

Seminar on Central Statutory Audit of Banks

Issues in Treasury Operations and Regulatory Requirements thereof

Organised & Hosted by
SIRC of ICAI

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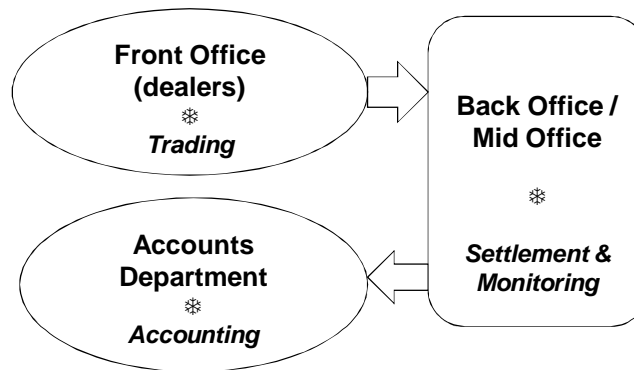
Domestic Treasury

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INVESTMENT & TREASURY DEPARTMENT

Typical Infrastructure
(Physical & Functional Separation)



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INVESTMENT & TREASURY DEPARTMENT

Important documents

- Investment Policy of the Bank
- Latest Master Circulars issued by Reserve Bank of India
- Subsequent Circulars & Monetary Policy issued by Reserve Bank of India

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Types of Domestic Transactions

- Repo and Reverse Repo

(Repo = Borrowing of Money)

Reverse Repo = Borrowing of security)

Re-Repo *permitted*

- Ready Forward Contracts

Funding by selling an instrument with repurchase on forward basis



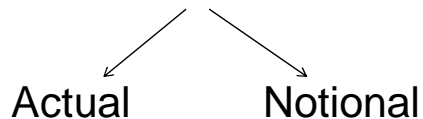
Double Ready Forward *prohibited*

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Types of Domestic Transactions

Short Sale of Securities



- Chronological Order of recording transactions (time stamp of deal ticket)
- Reported Deals
- Category of security (HFT)
- Monthly Certification by Concurrent Auditors

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Regulatory Restrictions Call Money Transactions

Participants	Borrowing	Lending
Scheduled Commercial Banks	Fortnightly Average should be within 100% of Tier I & II Capital	Fortnightly Average should be within 25% of Tier I & II Capital
	Max 125% in day	Max 50% in day
Co-operative Banks	Daily 2% of last March aggregate deposits	No limit

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OTHER IMPORATANT ASPECTS

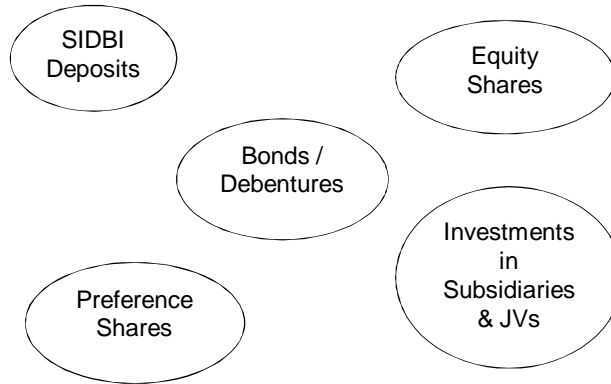
- CCIL
 - NDS OM : Negotiated Dealing System Order Match
 - CBLO : Collateralized Borrowing Lending Obligation
 - FX Clear : Fx Currency Trading Platform
- Dealing through brokers
- Minutes of Investment Committee
- Half Yearly Review by Board

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REGULATORY RESTRICTIONS

Non-SLR - *listed / unlisted*



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REGULATORY RESTRICTIONS

- Investments in Non-SLR

Type	Restrictions
Unlisted Non-SLR Securities	10% of the total Non-SLR as on last 31 st March
Securitisation Papers issued by Infra projects, Bonds issued by Securitisation Co.s	Additional 10% (but within overall ceiling of 20% of last 31 st March total Non-SLR)

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REGULATORY RESTRICTIONS

- Investments in Non-SLR

Type	Restrictions
Unrated Non-SLR Securities	Prohibited
Unrated Bonds of Infra Bonds	Within 10% ceiling of unlisted non-SLR
Original tenure of security	At least of 12 months (Except of CDs / CPs)

REGULATORY RESTRICTIONS

- Investments in Non-SLR

- Need to comply with disclosure requirements by SEBI (even for private placements)
- Debt securities to carry credit rating not less than investable grade (i.e., should be at least BBB- rated)

REGULATORY RESTRICTIONS

- Regulatory restrictions on investments : Liquid MFs < 12 m
 - Weighted average maturity of Liquid MFs less than one year should be within cap of 10% of net worth as on last year's 31st March

REGULATORY RESTRICTIONS

- Repo in Corporate Debt Securities
 - Instrument used for Repo should not be of original maturity less than one year (except CD / CPs / NCDs covered by RBI guidelines)
 - Should be held in demat form & listed
 - Should be rated AA and above

REGULATORY RESTRICTIONS

Exposure to Equity Market (Solo as well as Consolidated exposure)

(Ref. Para 2.3.1 of Master Circular on Exposure Norms)

Type	Limit (%age of net worth as on March 31 of previous year)
Aggregate (Fund & Non-fund based)	40%
Direct Investments	20%

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REGULATORY RESTRICTIONS

- Examples of Direct Exposures (20%)
 - Investment in shares
 - Convertible Bonds / Debentures
 - Equity Oriented MFs
 - Exposures to VC Funds

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REGULATORY RESTRICTIONS

- Zero Coupon Bonds or Low Coupon Bonds

Banks can invest in such bonds only if the issuer builds up sinking fund for all accrued interest and keeps the same invested in liquid investments / securities (Government Bonds)

(Banks advised to put in place additional conservative limits)

REGULATORY RESTRICTIONS

**Investment in Long Term Bonds
issued by Banks to finance
Infrastructure & Affordable Housing**

1. Lower of 2% of investing Bank's Tier I Capital or 5% of Issue size
2. Total exposure to such bonds to be within 10% of total Non-SLR Investments
3. Allotment to banks in primary issue size capped at 20%
4. Banks cannot hold own bonds

TYPES OF INVESTMENTS

HTM – Held To Maturity

AFS – Available For Sale

HFT – Held For Trading

TYPES OF INVESTMENTS

Balance Sheet Disclosure

- a) Government Securities
- b) Other Approved Securities
- c) Shares
- d) Debentures & Bonds
- e) Subsidiaries and JVs
- f) Others (CPs, MF Units, etc.)

HTM – Held To Maturity

Should be within 25% of total investments excluding:

1. Investments in Subsidiaries and JVs
2. Re-capitalisation Bonds issued by Gol
3. Long term Bonds issued by Infra Companies with residual tenure of not less than 7 years

HTM – Held To Maturity

Permitted securities w.e.f. 02.Sep.2004.....

1. SLR Securities
2. Non-SLR securities classified under HTM as on 02.Sep.2004
3. Recapitalisation Bonds issued by Gol
4. Investment in Subsidiaries / JVs
5. RIDF / SIDBI / RHDF Deposits
6. Long term Bonds issued by Infra Companies with residual tenure of not less than 7 years

HTM – Held To Maturity

25% ceiling can be exceeded w.e.f. 02.Sep.04 subject to following:

1. Excess consists of only SLR securities, upto 20.50%^ of DTL as on last Friday of second preceding fortnight
2. No fresh non-SLR securities permitted to be included in HTM except few

^21.25% wef 02.Apr.16, 21.00% wef 09.Jul.16, 20.75% wef 01.Oct.16 and 20.50% wef 07.Jan.17

^Additional shifting at beginning of Jul'16, Oct'16 and Jan'17 permitted (Ref. Circular dated 07.Oct.14)

HTM – Held To Maturity

Latest Circular issued on December 10, 2015:

Effective Date	SLR to be brought down along with ceiling on SLR in HTM
09.Jan.2016	21.50
02.Apr.2016	21.25
09.Jul.2016	21.00
01.Oct.2016	20.75
07.Jan.2017	20.50

HTM – Held To Maturity

Accounting

Profit would be first accounted in Profit & Loss Account and then appropriated to Capital Reserve Account (net of taxes)

Loss would be accounted in P & L Account

HFT / AFS

Accounting

Profit / Loss would be accounted in Profit & Loss Account

Valuation of Investments - HTM

- Are NOT marked to market
- Diminish in value other than temporary (i.e., impairment) is to be recognised
 - Default in repayment of its debt obligation
 - Loan with any bank is restructured
 - Credit rating of the company is downgraded below investable grade (BBB-)
 - Incurs loss for continuous period of 3 years and net worth is reduced by 25% or more
 - New company / project ... if break-even point is extended beyond gestation period

Valuation of Investments - HTM

- Premium in Book Value over face value to be amortised over the residual period
- Amortisation to be accounted for as a deduction under “Income on Investment - Interest earned”

Valuation of Investments – AFS / HFT

- AFS: M 2 M at least at quarterly
- HFT: M 2 M at least at monthly

Step	Particulars
I	Scrip-wise valuation
II	Balance Sheet Classification-wise aggregation
III	Ignore appreciation and provide for depreciation
	<i>Book Value not to undergo any change</i>

Shifting of category - HFT / AFS / HTM

HTM to AFS / HFT

- Approval of Board required
- Normally be allowed only at the beginning of the year
- No further shifting to/from allowed

Shifting of category - HFT / AFS / HTM

HTM to AFS / HFT

Accounting

- Transferred at Book Value (net of amortisation)
- Immediately marked to market and provision for depreciation made on the same day
- Thus, Book Value remains unchanged

Shifting of category - HFT / AFS / HTM

HTM to AFS / HFT

Disclosure Requirements

If value of sale and transfer of securities to / from HTM category > 5% of Book Value of opening HTM

Market Value and Book Value of HTM to be disclosed along with disclosure of excess of BV over MV for which provision not made

Shifting of category - HFT / AFS / HTM

AFS / HFT to HTM

Accounting

- Transferred at Book Value or Market Value which ever is lower (provision for depreciation would be used in case Market Value being lower than Book Value)

Shifting of category - HFT / AFS / HTM

AFS to HFT

- Approval of Board required / ALCO / Investment Committee
- In case of exigencies, CEO or Head of ALCO can also approve the same which should be later on ratified

Shifting of category - HFT / AFS / HTM

HFT to AFS

- Generally not permitted
- Permitted only in exception circumstances
- Approval of Board / ALCO / Investment Committee required

Shifting of category - HFT / AFS / HTM

AFS to / from HFT

Accounting

- Transferred at Book Value along with corresponding depreciation provision
- Book Value remains unchanged

Important Concepts (IFR)

1. Investments Fluctuation Reserves (IFR)

5% of Investment Portfolio which is created out of Profit and Loss Account but reversible below the line

Now the concept is dispensed off

Important Concepts (IFR)

Apr'05

Banks maintaining capital adequacy of 9%, excess IFR over 5% of AFS / HFT would be considered as Tier I capital

Oct'05

Banks maintaining capital adequacy of 9% as on Mar'06, entire IFR can be considered as Tier I capital

Important Concepts

2. Investment Reserve Account (IRA)

- Created out of excess of depreciation provision of AFS / HFT reversed in P & L A/C through below the line appropriation
- Reversible at net of 25% appropriation to Statutory Reserves and net of Tax Rate, below the line (*thus 100% Depreciation provision requirement can reverse IRA to the extent of 52.50%*)
- Dividends are payable out of current year's profit, so IRA cannot be used for the same

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VALUATION OF SECURITIES

Basic Concepts

Yield = Coupon Rate

(+) Discount

(-) Premium

(+) Risk Spread

Inter-relation between

Coupon Rate / YTM / Maturity Period /
Price

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VALUATION OF SECURITIES

(FIMMDA Fixed Income Money Market & Derivatives Association of India Subject to traded price in last fortnight)

Refer FIMMDA sheet

1. Central Government Securities
2. State Government Securities

Refer FIMMDA Par Yield Curve & Risk Spreads

3. Unquoted non-SLR Securities
4. Preference Shares

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VALUATION OF SECURITIES

Carrying Cost

5. Treasury Bills (T-Bills)
6. Commercial Papers
7. Regional Rural Bank (RRBs)

Carrying Cost as Book Value and use ZCYC (Zero Coupon Yield Curve) plus spread and arrive discounted PV

8. Zero Coupon Bonds (ZCBs)

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VALUATION OF SECURITIES

If Listed – MV and if unlisted break-up value

9. Equity Shares

Others

10. Securities (Equity / Debentures, etc.) acquired by conversion of advances

11. Bonds issued by State Electricity Companies (Discoms)

VALUATION OF SECURITIES

Others

12. Mutual Funds

13. VCFs

- Initially should be classified under HTM for 3 years
- Subsequently should be classified under AFS
(the transfer would be at the beginning of the subsequent year)
- M2M should be on daily / weekly basis

VALUATION OF SECURITIES

Others

14. Securities issued by Securitisation / Reconstruction Company

- Lower of Redemption Value and Net Book Value (Book Value less Provision)
- Incentive to spread shortfall over two years if asset is sold between 26.Feb.14 to 31.Mar.16

NPI Norms

1. Interest / Installments due for more than 90 days
2. Same for Preference Shares whether cumulative or non-cumulative. Due date to be the date of balance sheet
3. Unlisted Equity shares to be valued at Re. 1 if financials are not available
4. Advances and Investments – Both are classified in same category with exception of preference shares

NPI Norms

5. Conversion of Advances into Instruments to be considered as NPIs *ab initio* based on restructuring package in same asset classification
6. State Government Guaranteed Investments – similar to Advances
7. Central Government Guaranteed Investments – similar to Advances
8. Investments which are NPIs, 100% provision is required

Income Recognition

- Should be done on accrual basis except for income from units of MFs wherein cash basis is to be strictly followed.
- Concept of Yield
- Concept of 360 days / 365 days
- Money Market Instruments – 365 days
- G-Sec – 360 days
- Due date Diary

CERTIFICATION REQUIREMENTS & ROLE OF AUDITOR

- Monthly Certification of Short Sale Transactions by **Concurrent Auditors**
- Monthly Concurrent Audit reports to be placed before CMD
- Yearly certification of “Statement of Reconciliation of Bank’s Investments” by Auditors [Investment Register (aspect of NPIs), Investments kept with Branches]
- **Statutory Auditors** to certify correctness of computation of DTL / NDTL and CRR / SLR
- **Statutory Auditors** to issue certificate of compliance in key areas (RBI circulars)

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CRR / SLR

CRR - Cash Reserve Ratio - 4%

SLR - Statutory Liquid Ratio – 20.50%

DTL - Demand and Time Liabilities

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CRR / SLR

- **CRR**
 - Balance with Reserve Bank of India
- **SLR**
 - Cash or cash equivalents (Current Account with other SCBs)
 - Gold (at price not exceeding MV)
 - Government Securities
 - Treasury Bills
 - SLR Bonds
 - SLR securities acquired from RBI under LAF

Incremental CRR

(RBI Circular dated November 26, 2016)

Effective from fortnight beginning November 26, 2016 incremental CRR of 100% on increase in NDTL between 16.Sep.16 and 11.Nov.16

Reviewed on December 09, 2016 and discontinued

CONCEPT OF DTL

- Demand Liabilities
 - Current Deposits
 - Demand portion of Saving Bank A/C
 - Margins held against BG / LC
 - Matured Fixed Deposits (MFD)
 - DD / PO / MTs / TTs Payable
 - Adverse Balance in Advances A/C
 - Unclaimed Deposits

CONCEPT OF DTL

- Time Liabilities

Liabilities of the bank which are payable otherwise than on demand like FDRs, RDs, Time liability portion of Saving Bank A/Cs, Staff security Deposits, etc.

CONCEPT OF DTL

- **Other Demand and Time Liabilities (ODTL) includes –**
 - interest accrued on deposits
 - bills payable
 - unpaid dividend, suspense account
 - Net credit balance in Branch Adjustment account except for credit entries outstanding for more than 5 years

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CONCEPT OF DTL

- **Other Demand and Time Liabilities (ODTL) includes –**
 - Net Liability towards banking system in India
 - Netting off of liability against assets is permitted with respect to only banking system in India and not with respect to banking system outside India, thus, adverse NOSTRO Balances

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CONCEPT OF DTL

- Major Exclusions
 - Paid up Capital
 - Reserves and Surplus
 - Loan taken from RBI
 - Refinance from Exim Bank, NHB, NABARD, SIDBI
 - Funds borrowed under G-Sec Repo
 - Claims received from DICGC pending adjustment

CONCEPT OF DTL

- Major Exclusions
 - ECGC / Insurance claims received
 - Amounts received from court receiver
 - Adhoc provisions made (which are not made for any particular liability)
 - Eligible amount of incremental FCNR(B) and NRE deposits of maturities 3 years and above with base date 26.Jul.13 & o/s as on 07.Mar.14

CONCEPT OF DTL

- Typical discrepancies in calculation of DTL / NDTL
 - Adverse book balance of NOSTRO Accounts
 - Nostro Reconciliation Items
 - Interest Payable on Deposits which is accrued but not due
 - Buyers' Credits availed by customers of the bank

Forex Treasury

Types of Transactions

- Inter-Bank Transactions
- Merchant Transactions

Types of Transactions

- Regular Sale and Purchase
- Currency Swap
- IRSCCS (Interest Rate Swap and Cross Currency Swap)
- Placement and Borrowings
- Currency Futures
- Currency Options

Typical Issues related to Forex Treasury

- Nostro Reconciliation – Forced / Automated & age-wise analysis
- Inter-Branch Transactions vis-à-vis Nostro Reconciliation
- Non-recording of transactions in Nostro Mirror
- Value dating of Merchant transactions in Nostro

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Typical Issues related to Forex Treasury

- Buyer's Credit
- Cancellation of Forward – Passing of benefit to customers
- Valuation
- RBI Exposure Norms
- RBI Reporting Compliances

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Forex Treasury – Exposure Norms

Investment in Overseas Market

Type of Investment	Exposure Restriction
Money Market / Debt Market Instrument issued by foreign state with less than one year tenure	AA(-) S & P / FITCH Aa3 Moody's
Debt instrument other than money market	Board to lay down

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Forex Treasury – Exposure Norms

Loans / Overdraft

Particulars	Exposure Restriction
All types of overseas foreign currency borrowings	100% of unimpaired Tier I Capital or USD 100 mio whichever is higher

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Forex Treasury – Exposure Norms

Loans / Overdraft

Particulars	Exposure Restriction
Borrowing beyond 50% of unimpaired Tier I Capital	<ol style="list-style-type: none">1. Adherence to Board approved policy2. CRAR of 12%3. Minimum Maturity of 3 years4. FEMA / NOPL compliance

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Forex Treasury – Exposure Norms

Loans / Overdraft

Particulars	Exposure Restriction
Borrowing from whom?	International / Multilateral Financials Institutions in which Gol is shareholding member or is established by one or more governments

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Forex Treasury – Exposure Norms

Net Overnight Open Position Limit (NOOPL)

Particulars	Exposure Restriction
NOOPL	Board to decide subject to 25% of Tier I and II capital

- i. Calculate Net Open Position in single currency
- ii. Calculate Overall Net Open Position

Forex Treasury – Exposure Norms

Net Open Position in single currency

- i. Net Spot Position
- ii. Net Forward Position
- iii. Net Option Position

Forex Treasury – Exposure Norms

Net Open Position in single currency

i. Net Spot Position

Difference between foreign currency assets & Liabilities

ii. Net Forward Position

Spot Transactions Not yet Settled

Forward Transactions

Guarantees & similar commitments

Net future income / expenses not yet accrued but hedged

Net receivable / payable of currency futures / swaps

Forex Treasury – Exposure Norms

Net Open Position in single currency

iii. Net Option Position

Delta equivalent spot currency position

Forex Treasury – Exposure Norms

Overall Net Open Position

- i. Calculate Net open position for each currency
- ii. Calculate Net open position in Gold
- iii. Convert all into Rupee as per RBI / FEDAI guidelines. All derivatives to be reported on the basis of PV adjustments

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Forex Treasury – Exposure Norms

Overall Net Open Position

- iv. Arrive at sum of net short positions
- v. Arrive at sum of net long positions

*Overall net forex position is higher of (iv)
and (v)*

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Forex Treasury – Exposure Norms

Aggregate GAP Limit

*Board to decide and communicate to RBI
subject to upper cap of 6 times of Tier I &
II Capital*

QUESTIONS ???

Thank you !!!

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“The attitude of disrespect that many executives have today for accurate reporting is a business disgrace. And auditors ... have done little on the positive side. Though auditors should regard the investing public as their client, they tend to kowtow instead to the managers who choose them and dole out their pay.”

-Warren Buffett

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