SIRC of ICAI

LONG FORM AUDIT REPORT ON ADVANCES

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1

INTRODUCTION

- Traditional banking undergone metamorphosis in last decade
- Two major activities that remain unchanged, accepting deposits and granting advances
- In branch statutory audit – verification of the above two activities is essential
- Advances – chief revenue source for any bank



2

TYPES OF ADVANCES

DEMAND / TERM LOAN

Repayable on demand or through predetermined instalments

CC

Granted against security of stock/ debts and does not have a fixed repayment, but requires yearly renewal

OD

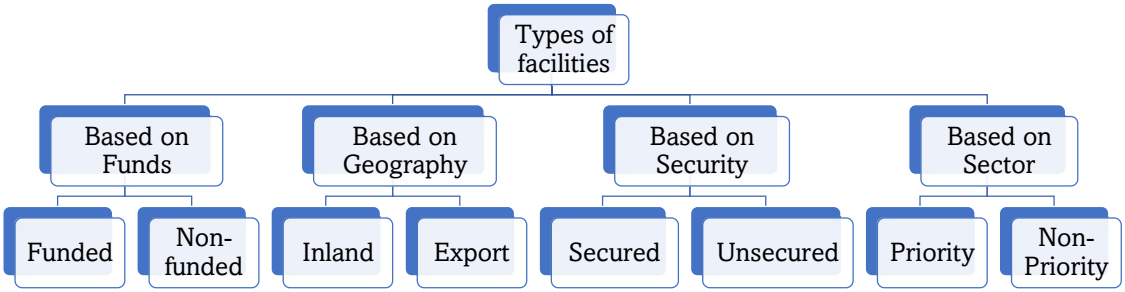
Similar to CC, but no security is taken or taken other than stock/debts

BILLS PURCHASED/ DISCOUNTED

Bill agreed by the buyer to pay within stipulated time and advance is granted by the bank against this bill

3

Classification of Advances



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Audit of Advances

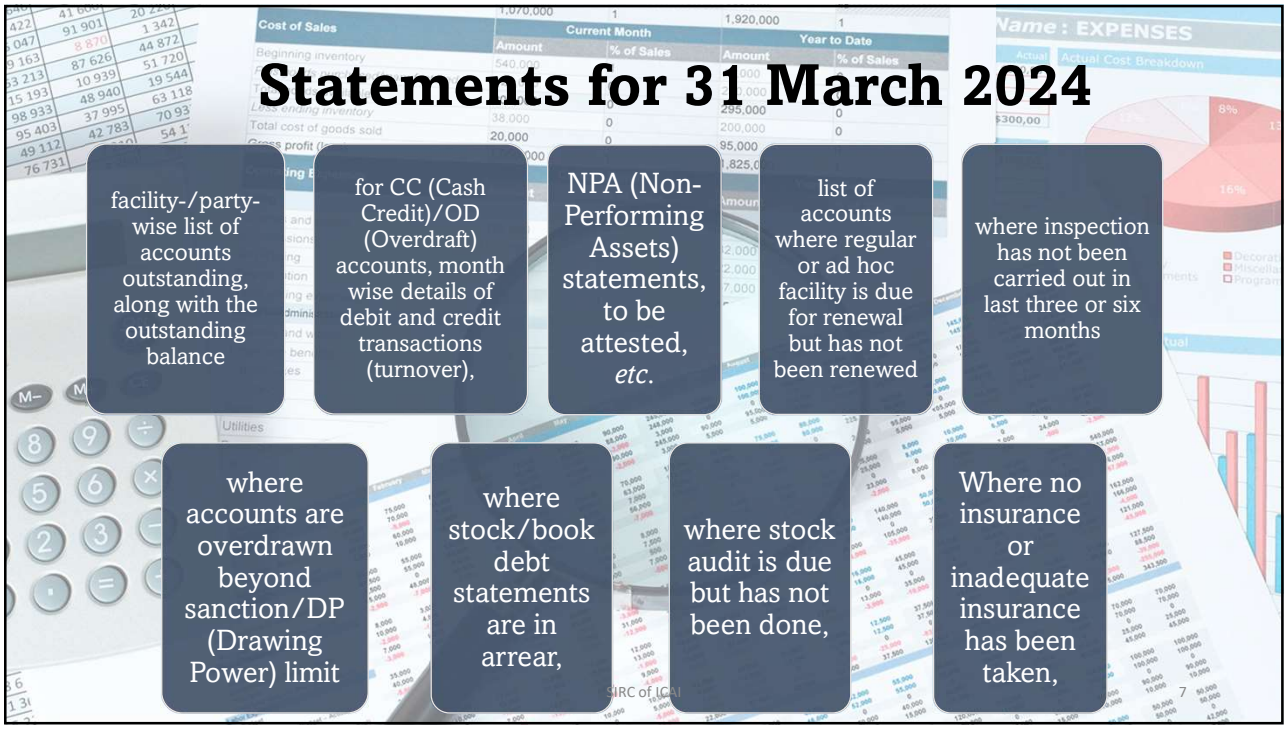
- Statements for March 31, 2024
- Extent of verification
- Stages of verification
- Indicators of fraud or irregular accounts/ red flags
- Verification of non-funded advances
- Reporting of verification and rectification

5

What to ask for?

- Sanctioning powers of authorities
- NPA statement of Previous Year
- Balance Sheet and Profit & Loss A/c of Previous Year
- Audit Report and LFAR of Previous Year

6


Statements for 31 March 2024
facility-/party-wise list of accounts outstanding, along with the outstanding balance
for CC (Cash Credit)/OD (Overdraft) accounts, month wise details of debit and credit transactions (turnover),
NPA (Non-Performing Assets) statements, to be attested, *etc*.
list of accounts where regular or ad hoc facility is due for renewal but has not been renewed
where inspection has not been carried out in last three or six months
where accounts are overdrawn beyond sanction/DP (Drawing Power) limit
where stock/book debt statements are in arrear,
where stock audit is due but has not been done,
Where no insurance or inadequate insurance has been taken,
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7

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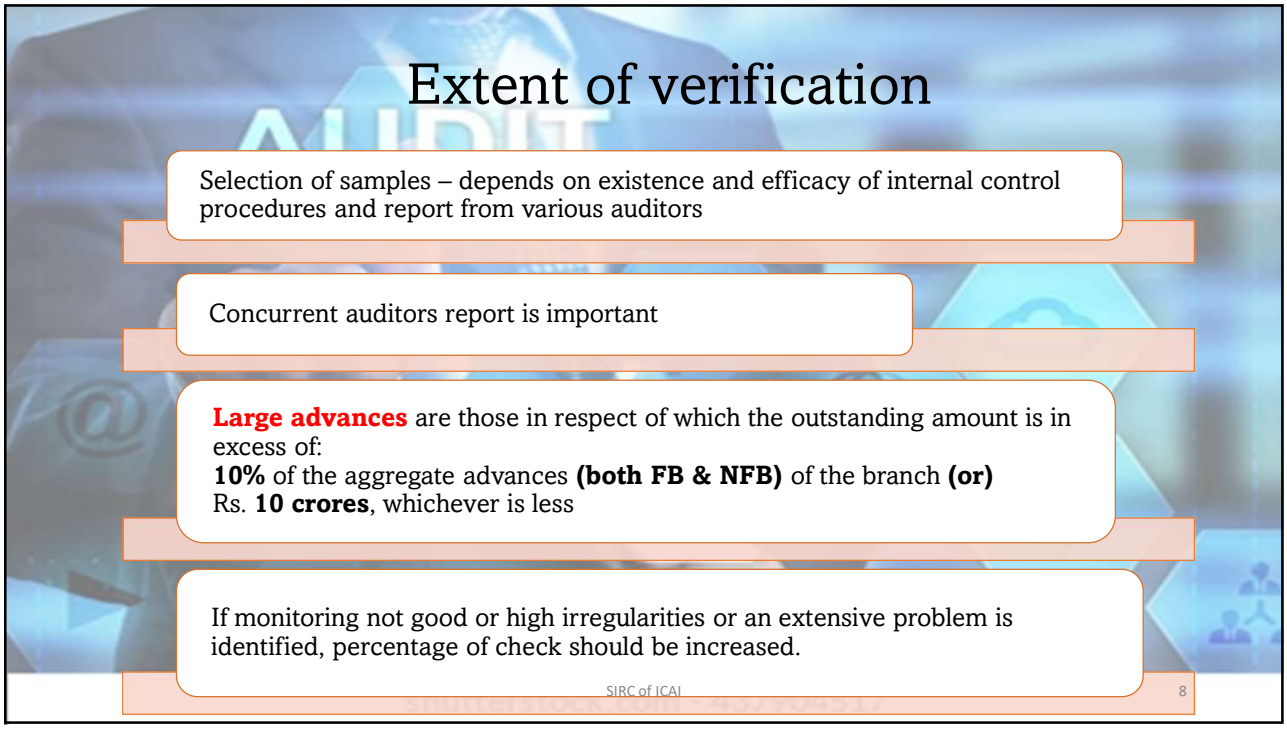
Extent of verification
Selection of samples – depends on existence and efficacy of internal control procedures and report from various auditors
Concurrent auditors report is important
Large advances are those in respect of which the outstanding amount is in excess of:
10% of the aggregate advances **(both FB & NFB)** of the branch **(or)**
Rs. **10 crores**, whichever is less
If monitoring not good or high irregularities or an extensive problem is identified, percentage of check should be increased.
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8

Stages of Verification



Pre-disbursement appraisal



Sanction & Documentation



Disbursement



Review and Monitoring



Renewal/ Enhancement

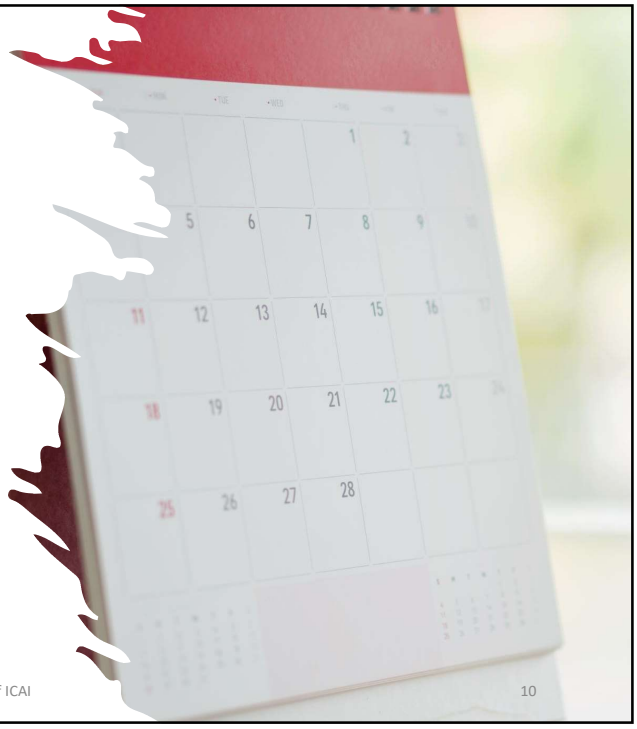


Asset classification

9

Pre-disbursement Appraisal

- Application from borrower
- KYC compliance
- Timely preparation of proposal for grant, renewal, enhancement or rephasement of loans
- Appraisal carried out in the prescribed manner e.g. CMA data. Turnover, MPBF
- Past dealings with / of the borrower
- Board Resolution
- Financial statements, tax assessments, visit report by branch etc.
- Credit reports especially in take over cases



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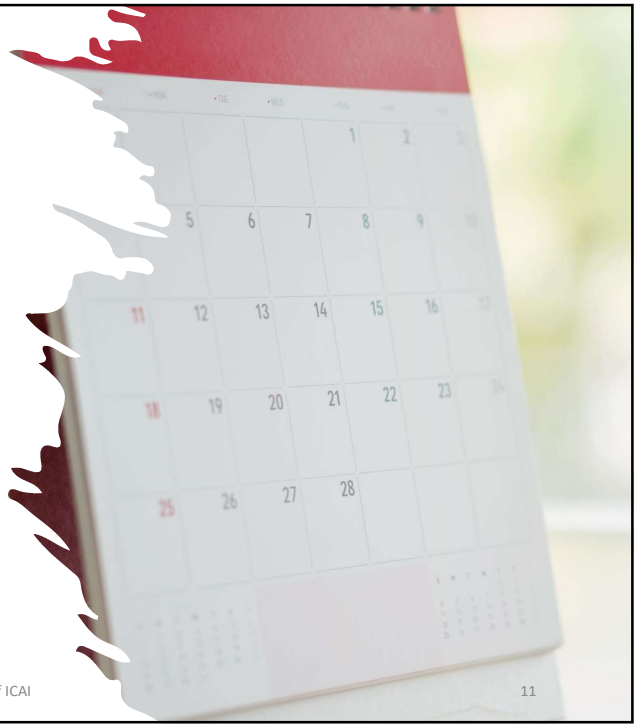
Pre-disbursement Appraisal

- Verify appraisal note of the bank – competent authority
- Whether projections are realistic
- Net worth Statement of borrower
- NOC from existing banker
- Adequacy of the security
- Ratios are satisfactory



11

LFAR Questions on Credit Appraisal

- Has the branch generally complied with the procedures / instructions of the controlling authorities of the bank. What, in your opinion, are the major shortcomings in credit appraisal, etc
- Have you come across cases of quick mortality in accounts?
- Whether in borrowal accounts the applicable interest rate is **correctly fed** into the system?
- Whether the interest rate is reviewed periodically?
- Have you come across cases of frequent renewal / rollover of short-term loans?
- Whether **correct and valid** credit rating has been fed into the system?

12

Sanctioning & documentation

- Within delegated powers
- Disbursement shall be in line with the terms of sanction
- All charges are collected
- Execute all documents as envisaged in the Sanction letter / legal report
- ICAI guidance note gives a detailed check list
- List out the deficiencies in documentation account wise in LFAR
- Additional Documentation in respect of Consortium Advances as per agreement
- Ensure lien is marked on deposits
- Verify margin money to be brought by borrower
- Charges created and filed with RoC

13

Documentation & disbursement

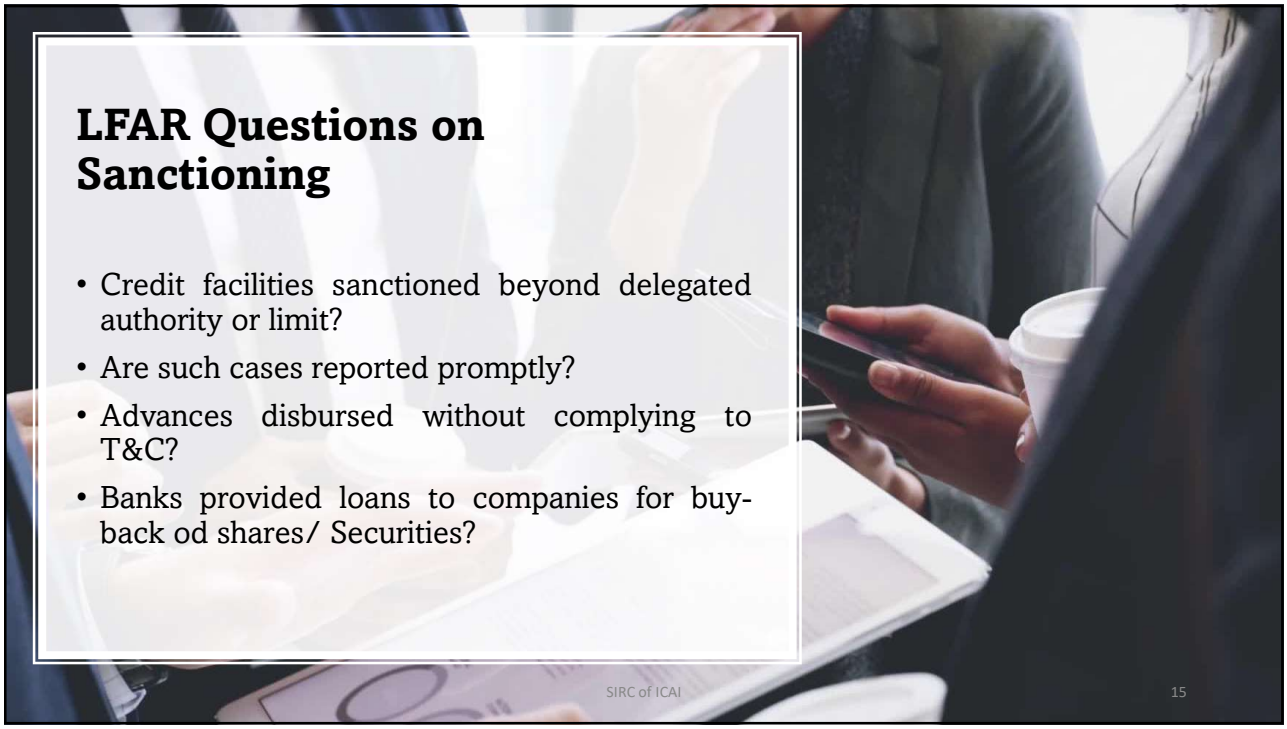
Ensure all documents as per sanction letter are executed:

- DPN
- Docs for hypothecation/ pledge/ mortgage
- Letter of guarantee
- Titles of immovable property
- Stamping of documents
- Insurance of movable and immovable property
- Endorsing insurance in bank's favour

Disbursement to be done as per agreed terms. Eg: Housing Loan

Disbursement to the third party (eg: Housing Loan/ Vehicle Loan)

14


LFAR Questions on Sanctioning
• Credit facilities sanctioned beyond delegated authority or limit?
• Are such cases reported promptly?
• Advances disbursed without complying to T&C?
• Banks provided loans to companies for buy-back od shares/ Securities?
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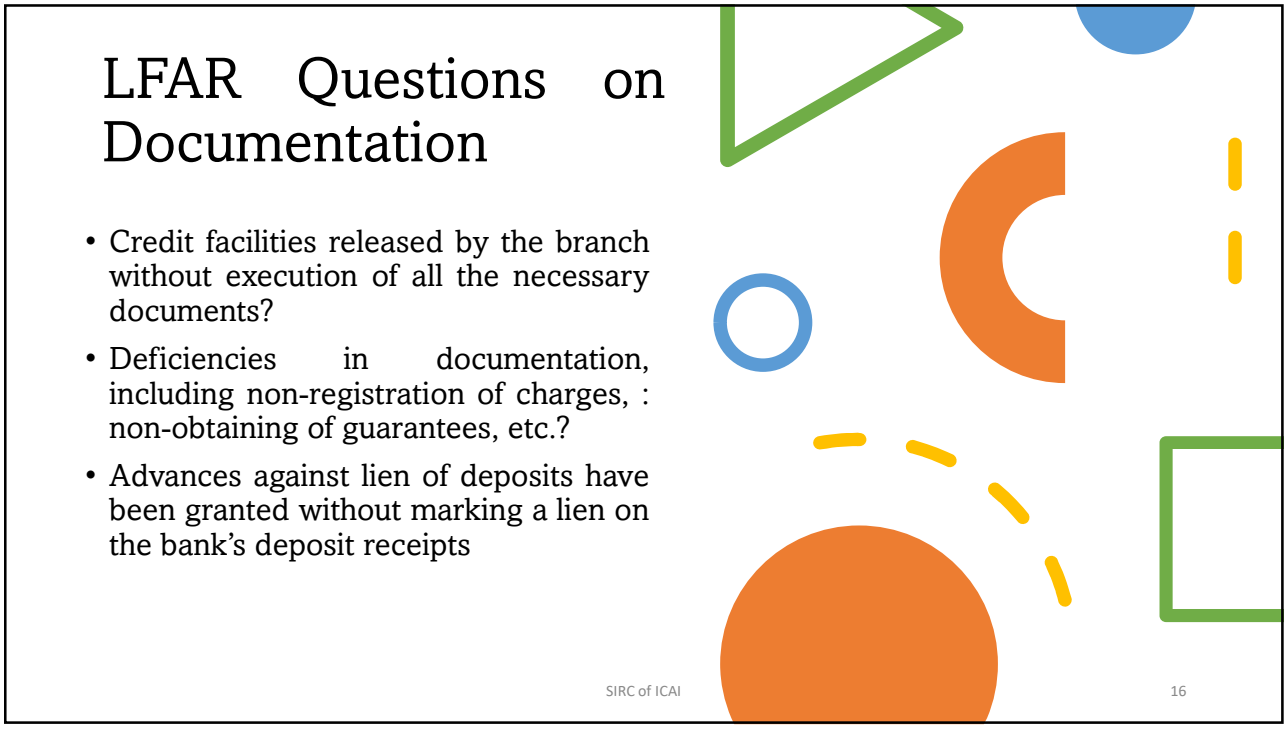
15


LFAR Questions on Documentation
• Credit facilities released by the branch without execution of all the necessary documents?
• Deficiencies in documentation, including non-registration of charges, : non-obtaining of guarantees, etc.?
• Advances against lien of deposits have been granted without marking a lien on the bank's deposit receipts
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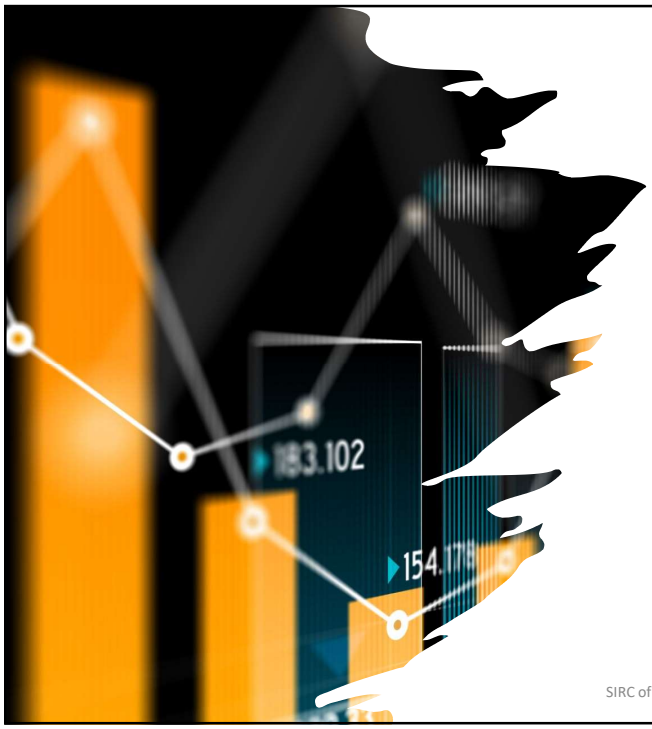
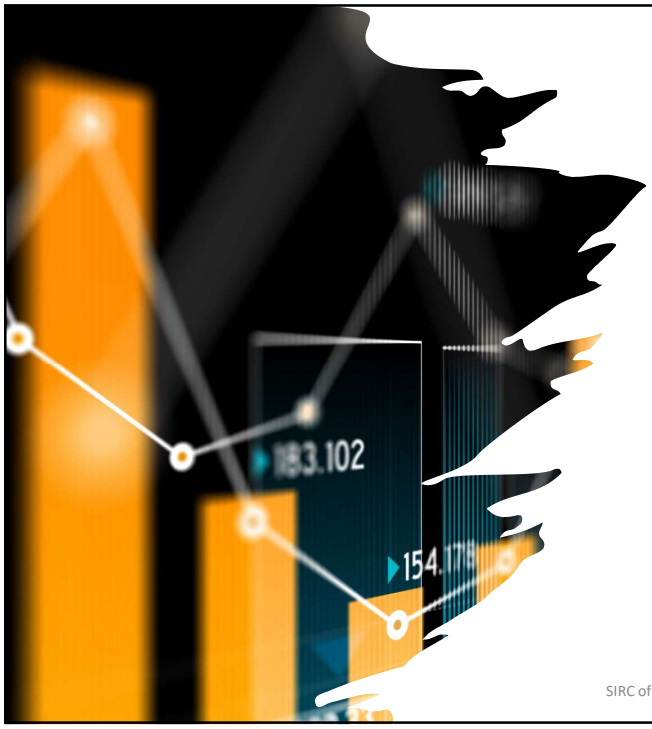
16



Review and Monitoring

- Most important stage
- *Any transaction susceptible to fraudulent transaction to be reported to RBI directly*
- Periodic review of operations
- Justify the end use
- Prompt reporting
- Exchange of information on consortium advances
- Renewal of WC limits every year
- Periodically obtaining financial statements, stock statements, etc and compare with the projections trend

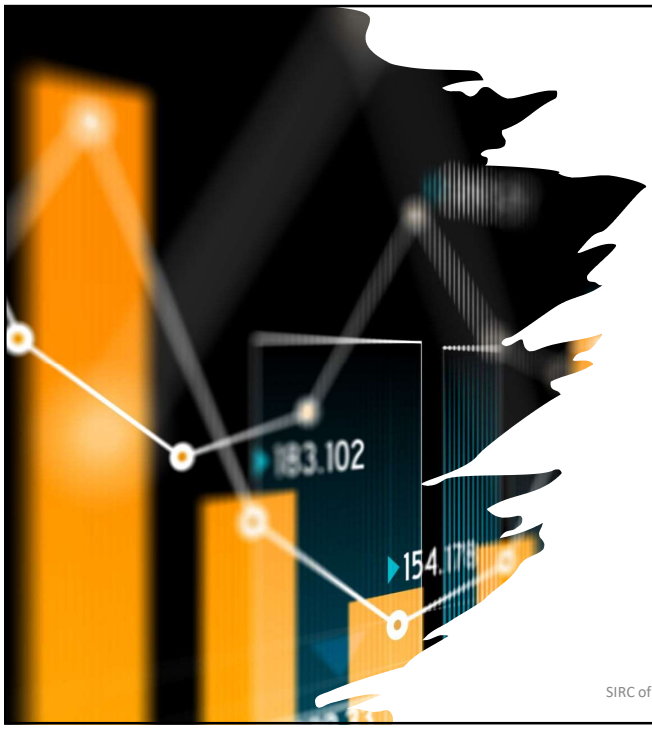
17



Review and Monitoring

- Intelligent scrutiny of bank statement/ debit-credit entries, withdrawals & deposits/ transfers to other accounts/ transfers to personal accounts
- Comparison of movement of stock/ book debts monthly with stock statements
- Many banks insist that book debts statement be certified by CA on a quarterly basis
- Verify if stock includes unpaid stock (represented by S.Crs), stock under L/C or stock under PC – to deducted while computing DP Limit

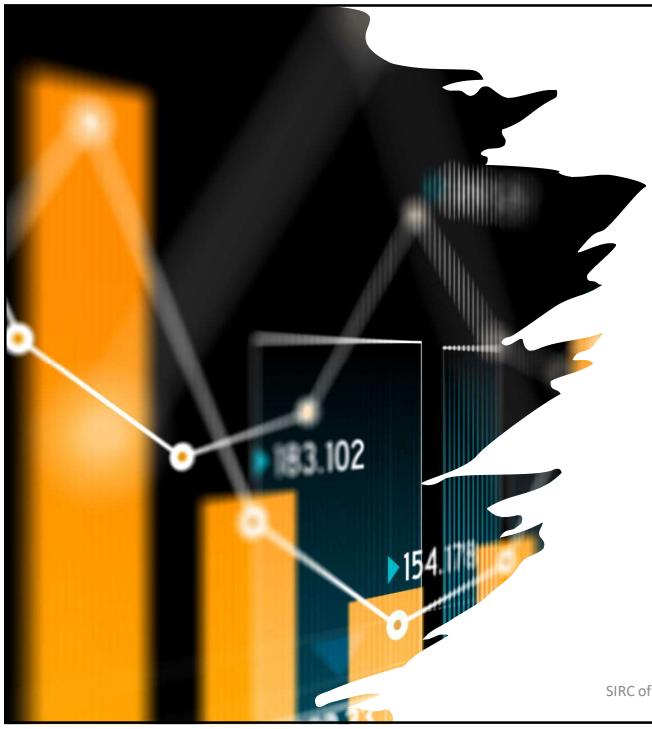
18



Review and Monitoring

- Maintenance of sufficient margin
- Ensure stock is not obsolete/ unrealizable
- Physical verification of the security provided
- NCE with sanctioned limits above Rs 25 lakhs, compulsory audit
- Interest and other charges collected on time
- Any irregularity
- Accounts overdue for renewal between 3 and 6 months and over 6 months
- ***Financial statements and Audit Report to be verified in detail for revised Schedule III and CARO 2020***

19



Review and Monitoring of NPA

- Timely recovery of all dues including credit card dues
- Whether legal action taken for recovery, wherever authorised/necessary. Eg. Sarfaesi, DRT, NCLT, IBC
- Whether NPAs are promptly reported to the controlling office
- Whether any re-habilitation done with respect to NPAs
- Whether OTS schemes are executed as per control office guidelines. Auditor to report cases above Rs. 50 lakhs in LFAR

20

LFAR Questions on Review and Monitoring

- Procedure laid down for periodic review/ balance confirmation followed by the branch?
- Are stock and book debts statement received regularly from the borrowers?
- Is there a system of obtaining stock audit reports periodically?
- Advances given to NCE beyond limits without obtaining audited accounts of borrowers?
- Due diligence report for consortium advances?
- Physical verification of securities charged to bank carried out? Any substantial deterioration in value?
- Comment on adverse features considered significant in top 5 standard large advances and which need management's attention
- Red Flagged Accounts - reporting

21

Indicators of frauds/ irregular accounts

- Major borrowers constitute 50% to 75% of the borrowings Bank does not pursue recovery of overdue bills
- Stock statements not received in time and yet drawing power limit is continued/ renewed
- On verification of CC a/cs/ OD a/c and bills a/c:

✓ Account is continuously overdrawn

✓ Cheques bounced due to insufficient funds

✓ Cheques deposited not honored and returned unpaid

✓ 12 month's turnover not commensurate with the sale and purchase shown in 12 monthly statements

✓ Realization of bills purchased/ bills discounted not received on due date & cleared by debit to the borrower's CC/OD a/c

✓ All overdue CC limits, OD limits, unrealized bills, unrealized interest bundled together and granted WCTL to avoid NPA.

22

Indicators of frauds/ irregular accounts



- Stock statements not submitted on time
- Item wise details not given, lumpsum figure given without quantitative details
- Compare statements over a period of time – same sheet with just period changed
- Unpaid stock not deducted for computing DP limit
- Stock includes items financed by the Bank under PC or LC or others
- Huge difference in annual stock statement and monthly statements
- Unusually high value stock in transit not commensurate with purchase statement
- Branch not obtained stock audit report
- Stock Audit report with adverse comments not considered by Bank
- Book debts ageing shows recoverable beyond 6 months
- Search Report from Registrar's office not obtained
- Branch not obtained NOC from builder

Renewal or Enhancement

- Generally renewed end of one year
- Nonrenewal can make account NPA
- Necessary documents required for realignment or enhancement
- Auditors to ensure Realignment or restructuring done as per RBI Norms
- To avoid docs from becoming time-barred, banks obtain LAD or ADS (Letter of Acknowledgment of Debt and Securities) or Balance Confirmation Certificate



Asset Classification

- Classification through computer system, without manual intervention – to be commented
- Classification according to IRAC Norms - SMA-0, 1, 2
- Downgraded or upgraded Accounts with outstanding more than Rs.10 crores to be listed with reason
- Restructured/Rephased accounts – reporting to authorities/RBI guidelines/regulatory stance to be verified and reported

25



Asset Classification

- Upgradations according to norms ?!
- Disagreement to be reported
- Accounts where IBC process mandated not initiated to be reported
- Accounts where IBC process by other creditors include the bank ? – To be listed and comment of provisioning – Highly difficult to assert
- SUIT FILED ACCOUNTS – ASSERTIONS
  - Branch promptness in ensuring decree execution – Age wise analysis to give
  - Concluded cases – recoveries appropriation
- Documents held at Centralized processing Centres – Auditors to assert receiving of documents to their satisfaction

26

LFAR Questions on Asset Classification

- Branch has identified advances into categories?
- Classification in line with RBI norms?
- SMA-0, 1 and 2 classified? Any disagreement with branch by auditor
- Changes incorporated in MOC?
- A/c > 10 crores downgraded or upgraded
- IRAC followed?
- A/cs restructured or rephased reported?
- IBC initiation
- Valuation reports for immovable properties?
- CPC- documents received?

27

Examples

- Evergreening - manipulate status of the NPA accounts to Performing status

Loans granted by the same Branch of the Bank or a different bank to credit to the CC A/c in the bank and save it from slipping to NPA.

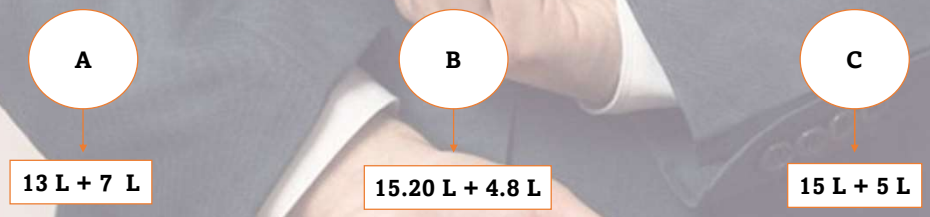
Amount again transferred from CC A/c to Loan Account and the loan is closed.

Get a list of Loans granted in Jan-Mar and see if the amount credited in CC A/c matches with the amount of Loan.

28

Examples

- Six new agricultural loans were sanctioned to individuals



Total Loan = Rs 59,60,000

Amounts transferred in different tranches to S institute, where all these individuals are employees.

29

Examples

Month	Interest Amount	Recovery	Date	Mode
Dec-20XX	1,22,621	45,000	22-Feb-XX	Cash
Jan-20XX	1,51,949	50,000	29-Mar-XX	Cash
Feb-20XX	1,54,613	90	29-Mar-XX	
Mar-20XX	1,60,140	5,00,000	30-Mar-XX	Transfer

ABC Current A/c
10.03.20XX
(Cash Payment)

→

ABC CC A/c
(Cash Deposit)

30



Example

- CC account on the verge of becoming NPA, limit / DP was overdrawn for a period of more than 90 days.
- However, without performing a credit appraisal, the bank sanctioned an ad-hoc increase in the DP and also increased the limit of the account so that the system does not identify the account as NPA.

Example

- A TL account on verge of becoming NPA, overdues not serviced for 90 days.
- An account of the borrower of the same branch used to finance the overdues on the 90th day and the funds again transferred to the borrower after a period of 4 days post closure of accounts.

31



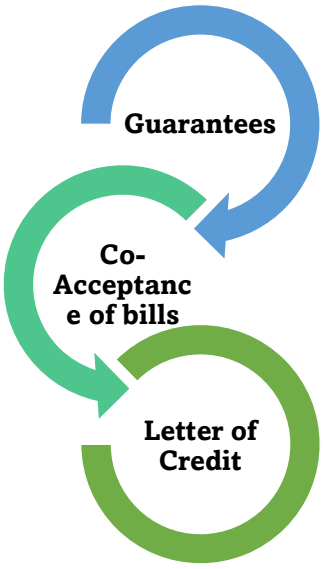
32

Lodging claims

- Claims due to the bank in relation to advances shall be lodged on time. Examples are: (only illustrative)
  - PMRY and other government schemes' subsidy
  - ECGC / CGTSI claims
  - Interest subvention on agricultural loans
- In certain cases the auditor may have to give specific certificates on the above matters

Verification of Non-funded advances

- Non-funded advances are off balance sheet items
- Disclosed as contingent liabilities in the Notes to Accounts



Monitoring the non fund based facilities

- Guarantees and Letters of credits
- Check the following:
  - Sanctioning
  - Margin requirement
  - Collecting charges / commission
  - Allocation of un-expired commission
  - Disclosure in the financial statements
- Is there any NFB slipped as funded LC/Gtee
- List out Interchangeability between FB & NFB post devolvement/invoking– **NEW INSERTION**
- LFAR calls for specific reporting

35

Special Points for TAKE HOME

- More Detailed verification/ assertion/ commitment – As per amended LFAR
- Proper classification of asset has a bearing on verification
- Verification need not be restricted to current year accounts only – **last year accounts IMPORTANT-NEW**
- Head Office Inspection & RBI inspection reports are to be gone through compulsorily
- **Independently to be listed out all reports -NEW**
- Verification of operations is of paramount importance – regularisation during the year end to be examined

36

Slide 35

WU1 Can add nature of guarantees/ BaslеI and II requirments of financial guarantees etc.,
Windows User, 14-02-2009

Special Points for TAKE HOME - contd

- Moratorium on advances has to be examined in tune with the sanction terms – education & housing term loans are examples
- Reschedulement and/or waivers are to be in accordance with the schemes/Norms of RBI
- Stock Audit every year for NPA > 5 crores
- Collateral securities of immovable properties – valuation once in three years for NPA

37

Conclusion

- Documentation of audit observations
- Summing up and discussion with Branch officials
- Review after discussion & follow up
- Final Report to be drafted with detailed statistics
- Wherever required provide for MOC

38



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