

**Seminar on Concurrent Audit of Banks**

**Audit of Advances (Domestic)**

**Fund Based and Non-Fund based**

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**By**

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## **PREAMBLE**

- Present discussion revolves around verification of advances (domestic)- Fund Based and Non Fund Based.
- Hold preliminary discussions with Branch Manager and advance officer to assess the depth of work and identification of team.
- Study the profile of Branch and composition of advances.
- Identification of team depends on advance mix. In the case of large corporate branches, we need to deploy CA or retired Bankers.
- In case the branch has large restructured accounts / NPA / Potential NPAs, the Partner himself should visit more number of times.

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## **PRELIMINARY APPROACH TO AUDIT**

Study Previous Period Concurrent Auditors' **Report** and **Compliance** thereof.

- R.B.I Inspection, if any.
- Stock Audit Reports
- LFAR up to Last March.
- RBIA/ Internal audit report- Internal Rating by auditors, risk classification (low / medium/ high).
- Overall quality of credit appraisal, monitoring and compliance.
- Familiarise with CBS of the Branch and obtain various Menu Instructions useful to the auditors.
- Bank Credit Policy- Exposure norms (individual/ group).
- Empaneled list of valuers/ advocates.
- Delegated authority of Branch Manager.
- Various returns (relating to advances) required to be submitted to higher offices.

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- Circulars issued by Bank from time to time, including Service Charges Circular.
- Auditors not to sit on the judgement or decisions taken by Branch/ Bank. To check whether the transactions/ decisions conform to the Policy guidelines.
- Importance to be given to checking high risk transactions with large financial implications rather than small transactions.
- Irregularities to be reported to Branch Manager on periodical basis and also towards the end of the month.
- Basic registers to be maintained at Branch Level:-
  - Insurance Register
  - Stock and Book Debts Statement
  - EM Register- CERSAI Registration
  - Inspection
  - MSOD/ QIS
  - Audited Balance Sheet
  - Review/ Renewal/ Short Review
  - Processing Charges/ Lead Bank Charges

- SMA 1, SMA 2 (Potential NPA)
- List of NPAs as certified by Statutory Auditors.
- Scope of audit/ Check List circulated by Bank.  
Care to be taken while replying to the format with Yes/ No questions.

## **WAY FORWARD**

- Ideally auditors are required to verify **all** advance accounts with outstanding balances. This is feasible in case of small branches but in case of large corporate branches, it is difficult.
- In such cases, take up accounts sanctioned during the month and that too those accounts after disbursement.
- Study Appraisal Note, Sanction Letter, Acceptance by the Customer.

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- Ensure that loans are Sanctioned based on appraisal notes containing all details including Financials, turnover figures, justification of renewal/ enhancement.
- Sanction letter to be drafted carefully duly incorporating all the essentials of Sanction (limit, margin, ROI, DP) etc. Sanction letter should contain only those conditions relevant for the borrower (as per constitution) and facility sanctioned.
- Loan accounts are opened with proper code with full details.
- Verify correctness of data fed into the system like ROI, margin, limit, commencement/ last instalment, security value, etc.
- Verify end use of Funds both in Loan/ C.C. type accounts. Most of the Banks are now insisting for a C.A. Certificate for the end use of Funds.

## **DOCUMENTS/ PAPERS TO BE CALLED FOR AND STUDIED IN EACH ACCOUNT**

- Stock and Book debts Statements- verification of DP.
- Audited Financial Statements
- Insurance Policies
- Latest Valuation Reports- from 2 valuers (wherever applicable)
- Advocate's opinion
- Stock Audit Reports
- Minutes of Consortium meetings (wherever applicable)
- Search report at the time of Sanction/ Renewal.

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## **Check-list – Cash Credit ( Hypothecation / Book Debts ):**

### **a) Documentation / Compliance of Sanctioned Terms**

1. Compliance of terms of sanction regarding rate of interest, margin, documentation, induction of share capital, creation of security.
2. Submission of Stock statement and Calculation of Drawing Power Correctly. Book Debts drawn on associate concerns, to be allowed for DP only if permitted in the sanction.
3. End-use of funds – Certificate from a CA required.
4. Charges to be filed within the prescribed time limit
5. Insurance : Adequacy , Location of Assets and Bank clause, risks covered, continuation of cover period.
6. In the case of Corporate Borrowers, Due Diligence Report on half yearly basis from the Company Secretary.



7. Scrutiny of High value credits/ debits/statement of account
8. Intra-group transactions
9. Diversion of funds
10. Frequency of excess drawing and adhoc requests.
11. Credit discipline – repayment of adhoc/ instalments and servicing of interest
12. Consortium Meetings - holding of quarterly meetings/exchange of information between banks.
13. Penal Interest for non-compliance of any terms and conditions

## **Scrutiny of Operations:**

1. Intelligent Scrutiny of operations (from statement of account)
2. Check excess drawing and drawing against un-cleared cheques
3. Monthly turnover to commensurate with sales and annual projections.
4. Branch Manager's explanation of unusual items & large transactions
5. Check whether ROI/ margin is correctly fed into the system.
6. Commitment charges for non/ underutilization of limits (As per sanction terms).

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## **Scrutiny of Stock/ Book Debt Statement:**

1. Regularity in Submission of Statement and in the prescribed format. Penal Interest for delayed/ non submission.
2. Maintaining stipulated margin
3. Slow and non- moving stock (from stock audit)
4. Age of book debts (Debtors) – Quarterly/Half yearly certification by CA if stipulated
5. Valuation of stock – cost/ market price whichever is lower
6. Unpaid stock and stock under usance L.C to be deducted.

## **Scrutiny of OPR /MSOD:**

1. Regularity in Submission of Statements
2. Actual performance vis-à-vis projections
3. Reasons for variations
4. Branch to convey adverse observations to the borrower and call for clarifications.

## **Check-list Term Loan:**

1. Compliance of terms of sanction including registration with ROC.
2. End-use of funds, disbursement by way of DD/PO/Cheques directly in favor of Suppliers. Verification of Original Invoices etc.
3. Disbursement by way of reimbursement only if permitted by sanction and after meeting all sanction terms. Proof of initial payment to be verified.
4. Repayment schedule to be as per the sanction and verify record of repayment
5. Disbursement strictly as per project report (in installments). If the disbursement schedule stretches beyond one year then yearly draw down schedule duly certified by the borrower should be obtained. Disbursement schedule should be entered in the CBS in the case of such Term Loans.
6. Check whether proper margin stipulated as per sanction brought in by the promoters/ Company.
7. Study Bank Statement.
8. Ensure that repayments are coming from internal accruals only and not from outside source.

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## **Check list Priority Sector Advances :**

1. Amount of individual loans small
2. Interest subsidy available
3. Test check of documents and classification
4. Lodgment of claims with ECGC
5. Check proper coding and classification as per the R.B.I guidelines.

## **Check list Non Fund Based Limits :**

### **a) Bank Guarantees**

1. Verify sanction terms/ margin/ commission, validity and action period. Verification of Commission to be done in all cases.
2. Limitation clause.
3. Register of guarantees issued
4. Reversal of expired guarantee after following extant guidelines
5. Attract Capital Adequacy Norms in the case of un reversed guarantees.
6. Fresh guarantees not to be issued when earlier guarantees were invoked and not paid.
7. Ensure that a Performance Guarantee is not classified as Financial Guarantee (and vice versa) in the system as the conversion and the risk weight are different for different types of guarantees.

## **Check list Non Fund Based Limits :**

### **b) Letter of Credit**

1. Examine sanction to verify L/Cs are issued as per terms.
2. L/C should be signed by authorized officials (Two)
3. Proper sanction for Extensions/Modifications
4. On devolvement no fresh L/C is to be issued
5. Discrepancies in documents promptly reported to negotiating banker/ shipper.
6. On non payment liability is crystallized and reported.
7. Commission on L/C to be checked.



## **Revenue Leakage (in respect of Advances)**

- 1. Read service charges circulars issued**
- 2. Major components of Leakage:**
  - **Processing Charges, particularly for extended period (to be collected at the time of sanction)**
  - **Upfront fees (to be collected at the time of sanction but not at the time of disbursement)**
  - **Documentation Charges**
  - **Fees for adhoc sanctions**
  - **Fees for modification in sanction terms**
  - **Fees for Misc. request like NOC/ Vacation of charge, etc.**
  - **Solvency Certificate Charges**
  - **Commission on L/C & B/G**
  - **EM/CERSAI Charges**

- 3. Penal Interest for delayed /non submission of stock and book debts/ QPR etc. (also expiry of External Credit Rating)**
- 4. Penal interest for non-compliance of terms and conditions**
- 5. Penal Interest for non/ delayed submission of Audited Financial Statement.**

## **OTHER AREAS TO BE VERIFIED**

- NPA divergence- Quick mortality Cases
- Transgression of delegated authority
- Compliance to LFAR
- Pre disbursement Audit
- Indiscriminate Sanction of advances/ adhoc/ TOD
- Review/ renewal/ short review of Limits  
Changing the renewal date in the system without actually doing the appraisal.

## **MONITORING OF ACCOUNTS**

- Poor operations / abnormal transactions in borrowal accounts.
- Frequent transfer of Funds among associates
- Unit visits/ stock verification/ stock audit
- False Compliance Certificate issued by the Branch.

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