

Statutory Audit of Bank Branches

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

Verification of Advances

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Presentation Outline

2

- Statistics
- Preliminary Review of Advances Portfolio
- Reports from CBS
- Advances sanctioned & renewed during the year
- Advances for Working Capital : Monitoring & Supervision
- Term Loans sanctioned during earlier years
- Restructuring of Advances
- Evergreening of Advances
- Early Warning Signals
- RBI Master Directions / Circulars

Deposits & Advances of Scheduled Commercial Banks

Source : Annual Reports of RBI & Reports on Trends & Progress of Banking in India

Year	Amount Rs. Crore	
	Aggregate Deposits	Non-Food Credit
1950-51	988	591
1962-63	2,042	1,588
1964-65	2,583	2,035
1969-70	5,028	3,971
1974-75	11,827	8,762
1979-80	31,759	21,537
1984-85	72,244	48,953
1989-90	1,66,959	1,01,453
1994-95	3,86,859	1,99,285
1999-00	8,13,345	4,10,267
2004-05	17,00,198	10,59,308
2009-10	44,92,826	31,96,299
2014-15	85,33,285	64,42,002
2019-20	1,35,67,492	1,03,19,097
2020-21	1,51,13,512	1,08,88,255

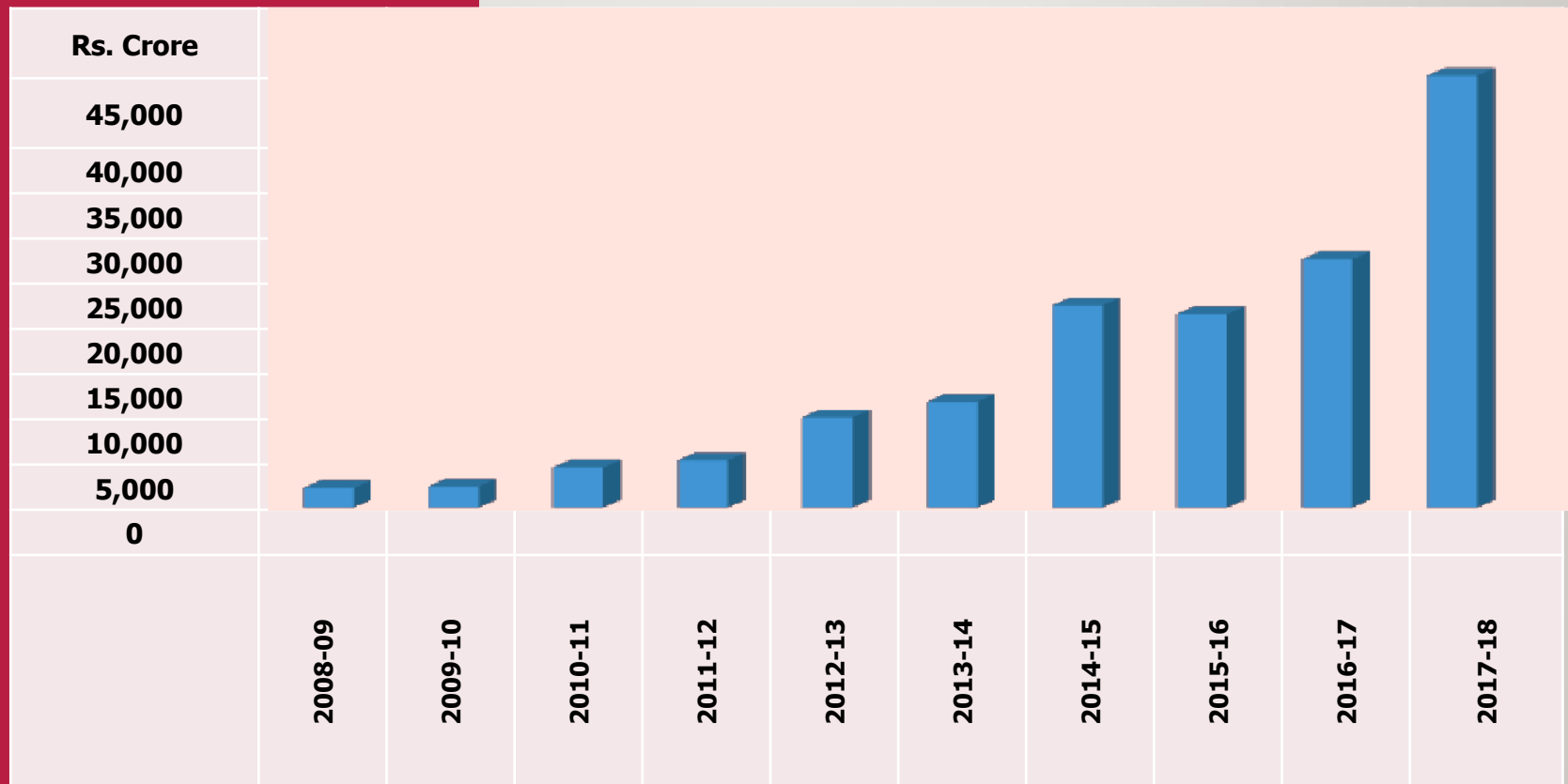
Deposits & Advances of Scheduled Commercial Banks

Source : Annual Reports of RBI & Reports on Trends & Progress of Banking in India

Year	Non-Food Credit	Amount Rs. Crore	
		Increase in Credit	% Increase
1962-63	1,588		
1964-65	2,035	447	28.1%
1969-70	3,971	1,936	95.1%
1974-75	8,762	4,791	120.6%
1979-80	21,537	12,775	145.8%
1984-85	48,953	27,416	127.3%
1989-90	1,01,453	52,500	107.2%
1994-95	1,99,285	97,832	96.4%
1999-00	4,10,267	2,10,982	105.9%
2004-05	10,59,308	6,49,041	158.2%
2009-10	31,96,299	21,36,991	201.7%
2014-15	64,42,002	32,45,703	101.5%
2019-20	1,03,19,097	38,77,095	60.2%
2020-21	1,08,88,255	5,69,158	5.5%

Amount involved in Fraud cases

Source:
RBI Annual Report 2017-18



Frauds in Banks

Year	Advances	Other	Amount Rs. Crore	
			Total	%
2017-18	22,558	18,609	41,167	54.8%
2018-19	64,539	6,995	71,534	90.2%
2019-20	1,81,942	3,526	1,85,468	98.1%
2020-21	1,37,023	1,399	1,38,422	99.0%

Frauds in Banks

- **India's biggest bank fraud is a telling tale of 7 public money put in jeopardy**
- As the [Enforcement Directorate](#) on Wednesday (Feb. 16) registered a case of money laundering against Gujarat-based ABG Shipyard based on the complaint of the State Bank of India (SBI), the company has been described as being involved in "[India's biggest bank fraud](#)." The company's chairman, [Rishi Kamlesh Agarwal](#), was questioned by the Central Bureau of Investigation (CBI) for defaulting on loans amounting to 22,842 crore rupees (\$3.03 billion) that ABG Shipyard took from 28 banks.
- The loan account had been declared as a non-performing asset (NPA) in July 2016, after futile attempts at restructuring it by the SBI and a failure to recover the money through the process laid out under the Insolvency and Bankruptcy Code (IBC). It was declared a fraud in 2019.

Preliminary Review of Advances Portfolio of the Branch

- Observations in prior years' LFAR
- 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
- Control Returns re. advances sanctioned beyond delegated authority, TODs sanctioned

Preliminary Review of Advances Portfolio

- Stressed A/cs (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
- 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

10

- Changes in repayment schedules
- Overdue report
- Non-Review-renewal accounts
- Interest failure report
- Exception reports
- 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

Advances sanctioned & renewed during the year

- Documents submitted by the applicant
 - ✓ Before sanction of advance
 - ✓ During & after disbursement
- Documents created / generated by the Bank
- Documents obtained from third parties



Advances sanctioned & renewed during the year

12

- **Application**

- ✓ Application in bank's format
- ✓ Audited Financial Statements
- ✓ Income Tax & GST Returns
- ✓ Net worth / tax returns of Promoters & guarantors
- ✓ Project Report (with cash flows)
- ✓ Quotations of assets to be purchased
- ✓ KYC documents of the borrowers / promoters
- ✓ Financial Projections – CMA
- ✓ Confidential Report & NOC from the existing bankers

- **Credit Appraisal**

- ✓ Critical review of credit appraisal note (especially advances sanctioned at the Branch level)

Advances sanctioned & renewed during the year

- **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)
 - ✓ Creation of Mortgage

Advances sanctioned & renewed during the year

14

- **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.

Advances for working capital : Monitoring & Supervision

- Critical Review to be done by SBA
- Timely Submission of stock & book debts statements
- 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 16
 - ✓ Exclusion of unpaid stocks / deduction of sundry creditors, as per the policy of the bank
 - ✓ Exclusion of receivables > 90 days
 - ✓ Exclusion of receivables – Escalation claims not acknowledged by customers
 - ✓ 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
- Monitoring of operations in CC a/cs as per DP calculated by the Branch
- Review of
 - ✓ Debit & credit transactions in CC (diversion of funds, if any, to be ascertained)
 - ✓ Bills discounting transactions
 - ✓ Materials purchased under LC
- Stock Audit Report – Adverse features

Term Loans sanctioned during earlier years

17

- 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.

Restructuring of Advances

Applicable circulars

- ✓ RBI Master Circular dated October 01, 2021
- ✓ MSME Sector – Restructuring of Advances dated August 6, 2020
- ✓ Resolution Framework for COVID 19 related stress dated August 6, 2020
- ✓ Resolution Framework 2.0 – Resolution of COVID 19 related stress of MSME dated May 5, 2021
- ✓ Resolution Framework 2.0 – Resolution of COVID 19 related stress of Individuals and small business dated May 5, 2021

Restructuring of Advances – MSME

19

- Conditions to be complied:
- The borrower should be classified as MSME as on March 31, 2021
- The borrower is GST-registered on the date of implementation (other than exempt entities)
- The aggregate exposure (FB+NFB) of **all lending institutions** does not exceed ₹50 crore as on March 31, 2021
- The borrower's account was a 'standard asset' as on March 31, 2021
- Account was not already restructured under MSME restructuring circulars
- **Restructuring is invoked by September 30, 2021 and implemented within 90 days**
- Provision of 10% of residual debt

Restructuring of Advances – MSME

20

- Accounts slipped into NPA between April 1, 2021 and date of implementation may be upgraded, as on the date of implementation
- Implementation means and includes:
 - ✓ all related documentation is completed
 - ✓ creation and perfection of security charge
 - ✓ the new capital structure and / or changes in the terms and conditions of the existing loans get duly reflected in the books of all the lenders and the borrower.

Restructuring of Advances – Individuals and Others

21

- Eligible borrowers:
 - ✓ Individual having personal loans
 - ✓ Loans for business - aggregate exposure not more than Rs.50 crore as on March 31, 2021
 - ✓ Small businesses other than MSME having aggregate exposure Rs.50 crore or less
- Borrower should not have availed of any resolution in terms of the Resolution Framework – 1.0 (Circular dated August 6, 2021) *
- Borrower was classified as Standard by the lending institution as on March 31, 2021
- Last date for invocation is September 30,2021
- Maximum moratorium period 2 years
- Overall cap on extension of residual tenor, (including moratorium) shall be two years
- To be implemented within 90 days from invocation date

Restructuring of Advances – Individuals and Others

- Conditions for implementation
 - ✓ Documentation is completed
 - ✓ Necessary collaterals are provided as per revised stipulations
 - ✓ Necessary changes in repayment schedule, EMI, etc. are made in bank's CBS
 - ✓ borrower is not in default with the lending institution as per the revised terms.
- Account slipped into NPA between invocation and implementation may be upgraded as Standard
- Provision - provisions held as per the extant IRAC norms immediately before implementation, or 10 percent of the residual debt whichever is higher
- In case of borrowers who have availed benefit under COVID Resolution Framework 1.0 (Dated August 6, 2020) and where moratorium / extension in residual tenure was granted for less than 2 years – the same can be extended up to 2 years under this circular without treating as multiple restructuring.

Significant audit observations in Advances

- Sufficient Drawing Power not available
- 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
- Upgradation by recovery of critical overdue amount
- 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

Evergreening of Advances

- Disbursement of loans to the borrowers (same branch or other branches) to repay overdue instalments or excess in working capital facilities. 24
- Disbursement of loans to group / associate entities, directors / promoters, their relatives, employees etc. which re 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.

Early Warning Signals for Advances

25

- Frequent overdrawing in CC / OD a/cs.
- 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 and devolvement 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

- 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

- 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

- Liabilities appearing in ROC search report, not reported by the borrower in its annual report.
- Substantial related party transactions.
- 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.
- 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.

RBI Master Directions & Circulars

- Loans and Advances – Statutory and Other Restrictions : July 01, 2015
- Exposure Norms : July 01, 2015
- Ad-hoc / Short Review / Renewal of credit Facilities –Reiteration of earlier guidelines : August 21, 2020
- New Definition of Micro, Small and Medium Enterprises – Clarifications in line with the modified definition of MSME's : August 21, 2020
- Frauds – Classification and Reporting by commercial banks and select FIs : July 01, 2016 (Updated as on July 03, 2017)
- Priority Sector Lending (PSL)– Targets and Classification : September 04, 2020 (Updated as on October 26, 2021)
- Lending to Micro, Small & Medium Enterprises (MSME) Sector : July 24, 2017 (Updated as April 25, 2018)

RBI Master Directions & Circulars

30

- Reserve Bank of India (Relief Measures by Banks in Areas affected by Natural Calamities) Directions 2018 – SCBs : October 17, 2018
- Kisan Credit Card (KCC) Scheme : July 04, 2018
- Housing Finance : July 01, 2015
- Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances : October 1, 2021
- RBI Clarifications dated November 12, 2021 and February 15, 2022

31 **Thanks !!!**

