

Jaipur Branch of CIRCA of ICAI



*Verification of
Advances in Bank
Branch Audit &
Early Warning
Signals*

Disclaimer

These are my personal views and can not be construed to be the views of the ICAI/RBI/Bank or my firm, Member applied his decision with his professional skepticism and concept of Materiality (SA - 320).

No representations or warranties are made by the Branch /Study Circle/bank/RBI with regard to this presentation.

These views are my personal views and shall not be considered as a professional advice.

Example given during the session is only for the academic purpose only.



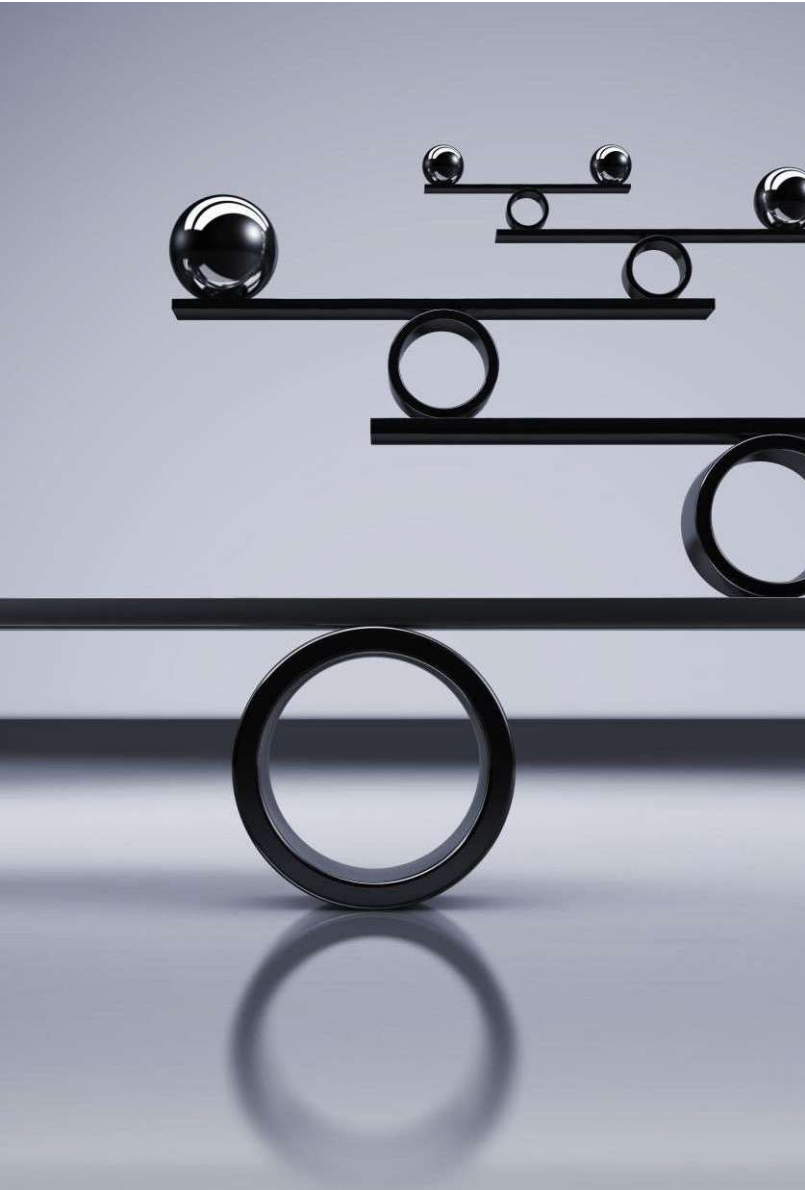
Audit of Advances

- **General Audit Procedures**

- Appraisal
- Sanction
- Disbursement
- Documentation
- Post disbursements

- **Specific Audit Procedure - Product wise**

- Agriculture Loans
- Housing Loans
- MSME & Priority Sector Loans
- Emergency Credit Line Guarantee Scheme (ECLGS)



Types of Advances

1. Funded Loans
2. Non-Funded Loans



1. Funded Loans

- Term Loans
- Cash Credit
- Overdraft
- Funded Interest Term Loans
- Demand Loans

(Retails / MSME / CRE)



2. Non-Funded Loans

- Letter of Credit (LC)
- Bank Guarantee (BG)
- Bills Discounting

Criteria for Selection of Accounts for Verification (TL/ CC)

1. Read last year's LFAR and audit report
2. Read concurrent, Stock Audit, & compulsory internal audit reports and ASM Report in applicable account
3. Take account turnover and start working on that
4. Accounts showing inadequate turnover vis-à-vis sanctioned cash credit limits
5. Accounts sanctioned during the current financial year
6. Accounts sanctioned in the month of March of the current year
7. Accounts continuously under monitoring, including SMA and NPA accounts
8. Accounts pending for review / renewal / full review
9. Account review for shorter period
10. Restructured Accounts

Term Loan Verification



Audit of term Loan Accounts

- Read sanction terms & conditions in detail and carefully
- Check full compliance of sanction terms and identify deviations
- Verify purpose of loan vis-à-vis actual utilization
- Disbursement should be linked with % of completion (e.g., new sanction – hotel example)
- In case account is disbursed 100%, ensure there is possible diversion
- Verify disbursement schedule vs actual utilization
- Check if any construction account – confirm RFRA form (or relevant approval)
- Track project start date and moratorium period

Audit of term Loan Accounts

- Verify quotations in case of machinery loan (invoice, GST, e-way bill, etc.)
- Confirm machine delivered, installed, and production started
- Identify cases where **machinery not received but payment** made
- Check for **over-invoicing / inflated** project cost
- Carry out supplier verification through online sources (GST, MCA, Google, DD)
- **Verify margin contribution** brought in by borrower
- Ensure **asset is created** and **properly charged** to bank
- Special focus on **DCCO** – whether achieved or not
- **If not, verify whether extension is approved with proper supporting**
- Check for delay in project implementation and reasons
- Analyze cost overrun and source of funding

Basic Verification



Compare Balance Sheet
& Stock Statement



Check Account
Transactions & Patterns



Review Sanction
Terms & Conditions

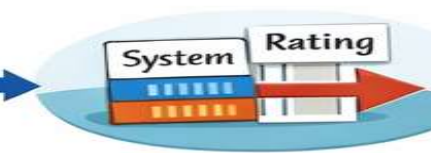


Check Delay in
Interest Payment

Credit Rating & Monitoring



Check Adverse
Credit Ratings



Compare System
vs. Latest Ratings



Review & Analyze
Downgrade Reasons



Review & Analyze
Downgrade Reason

Drawing Power (DP) Checks



Exclude Creditors
& Bills Discounting



Exclude Related
Party Debtors



Exclude DP
without Exceptions



Adjust DP
without Exceptions

Special Attention Accounts



Check Large Subsidy
Amounts



Closed Business
Still Paying Interest



Deceased / Inactive
Proprietor Issues



PAN of Deceased
Still Active

Audit of Cash Credit Accounts

- Check **balance sheet and compare with stock statement**
- Check transaction pattern in the account (normal vs abnormal)
- Identify **unusual transactions, round tripping**, or sudden spikes
- Check **compliance with sanction terms & conditions**
- Verify delay in interest servicing or limit fully utilized
- Check for frequent over drawings / excess over limit
- Check **credit rating in adverse / stressed accounts**
- Verify **latest credit rating** and compare with system rating
- Analyse **impact of rating change** on interest and risk
- Review reasons for downgrade and correlate with deficiency in account.

Audit of Cash Credit Accounts

- Verify DP calculation and underlying data
- Ensure creditors are correctly treated in DP
- Ensure bills discounted are not considered as debtors
- Exclude related party debtors from DP
- Ensure DP is based on genuine and realizable assets
- Check for inflation of stock / debtors
- Compare DP with actual utilization and identify excess drawing
- Business closed but interest servicing continues
- Loss due to fire or major event but account remains standard
- Borrower deceased but account continues without legal transfer
- PAN of deceased / inactive person still active

Other Important Area/ Points

- Check first-time disbursement of cash credit
- Verify payments to related parties or beyond proposed limit
- Accounts with large subsidy exposure
- DP calculated based on dealer/agent sales
- Treatment of subsidy
- Increase in Drawing Power (DP) vs Books and Bank advances



Audit Procedures for Different types of Advances



Agricultural Loans

- Due Diligence & Assessment of Requirements
- Adherence to RBI guidelines for revised KCC scheme – RBI Master Circular in 2018
- Activities eligible for crop season linked classification- Annexure 2 of RBI Master Circular dated 01.10.2021
 - Loans to Individual Farmers, SHGs etc. directly engaged in Agricultural only
 - Loans to Corporate Farmers
 - Loans to Primary Agriculture Credit Societies for on-lending to agriculture
 - Loan to agriculturist for other than agricultural purpose.
(Eg. car loan to Farmer)



Housing Loans

- Purchase of Plot : Declaration - Interest Rate etc.
- Construction on Plot : Copy of Plan - Undertaking from borrower - Architect Certificate - Stagewise disbursement etc.
- Purchase of Ready built house - Architect Certificate-residual age of property etc.
- Purchasing / constructing a second house - For self occupation purpose only : RBI Master Circular para 2(b)(ii)



MSME & Priority Sector Loans

- MSME Eligibility : Even Wholesale & Retail trade included as per MSME Notification dated July 2, 2021
- New definition of MSME :as per MSME Notification dated June 26, 2020 & July 2, 2021 & March 20, 2025
- Education Loans to Priority Sector - Loans upto Rs. 10 lacs for education
- Emergency Credit Line Guarantee Scheme (ECLGS) : To eligible borrowers whose accounts were not overdue for more than 60 days as on 29.02.20 or 31.03.21
- Pradhan Mantri Street Vendors Atmanirbhar Nidhi: Eligible Vendors - Upto Rs. 10,000



Other Loans

- **Loan Against Properties** (Mortgage Loans) : Bank Policy / Valuation Report / Title Report / Residual age of Property
- **Loan against Term Deposit** : No loans against TDRs of other Banks / Appropriate Margin/ Interest rate
- **Loan Against Gold / Silver**: Adherence of RBI guidelines / Bank Policy / Tenure only for 12 months / Loan to Value ratio 75% / ownership and appraiser certificate

Bank Guarantees

Letter of Credits

Non Fund
Based

Bank Guarantees (BG)

To those customers who are regular enjoying credit facilities (Except as mentioned in RBI Master circular dated 09.11.2021)

Worth of Guarantors / payment of commission

Terms of Sanction : Margin / security / purpose / period / beneficiary / bank charges & Commission

Financial or Performance Guarantee

Letter of Credit (LC)

Bank Policy / appraisal guidelines
meticulously followed

“without recourse” LCs not opened

Devolvement of LC

Reversal of Liability of LC – To be
reversed on the date of expiry of LC

MRL that no LC is devolved, if not
devolved

Review of Important Reports

Previous years' Audit Reports

Latest internal inspection reports of branch

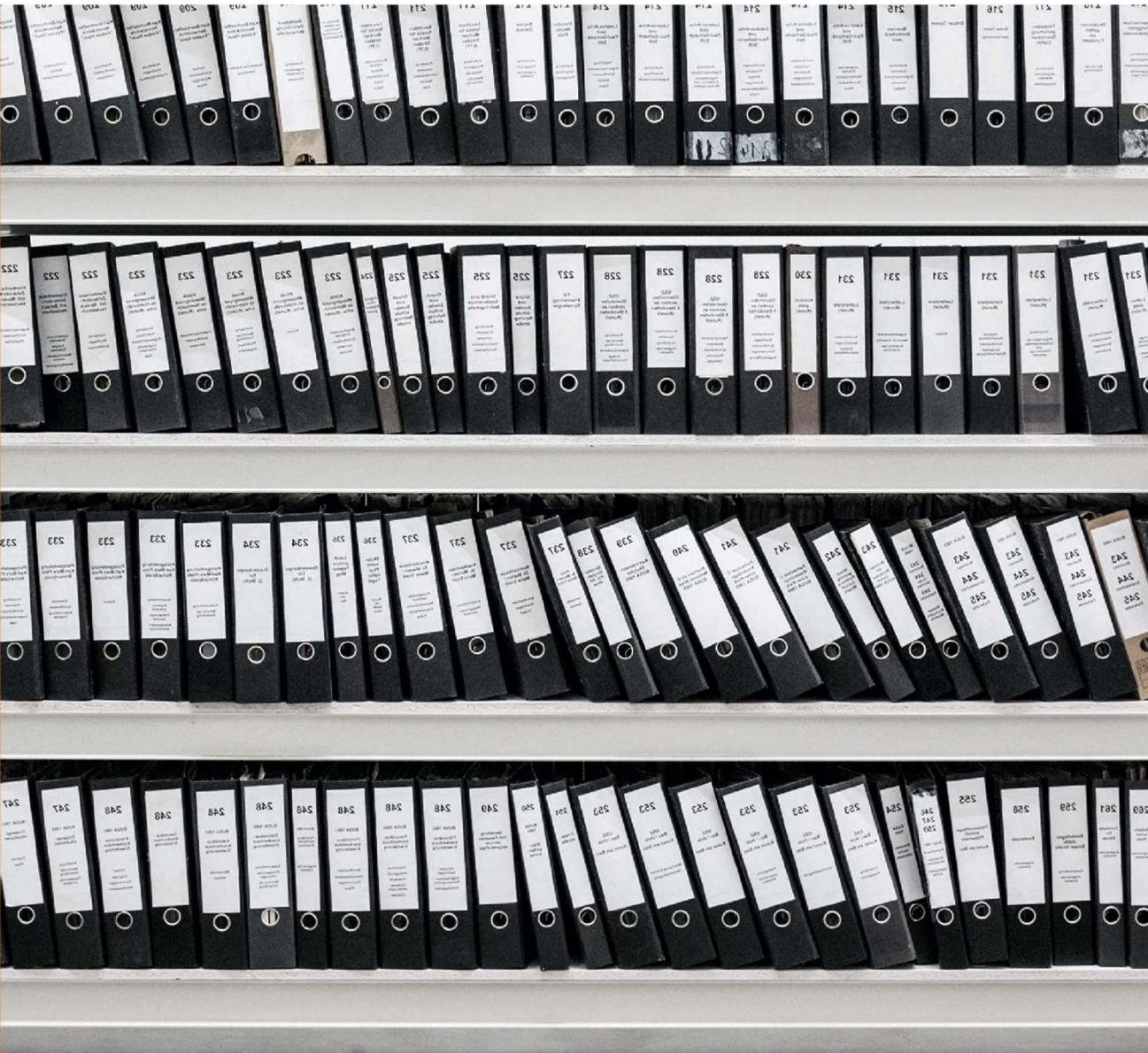
Latest inspection report of RBI

Concurrent / Internal Audit Report

Report on verification of security

Any other internal reports specially related to particular account

Manager's charge-handing-over report when incumbent is changed



Other Important Parameters for Documents Verification

Documentation

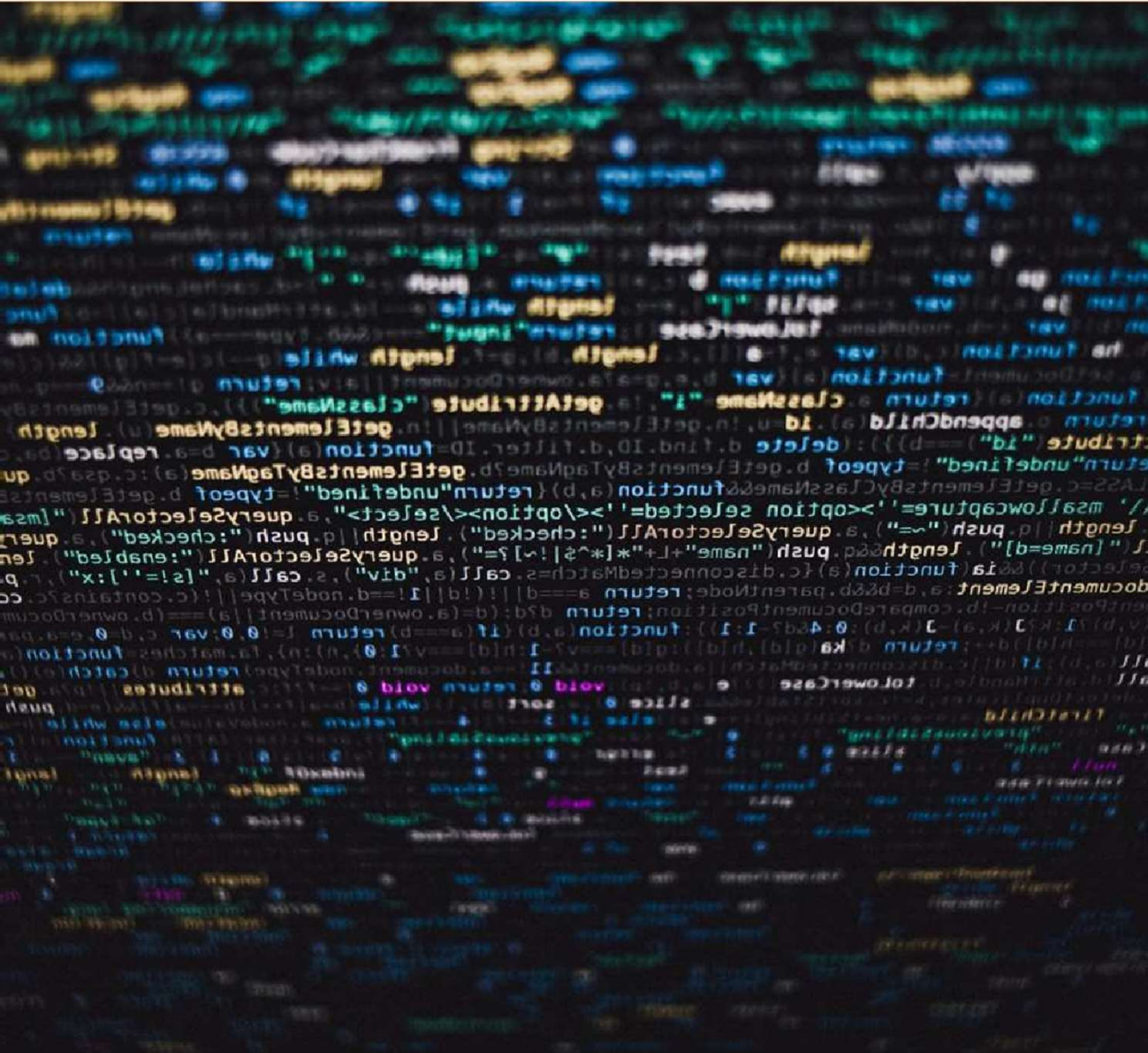
1. Latest Sanction Letter
2. Restructuring Sanction letter/ Consortium Sanction Letter
3. OTS Related Documents
4. Consortium Meeting Minutes
5. Lead Bank Certificate
6. Technical Viability Certificate
7. Bank Stock Audit Report (Valn of stock and Debtors) as certified by Auditor
8. Monthly Stock Statements for the year in case of WCTL
9. Title Documents of Prime and Collateral Securities
10. Mortgage Register and entry of the security duly authorized

Documentation

11. Hypothecation Deed
12. Details of Charge created/shifted as per MCA
13. Vetting Letter
14. Affidavits required as per terms of Sanction
15. Declaration of Hedge/Unhedged Foreign Currency transactions from Client
16. Standing Instruction Letter
17. Credit Rating Document and IOB Internal Rating Document
18. Latest Audited Financial Statements
19. Details regarding Pledge of shares of Promoters as per Sanction Details if any
20. CERSAI Documents

Documentation

21. Balance Confirmation from Customers
22. Others (as per Sanction Letter conditions)
23. Engagement Letter
24. Management Representation Letter
25. Obtain Relevant document, details, certificates, etc as part of engagement documentation in terms of SA 230
26. For explanations obtained from the branch management or any other fact matters obtain a representation letter confirmation in terms of SA 580



Other Key Points

Audit of Credit Monitoring

Early Warning Signals and Red Flagged Accounts



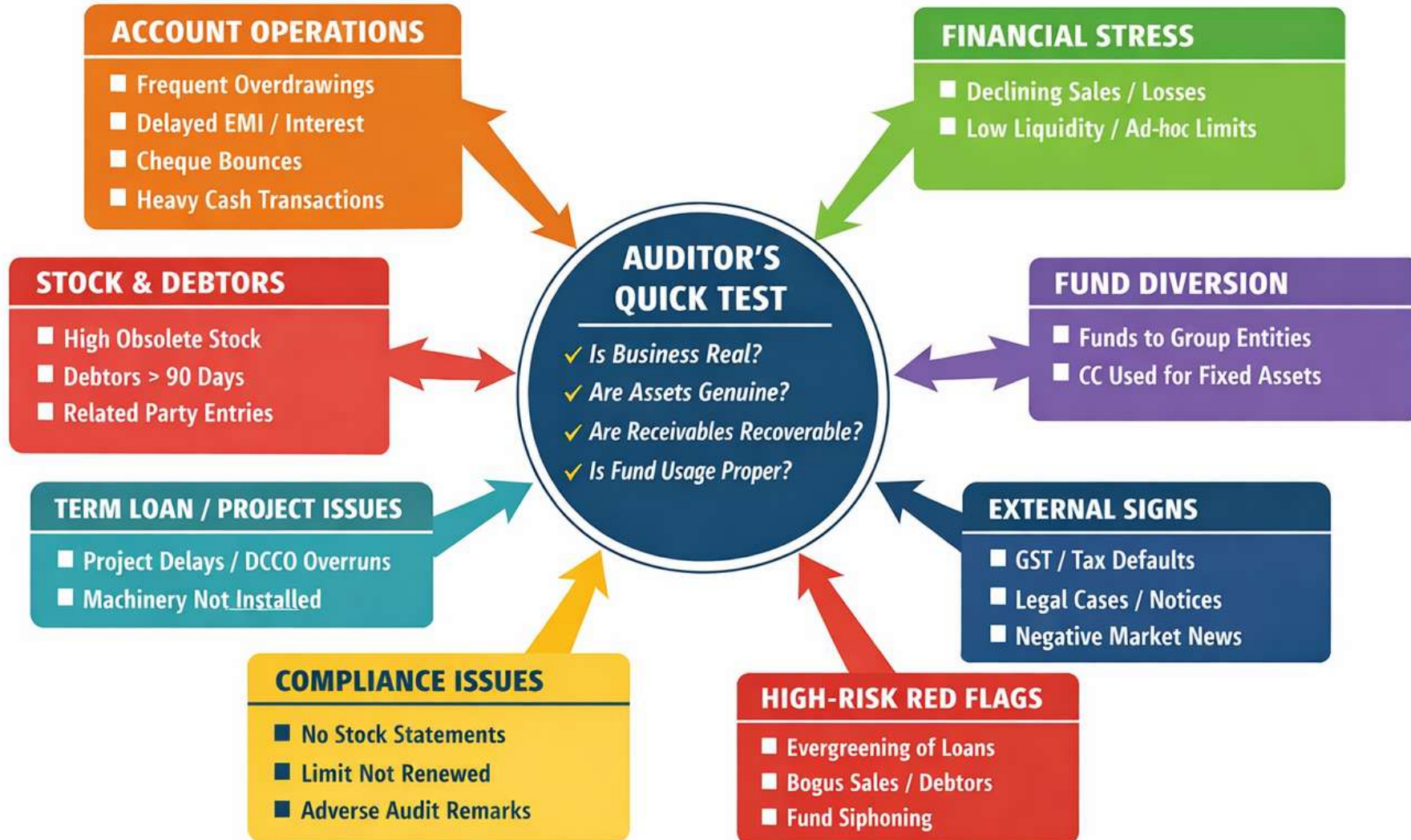
Instances in Annexure 1 to RBI Master direction on Frauds – dated July 1, 2016 & updated July 3, 2017



Reporting to top management / audit committee if > 5 crore (RBI Master Direction on frauds dated July 1, 2016 & updated July 3, 2017)

EARLY WARNING SIGNALS (EWS)

Key Alerts in Bank Audit to Detect Potential NPAs



EARLY WARNING SIGNALS (EWS)

Account Operations

- Irregular drawings / frequent over-limit usage
- Delay in interest / EMI servicing
- Cheque returns / devolvement of bills
- Heavy cash transactions without business logic
- Non-routing of full sales through bank

Financial Stress

- Declining sales / turnover
- Continuous losses / shrinking margins
- Deteriorating liquidity (current ratio)
- Frequent request for ad-hoc limits / enhancement

Stock & Debtors

- Sudden increase in stock / debtors without sales growth
- High obsolete / non-moving stock
- Debtors >90 days / slow recovery
- Related party debtors / circular transactions
- Fake / accommodation entries

Fund Diversion

- Transfers to related/group entities
- Use of CC for capital expenditure
- Unusual inter-account transfers
- Investment in unrelated activities

EARLY WARNING SIGNALS (EWS)

Term Loan / Project

- ✓ Delay in project / DCCO not achieved
- ✓ Frequent extension without justification
- ✓ Cost overrun without funding source
- ✓ Machinery not installed / project not started
- ✓ EMI paid from external sources

Compliance Issues

- ✓ Non-submission of stock statements
- ✓ Non-renewal of limits
- ✓ Adverse audit remarks not complied
- ✓ Frequent change in management/auditors
- ✓ Non-cooperation with bank

External Indicators

- ✓ GST / statutory dues unpaid or mismatched
- ✓ Legal cases / recovery notices
- ✓ Negative market information
- ✓ Industry / sector downturn

High-Risk Red Flags

- ✓ Evergreening of loans
- ✓ Bogus debtors / fictitious sales
- ✓ Diversion / siphoning of funds
- ✓ Business closed but account active



Applying Professional Skepticism

Potential Window Dressing

- Generally at Quarter Ending
- Transfer from unutilized credit limits to deposit & reverse
- Allowing loans against such deposits
- Scheme manipulations (e.g. Non priority advance to priority advance)

Indications of Rushed Sanctions

- Comparing volume of advances for last fortnight with that of previous fortnight
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Applying Professional Skepticism

Potential Ever-Greening of Week Credit Facilities

- Fictitious book-entries in CC & OD accounts
- Analysing movement in Accounts Restructured
- Movement in SMA / Potential NPAs
- To collect information on Movement in NPA

Using Internal / Concurrent Auditor's work in Planning (SA – 610)

- Material errors and frauds (Suspected / Alleged)
 - Divergence in RBI's IRACP Norms / NPAs suggested not taken into effect
 - SMA/ RFA/ Wilful defaulters/ Non-Co-operative borrowers
 - Other Material Irregularities
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Preliminary
Audit
Procedures

PREVIOUS YEAR'S MOC EFFECT

YEAR END ADJUSTMENT – CLOSING
CIRCULARS

BALANCING OF NFB LIMITS - GLB

CONSISTENCY CHECKS

- Automation of IRACP Norms
- Asset Classification Reports
- NPA Ageing



Thank
you

CA. Rohit Porwal

Email: carohitporwal@gmail.com

Mob. No. +91-7566958480

