status of such CC/OD accounts.
- This will be applicable in those accounts which are classified as standard as on February 29, 2020,

AUDITORS PERSPECTIVE

Statutory Branch Auditors are required to diligently consider the above RBI circulars . They are also required to go through the guidelines issued by Bank's Board issued in the light of these circulars to comment on the compliances made by the Branch in relation to procedural and documentation requirement.

Besides the Auditors may use following broad checks during the course of examination of MSME accounts :

In respect of Restructuring of Accounts

a) The account may be in default but it should be Standard as on January 1st,2020.

- b) RBI has permitted the restructuring of accounts of MSME only. Therefore the loan accounts of traders, educational institutions, trusts are not eligible for
- c) Auditors should verify the MSME registrations of the borrowers
- d) The borrower entity is required to be registered under the GST Act. Those MSMEs who are registered under GST Act on the date of implementation of the restructuring shall only be eligible. However, this condition will not apply to MSMEs that are exempt from GST-registration. This shall be determined on the basis of exemption limit for obtaining registration under GST as on January 1, 2020.
- e) Accounts which have been restructured earlier, in terms of the circular dated January 1, 2019, shall be not be eligible for restructuring now.
- f) The credit facility should not be over Rs.25.00 crores. This includes fund based & non based limits both. This will also include terms loans granted for vehicle purchase, home loans etc.
- g) The account should continue to be Standard till the date of implementation of
- h) Application for restructuring is to be obtained from the borrower along with the following:
- Latest audited accounts of the Enterprise including its Net worth;
 - Details of all liabilities of the enterprise, including the liabilities owed to the State or Central Government and unsecured creditors, if any;
 - Nature of stress faced by the enterprise; and suggested remedial actions;
- i) Restructuring exercise to be completed before December 2020, which means :
- # All related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are completed by all lenders; and
- # the new capital structure and / or changes in the terms and conditions of the existing loans get duly reflected in the books of all the lenders and the borrower.
- j) Restructuring is not permitted in cases of frauds , willful defaults, diversion of funds or malfeasance, etc
- k) For MSME borrowers having credit facilities under a Consortium of Banks or Multiple Banking Arrangement (MBA), the consortium leader, or the bank having the largest exposure to the borrower under MBA, as the case may be, shall take lead role if the account is reported as stressed either by the borrower or any of the lenders under this Framework. Lead Lender will also coordinate between the

different lenders. Branch shall communicate to lead lender status of account as default/stressed immediately on receipt of early warning signals and requisition for consortium meeting at earliest to explore suitable action under intimation to other members of consortium.

l) Sanction of additional facility is permissible in restructuring.

m) Bank has to assess the financial viability. The parameters may, inter-alia. Include the Debt Equity Ratio. Debt Service Coverage Ratio, Liquidity or Current Ratio, etc. which would be as per Bank's credit policy.

n) The restructuring exercise is to be judicious and not accommodative.

o) The three months moratorium allowed under COVID 19 Relief Package will be in addition to the restructuring exercise done.

In respect of COVID-19 – Regulatory Measures

a) Moratorium/ deferment can only be allowed in those accounts which were Standard as on February 1st,2020. This is the prime condition. The auditors need to verify this.

b) Request for allowing the moratorium for the payment of term loan installments / deferment of interest on working capital loan to be obtained from the borrower entity. The lending institution cannot do on its own.

c) The request of the borrower entity is to be forwarded to the appropriate authority for its approval.

d) The reschedulement of the installment is to be documented and necessary data inputs to be changed in the core banking solution.

e) As per the RBI circular the installments falling due in the period March 2020 to May 2020 can be shifted across the board by three months after the moratorium period. However interest on working capital for this period is required to be paid in June 2020.

f) In respect of working capital , any change in drawing power' by reducing the margins and/or by reassessing the working capital cycle is should be documented, need based and justified. Approval of appropriate authority is required to be held on record.

g) As per RBI circular the moratorium period, wherever granted, shall be excluded by the lending institutions from the number of days past-due for the purpose of asset classification under the IRAC norms. However this will be applicable only on those accounts where

moratorium period/deferment is allowed. Accounts where moratorium/ deferment is not requested/ not allowed, these kind of accounts shall continue to be covered by 90 days norms of asset classification.

h) In respect of accounts in default but standard where asset classification benefit is extended, lending institutions shall make general provisions of not less than 10 per cent of the total outstanding of such accounts, to be phased over two quarters as under:

(i) Quarter ended March 31, 2020 not less than 5 per cent

(ii) Quarter ending June 30, 2020 not less than 5 per cent

All other provisions required to be maintained by lending institutions, including the provisions for accounts already classified as NPA as on February 29, 2020 as well as subsequent ageing in these accounts, shall continue to be made in the usual manner.

i) The lending institutions shall suitably disclose the following in the 'Notes to Accounts' while preparing their financial statements for the half year ending September 30, 2020 as well as the financial years 2019-20 and 2020- 2021:

(i) Respective amounts in SMA/overdue categories, where the moratorium/deferment is extended.

(ii) Respective amount where asset classification benefits is extended.

(iii) Provisions made during the Q4FY2020 and Q1 FY 2021 in terms of paragraph 5 of circular dated April 1 7th,2020

(iv) Provisions adjusted during the respective accounting periods against slippages and the residual provisions in terms of paragraph 6 of the circular

Auditors are required to update themselves with the recent RBI circulars. This will help them in correct assets classification and for preparing a good Long Form Audit Report (LFAR)

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