

Seminar
on
Bank
Branch
Audit : 2025

Advances

Pune Branch of
Western India Regional Council of
The Institute of Chartered
Accountants of India

March 15, 2025

CA Prakash P. Kulkarni

Presentation Outline

2

- Preliminary Review of Advances Portfolio
- Reports from CBS
- Gold Loans
- Retail Loans
- Advances for Working Capital
- Advances sanctioned & renewed during the year
- Term Loans sanctioned during earlier years
- Restructuring of Advances
- Evergreening of Advances
- Early Warning Signals

3 Credit Growth

Amount in Rs. Crore

| Sector | 22.Mar,2024 | 24.Jan,2025 | Increase |
|---|--------------------|--------------------|------------------|
| 1. Agriculture & Allied Activities | 20,71,251 | 22,53,510 | 1,82,259 |
| 2. Industry (Micro and Small, Medium & Large) | 36,52,804 | 38,74,601 | 2,21,797 |
| 3. Services | 45,92,227 | 50,13,597 | 4,21,370 |
| 4. Personal Loans | 53,31,290 | 58,31,547 | 5,00,257 |
| Sub-total | 1,56,47,572 | 1,69,73,255 | 13,25,683 |
| Others | 7,61,511 | 8,45,322 | 83,811 |
| Total Non-Food Credit | 1,64,09,083 | 1,78,18,577 | 14,09,494 |

Preliminary Review of Advances Portfolio of the Branch

- Observations in prior years' LFAR 4
- Annexure to LFAR (for advances > Rs. 2 crore)
- Concurrent Audit / Internal Inspection Reports
- RBI Inspection Report
- Internal Branch Risk Rating
- List of top 10 / 20 borrowers of the Branch
- Analysis of Advances Portfolio of the Branch
 - ✓ Corporate / Large Advances
 - ✓ Priority Sector Advances
 - ✓ Retail Advances
 - ✓ Agricultural Advances
- Storage of loan documents at Central Processing Centre / Other Locations

Preliminary Review of Advances Portfolio

- Reports re. advances sanctioned beyond delegated authority, TODs sanctioned
- Stressed A/cs (SMA0, SMA1, SMA2)
- Restructured A/cs
- A/cs wherein internal / external credit rating is downgraded
- NPA portfolio comparison : current & previous year
- A/cs declared as fraud / suspected fraud
- A/cs upgraded during the year
- Quick Mortality cases during the year

Other documents to be reviewed

- Credit Policy of the Bank
- Inherent weaknesses in the credit appraisal, sanction and monitoring & supervision of the Bank – Prior years' LFAR

Review of Reports from CBS

- Changes in repayment schedules
- Overdue Report
- Non-Review-renewal accounts
- Interest failure report
- Exception reports re Advances
- NPA accounts upgraded during the period
- NPA & PA a/cs closed during the period
- Change in securities
- Turnover in working capital a/cs
- Drawing Power
- Probable NPAs
- Loan a/cs foreclosed
- Loans transferred from other branches
- User induced debits in fully disbursed term loan a/cs

Gold Loans : Salient Audit Observations

- Outstanding Gold Loans

| As on | Amount Rs. Crore | Increase |
|-------------|---------------------|----------|
| 24.Mar,2023 | 89,370 | |
| 22.Mar,2024 | 1,02,562 | 13,192 |
| 24.Jan,2025 | 1,78,861 | 76,299 |

- Purpose : Domestic, Agriculture, Business Retail
- Documents for holding of land, agricultural activity not obtained
- Purpose-wise Credit requirements of the borrower for agricultural activity not assessed
- Supporting documents not obtained end-use of funds

Gold Loans : Salient Audit Observations

- Inspections not carried out by bank's officials 9
- Bullet repayment of 12 months sanctioned without considering crop season
- Value of gold pledged not determined on monthly basis based on rate informed by HO
- Realisation of loan by sale of crop not ensured
- Evergreening of loans by sanctioning fresh loans to borrower / family members

Gold Loans : RBI Warnings

- Irregular practices observed in grant of gold loans : RBI Circular dt. 30 Sept. 2024 ¹⁰
- Shortcomings in use of third parties for sourcing and appraisal of loans
- Valuation of gold without the presence of the customer
- Inadequate due diligence and lack of end use monitoring of gold loans
- Lack of transparency during auction of gold ornaments and jewellery
- Weaknesses in monitoring of LTV
- Incorrect application of risk-weights
- Practice of rolling over loans at the end of tenor, with only part payment

Gold Loans : RBI Warnings

- Gold loans disbursed in cash to total gold loans¹¹ disbursed
- Many loan accounts were closed within a short time from sanction
- Non-categorisation of gold loans as NPA in the system, evergreening by renewing overdue loans/issuing a fresh loan

Retail Loans

- Verification of documents, appraisal, sanction & management of loans can not be outsourced.
- Credit Due Diligence can be based on parameters.
- Minimum income criteria, employment details, age, property details, purpose of the loan, type and value of commodities to be hypothecated etc.
- CIBIL Score
- Pre-sanction visits to applicants' office & residence
- Positive De Duplication check on bank's database
- Negative De Duplication check : Earlier rejected applications, RBI defaulters list, AML violations
- Disbursement
- Post-disbursement follow-up

Advances for Working Capital : Appraisal

- Shortcoming to be pointed out by SBA
- Comments by Statutory Auditors regarding variations in inventories & receivables as reported in CARO not considered during appraisal
- Comments not called from borrowers for:
- Decline in sales and increase in profit during last 3 years
- Increase in receivables over 6 months
- Valuation of non-moving inventory as identified by Stock Auditors
- Substantial reduction in loans from Promoters

Advances for Working Capital : Monitoring & Supervision

- Critical Review to be done by SBA
- Timely Submission of stock & book debts statements, updation of security value / DP in CBS.
- Statements submitted in bank's format, with all required details, with undertaking, signed by authorised signatory.
- Party-wise details of sundry debtors (less than & more than 90 days), sundry creditors, inventories (classified into Raw Materials, WIP, Finished Goods, etc.) with rate, quantity and value, details of slow / non-moving inventories, inventories not owned by borrower, inventories with third parties, stocks under LC.

Advances for Working Capital : Monitoring & Supervision

- Computation of drawing power by the Branch ¹⁵
- ✓ Exclusion of unpaid stocks / deduction of sundry creditors
- ✓ Exclusion of receivables > 90 days
- ✓ Exclusion of receivables – Escalation claims not acknowledged by customers, Subsidies
- ✓ Exclusion of Materials purchased under LCs / Buyers' Credit
- Re-computation of Drawing Power by SBA, if required
- Account to be classified as NPA, if not within DP

Advances for Working Capital : Monitoring & Supervision

- Monitoring of operations in CC a/cs as per DP¹⁶ by the Branch : Alerts system
- Debit & credit transactions in CC, to find out diversion of funds, if any. Identify abnormal transactions, such as:
 - ✓ Payments made to / Remittances received from Group companies, not appearing in statement of receivables & creditors submitted alongwith stock statement
 - ✓ Large remittances made, not for materials procurement
 - ✓ Large variations in collections & payments on week-to-week basis
 - ✓ Remittances received from particular parties before debit of term loan instalment, CC or TL interest

Advances for Working Capital : Monitoring & Supervision

- Bills discounting transaction
 - ✓ Discounting of bills, which are not customers of the borrower
 - ✓ Discounting of bills of particular parties, before due dates of LCs
 - ✓ Realisation not received from particular parties & bills discounted debited to CC a/c after due date
- Materials purchased under LC
 - ✓ LCs issued in favour of parties, not suppliers of the borrower
 - ✓ LCs issued to certain parties, just before large LCs become due for payment

Advances for Working Capital : Monitoring & Supervision

- Monitoring of operations in CC a/cs as per DP ¹⁸ by the Branch : Alerts system
- Review of:
 - ✓ Debit & credit transactions in CC (diversion of funds, if any to be ascertained)
 - ✓ Bills discounting transactions
 - ✓ Materials purchased under LC
- Insurance for Stocks
 - ✓ Types of Risks covered
 - ✓ Adequate Coverage
- Stock Audit report – adverse features

Advances sanctioned & renewed during the year

- **Application** (with all supporting documents)¹⁹
- **Sanction**
 - ✓ Sanction by appropriate authority as per delegation of powers
 - ✓ Terms & conditions – compliance
 - ✓ Rate of interest, as per bank's policy & internal rating
- **Loan documentation**
 - ✓ Agreement
 - ✓ Hypothecation / Mortgage Deeds
 - ✓ Demand Promissory Notes
 - ✓ Vetting of documents by legal counsel / dept.
- **Security created**
 - ✓ Valuation of security (valuation report)

Advances sanctioned & renewed during the year

20

- **Security created (contd.)**
 - ✓ Registration of charges with Registrar's office
 - ✓ Registration of charge with ROC
 - ✓ CERSAI charge creation
 - ✓ Security of shares, debentures, bank's FDs
- **Disbursement**
 - ✓ Stage-wise disbursement of term loans
 - ✓ Margin requirements
 - ✓ Utilisation – certification by CAs
- **Insurance**
 - ✓ Appropriate insurance cover for assets hypothecated / mortgaged
- **Inspection**
 - ✓ Pre & post sanction visits by Bank's officials.
 - ✓ Adequate documentation of visit report.

Term Loans sanctioned during earlier years

- Observations in prior audit report (pending compliances)
- Review of audited Financial Statements
- Monitoring & Supervision

Recovery

- Serviced through funds generated from business operations.
- Auditors to verify the nature and timing credits, to ensure genuine sources.

Key Fact Statement

- RBI Circular dt. April 15, 2024
- Legally significant basic fact regarding loan agreement to be provided to the borrower
- In local language
- Purpose : Easier to understand for the borrower
- Sanctioned loan amount, disbursement schedule, Interest Rate, Fees / charges, Annual Percentage Rate, Contingent Charges, loan clauses.

Restructuring of Advances

- Framework for Compromise Settlements & Technical Write Off dt. 8 June 2023
- Compromise settlements wherein period of repayment more than 3 months. Advances should be treated as restructured.

Significant Audit Observations in Advances

- Critical negative features not considered during appraisal
- Non-compliance of terms & conditions of sanction of credit facilities
- Non-compliance of critical terms of restructuring
- Unsatisfactory business performance
- Non-review / renewal of working capital limits
- Sufficient Drawing Power not available
- Turnover in CC a/c not commensurate with limit
- Payments from CC a/c not monitored
- Information not shared among various banks
- External credit rating not obtained
- Negative features pointed out in stock audit / internal inspection not rectified / replied by the borrower

Significant Audit Observations in Advances

- Upgradation by recovery of critical overdue amount 25
- Upgradation without recovery of overdue amount in percolation accounts
- Solitary credits near to balance sheet dates
- Credits by way of reversals considered in turnover by system
- Non-identification NPAs on on-going basis
- Non-classification of all accounts of same borrowers due to different customer codes

Factors for facilitating Frauds

- Opening current account with banks outside 26 consortium without the No Objection Certificate from lenders.
- Deficient and fraudulent services/certificates by Third Party Entities (TPEs).
- Diversion of funds by the borrowers through various means including through associated / shell / front-end companies.
- Lapses in credit underwriting standards.
- Failure to identify the Early Warning Signals (EWS) of incipient frauds.

Evergreening of Advances

- Disbursement of loans to the borrowers (same branch or other branches) to repay overdue instalments or excess in working capital facilities. 27
- Disbursement of loans to group / associate entities, directors / promoters, their relatives, employees etc. which are utilised for repayment of overdues. Such loans are repaid by facilities granted to the borrowers.
- Frequent reschedulement of term loans
- Debit & credit entries passed in the same a/c (term loans or CC) Credit entries are treated as recovery.

Data Analytics through CBS for Early Warning Signals for Advances

- Master Directions RBI/DOS/2024-25/118 **28**
DOS.CO.FMG.SEC.No.5/23.04.001/2024-25 dated July 15, 2024 on "Fraud Risk Management in Commercial Banks"
- Comprehensive Early Warning Signals (EWS) framework integrated with Core Banking Solution (CBS)
- Setting up dedicated Data Analytics and Market Intelligence (MI) Unit
- Capture broad indicators based on transactional data of accounts, financial performance of borrowers, market intelligence and conduct of borrowers.

Verification of Parameters in Master Data

- **Parameters in Master Data of Loan A/c** 29
- Sectoral Classification – Priority Sector
- Rate of Interest – Set Off
- Tenure of Loan
- Instalment of Principal
- Ballooning of Instalments
- EMI
- Crop Pattern
- Parameters for Stock Statement

Early Warning Signals for Advances

- Frequent overdrawing in CC / OD a/cs. 30
- Frequent Sanction of adhoc limits.
- Credits in CC a/cs not sufficient to service interest on CC.
- Term loan instalments not being serviced through cash generated from operations.
- Funding of the interest by sanctioning additional facilities.
- Frequent invocation of BGs, devolvment of LCs
- Defaults in payment obligations of the banks.
- Delays in payments to Suppliers.
- Delays in payment of Statutory dues.

Early Warning Signals for Advances

31

- Frequent bouncing cheques for the reason of inadequate funds.
- Funds coming from other banks to liquidate the outstanding loan amount.
- Receivables remaining overdue for a long time after due date.
- Floating front / associate companies by investing borrowed money.
- Reduction in the stake of promoters / directors.
- Sale / Pledge of shares by Promoters
- Large number of transactions with inter-connected companies and large outstanding from such companies.

Early Warning Signals for Advances

32

- Significant movements in inventory, disproportionately higher than the growth in turnover.
- Significant movements in receivables, disproportionately higher than the growth in turnover and/or increase in ageing of the receivables.
- Disproportionate increase in other current assets.
- Significant increase in working capital borrowing as percentage of turnover.
- Critical issues highlighted in the stock audit report.

Early Warning Signals for Advances

33

- Liabilities appearing in ROC search report, not reported by the borrower in its annual report.
- Substantial related party transactions.
- Business Transactions with shell companies.
- Frequent request for general purpose loans.
- Movement of an account from one bank to another.
- Not routing of sales proceeds through bank.
- LCs issued for local trade / related party transactions without underlying transactions.
- High value RTGS payment to unrelated parties.
- Heavy cash withdrawal in loan accounts.
- Non-submission of information (Stock & Book Debts statements, QIS) on timely basis to bank.
- Purchase Invoices without GSTN.

Certification of Advances by SBAs

34

- Advances for Balance Sheet presentation, classified into:
 - ✓ Nature of Advances : Bills Purchased / discounted, Cash Credit, Overdrafts & Loans payable on demand, Term Loans
 - ✓ Secured by tangible assets, Covered by bank / government guarantees, Unsecured
 - ✓ Priority, Public Sector, Banks, Others
 - ✓ Advances in India, Outside India
- Statement of NPAs
- Movement in NPAs
- Sectoral classification – Capital Markets, Real Estate,
- Interest on NPAs
- Information re. Restructured A/cs

Agricultural Advances

- A

36 **Thanks !!!**

