

Audit of Agriculture Advances during Bank Branch Audit

India is an agro based nation and agriculture is a key sector of Indian economy contributing significantly in GDP and employment. As per the RBI guidelines, agriculture is a priority sector and the banks are required to lend 18% of Adjusted Net Bank Credit (ANBC) to agriculture sector. As a bank branch auditor, the auditor is required to examine various important aspects relating to agriculture advance such as compliance to eligibility norms, sanction process, documentation, security creation, asset classification, etc. Besides, the auditors are also required to certify the eligible amount of interest subvention on crop loans which is provided by the banks to the borrowers and later claimed from RBI. To know more about audit of agriculture advances during a bank branch audit, read on...



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Eligible Activities under Agriculture Credit

As per RBI's master circular No RBI/2015-16/53FIDD.CO.Plan. BC.4 /04.09.01/2015-16 dated July 1, 2015, the lending to agriculture sector has been defined to include

- (i) Farm Credit,
- (ii) Agriculture Infrastructure, and
- (iii) Ancillary Activities.

Farm Credit Include

- (i) Crop loans to farmers.
- (ii) Medium and long-term loans to farmers for agriculture and allied activities (e.g. purchase of agricultural implements and machinery, loans for irrigation and other developmental activities undertaken in the farm, and developmental loans for allied activities).
- (iii) Loans to farmers for pre and post-harvest activities, viz., spraying, weeding, harvesting, sorting, grading and transporting of their own farm produce.
- (iv) Loans to farmers up to ₹ 50 lakh against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months.
- (v) Loans to distressed farmers indebted to non-institutional lenders.
- (vi) Loans to farmers under the Kisan Credit Card Scheme.
- (vii) Loans to small and marginal farmers for purchase of land for agricultural purposes.
- (viii) Loans to corporate farmers, farmers' producer organisations/companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities, viz., dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture up to an aggregate limit of ₹ 2 crore per borrower.

Agriculture Infrastructure Include

- i) Loans for construction of storage facilities (warehouses, market yards, godowns and silos) including cold storage units/ cold storage chains designed to store agriculture produce/products, irrespective of their location.
- ii) Soil conservation and watershed development.
- iii) Plant tissue culture and agri-biotechnology, seed production, production of bio-pesticides, bio-fertilizer, and vermi composting. For the above loans, an aggregate sanctioned limit of ₹ 100 crore per borrower from the banking system, will apply.

Ancillary Activities Include

- (i) Loans up to ₹ 5 crore to co-operative societies of farmers for disposing of the produce of members.
- (ii) Loans for setting up of Agriclincs and Agribusiness Centres.
- (iii) Loans for Food and Agro-processing up to an aggregate sanctioned limit of ₹ 100 crore per borrower from the banking system.
- (iv) Loans to Custom Service Units managed by individuals, institutions or organisations who maintain a fleet of tractors, bulldozers, well-boring equipment, threshers, combines, etc., and undertake farm work for farmers on contract basis.(v)Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi-Purpose Societies (LAMPS) for on-lending to agriculture.
- (v) Loans sanctioned by banks to MFIs for on-lending to agriculture sector
- (vi) Outstanding deposits under RIDF and other eligible funds with NABARD on account of priority sector shortfall.

Kisan Credit Cards (KCC)

Kisan Credit card aims at providing adequate and timely credit support to the farmers under a single window, to enable them to conveniently avail bank loans for various purposes such as short term requirements for cultivation of crops; to meet post harvest expenses, working capital for maintenance of farm assets and allied agriculture activities investment credit requirement for agriculture and allied activities.

KCC scheme was introduced in 1998 and subsequently modified through various RBI circulars and presently governed by RBI Master Circular No RBI/2017-18/4FIDD.CO.FSD. BC.No.7/05.05.010/2017-18 dated July 3, 2017, However, it may be noted that KCC is not a type of loan, but is a channel for granting either short term or long term agriculture finance.

As per the extant guidelines, the salient features of the scheme are as below:

Eligibility	<ol style="list-style-type: none"> i) Farmers -individual/joint borrowers who are owner cultivators; ii) Tenant farmers, oral lessees & share croppers; iii) Self Help Groups (SHGs) or Joint Liability Groups (JLGs) of farmers including tenant farmers, share croppers etc.
Fixation of limit	<p><i>The short term limit to be arrived for the first year (For cultivating single crop in a year):</i></p> <p>Scale of finance for the crop (as decided by District Level Technical Committee) x Extent of area cultivated + 10% of limit towards post-harvest/household/ consumption requirements + 20% of limit towards repairs and maintenance expenses of farm assets + crop insurance and/or accident insurance including PAIS, health insurance & asset insurance.</p> <p><i>Limit for second & subsequent year:</i></p> <p>First year limit for crop cultivation purpose arrived at as above plus 10% of the limit towards cost escalation / increase in scale of finance for every successive year (2nd, 3rd, 4th and 5th year) and estimated term loan component for the tenure of Kisan Credit Card, i.e., five years.</p> <p><i>Maximum Permissible Limit</i></p> <p>The short term loan limit arrived for the 5th year plus the estimated long term loan requirement will be the Maximum Permissible Limit (MPL) and is to be treated as the Kisan Credit Card limit.</p>
Disbursements	The short term component of the KCC limit is in the nature of revolving cash credit facility. There should be no restriction in number of debits and credits. However, each installment of drawable limit drawn in a particular year will have to be repaid within 12 months The long term loan for investment purposes may be drawn as per installment fixed.
Validity/Renewal	Banks may determine the validity period of KCC and its periodic review. The review may result in continuation of the facility, enhancement of limit or cancellation of the limit/withdrawal of the facility depending upon increase in cropping area/pattern and performance of the borrower.
Repayment	The repayment period may be fixed by banks as per the anticipated harvesting and marketing period for the crops for which the loan has been granted. The term loan component will be normally repayable within a period of 5 years depending on the type of activity/investment as per the existing guidelines applicable for investment credit.

Margin	As per the policy of individual banks
Security	Hypothecation of crops and mortgage of agriculture land. Collateral security (agriculture land) is waived for KCC limit upto ₹ 1.60 lakh. (raised from ₹ 1 lakh w e f February 7, 2019)
NPA norms	The extant prudential norms on income recognition, asset classification and provisioning are applicable for loans granted under KCC scheme.

However, it may be noted that KCC is not a type of loan, but is a channel for granting either short term or long term agriculture finance.

Interest Application on Agriculture Loans

- The interest on agriculture loans are normally charged at half yearly or annual rests.
- Compounding of interest is generally not permitted in respect of an agriculture advance unless it turns out to be a non performing advance.

Interest Subvention

The interest subvention scheme for farmers provides short term credit to farmers at subsidised interest rate. The scheme is governed through letter No 1-7/2018-Credit-I dated 11.02.2019 of Ministry of Agriculture and Farmers Welfare, Government of India. The salient features of the scheme are as under :

- The scheme covers all farmers availing short term crop loans upto one year for an amount not exceeding ₹ 3 lakh.
- Under the scheme, the farmers can avail concessional crop loans at 7% per annum as against normal 9% per annum. In addition, an additional interest subvention at 3% per annum is also provided for prompt payment within a period of one year from date of advance resulting in effective rate of interest of only 4% per annum for loans upto ₹ 3 lakh.

- In order to discourage distress sale by the farmers, the scheme extends interest at 7% per annum to small and marginal farmers having KCC upto 6 months post harvest against negotiable ware house receipts for keeping their produce in warehouses accredited by Warehousing Development Regulatory Authority.
- The interest subvention claims made by the banks have to be duly audited by the Statutory Auditors about their correctness.

Prudential Norms for Agriculture Loans

- Prudential norms on Income recognition, Asset Classification and provisioning for agriculture credit is governed by RBI master circular No RBI/2015-16/101 DBR No. BP.BC.2/21.04.048/2015-16 dated July 1, 2015.
- As per para 4.2.13 of RBI Master Circular, a loan granted for short duration crops will be treated as NPA,

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if the installment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.

- The above norms are applicable only to Farm Credit extended to agricultural activities as listed at paragraph III (1) of the Circular on Priority Sector Lending – Targets and Classification FIDD.CO.Plan. BC.54/04.09.01/ 2014-15 dated April 23, 2015. An extract of the list of these items is furnished in the Annexure - 2 of the said circular in respect of agricultural loans, other than those specified in the Annexure - 2 and term loans given to non-agriculturists, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.
- The following need to be taken into consideration in respect of asset classification of agriculture loans :

Short/Long duration Crop	Long duration crops would be crops with crop season longer than one year and crops, which are not "long duration" crops, would be treated as "short duration" crops
Crop Season	The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him.
State Level Bankers' committee	The State Level Bankers' Committee (SLBC) is as an apex inter-institutional forum to create adequate coordination machinery in all States, on a uniform basis for development of the State. Duration of crops/crop season is determined by SLBC of each state.

Agriculture Advances Affected by Natural Calamities

Para 4.2.13 of the master circular; deals with the agriculture advances affected by natural calamities.

In case of natural calamities affecting the repaying capacity of the borrowers engaged in eligible agriculture activities, the banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or rescheduling of the repayment period; and the sanctioning of fresh short-term loan.

In such cases of conversion or re-scheduling, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms and conditions and would be treated as NPA if interest and/or installment of principal remains overdue for two crop seasons for short duration crops and for one crop season for long duration crops.

Recent Frauds/Major Irregularities in Agriculture Loans

In case of natural calamities affecting the repaying capacity of the borrowers engaged in eligible agriculture activities, the banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or rescheduling of the repayment period; and the sanctioning of fresh short-term loan.

The auditors are advised to note key facts of certain recent agriculture loan frauds / major irregularities which are summarised below:

- ABC Co. Ltd. fraudulently availed loans from various banks in the guise of crop loans to 8-10 thousand farmers on the basis of guarantee given by ABC Co. Ltd. These loans were illegally availed in the name of non existing bogus farmers through forged documents, photographs, etc. The sanctioned crop loans were deposited in the bogus savings accounts of the farmers and on the same date transferred in the current account of ABC Co. Ltd.
- XYZ Ltd., a company engaged in rice manufacturing, availed credit facilities from bank with the object of making payment to farmers who provided paddy to it. The loans were disbursed through Joint Liability Groups (a small group of villagers that approach a bank for an institutional loan) even though the company had already received the paddy and hence, not entitled to such funding. Further, the JLGs were nonexistent entities. The bank also violated NABARD guidelines which state that JLG members must be from the same area/village.
- In order to achieve the agriculture advance targets, crop loans were given at subsidies rates to farmers but immediately the entire amounts were returned and put in fixed deposits higher rate of interest. Hence, the loans were not used for agriculture purposes and interest subvention benefits were provided for non-agriculture activities.

Key Points for Audit of Agriculture Advances

While doing the audit of agriculture advances, the auditors are advised to ensure:

- Full compliance of proper due diligence and KYC process is followed by the branch while granting the agriculture advance including pre-sanction visit, obtaining KYC documents, etc.
- Verification of end use of bank funds through post sanction inspection and obtaining documentary evidence is made by the branch to ensure that funds are used only for agriculture activities.
- Prescribed documents are executed.
- Credit limit is fixed as per the extant guidelines.
- Agriculture credit is extended only after obtaining NOC from existing credit agencies in the area of finance.
- In case of mortgage of agriculture land, the following are duly taken into records :
 - Non encumbrance certificate of panel advocate.
 - Copy of land revenue extracts.
 - Recording of bank's lien in the records of revenue authorities.
- Only eligible activities as mentioned above are classified in agriculture credit.
- NPA norms as applicable to farm credits is extended only to eligible agriculture activities and for other agriculture loans.
- Comprehensive verification of interest subvention claim is made to ensure that interest subvention is provided only to eligible borrowers as per the scheme.
- In case of agriculture debt relief/waiver, the relief granted is as per the relevant schemes and bank's circulars, and given only to the eligible borrowers. ■