

PRESENTATION ON
AUDIT OF ADVANCES
(INCLUDING REPORTING OF ADVANCES UNDER
LONG FORM AUDIT REPORT)

BY

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Background

Preliminary

- ❖ Advances generally constitute the largest item of the assets
- ❖ Advances constitutes one of the major areas of verification for the auditors
- ❖ Lending activity of banks are closely regulated by RBI
- ❖ Lending as major source of income



Background

Major Area of Concern

- ❖ Sanction without proper documents and/or without approval of appropriate authority
- ❖ Allowing withdrawals / disbursement in excess of available limit
- ❖ Diversion of funds
- ❖ Offering securities in favour of more than one bank
- ❖ Availing facility on the basis of forged documents / Unrealistic projections
- ❖ Discounting of Accommodation Bills
- ❖ Inflating value of stock / book debts



Classification of Advances

Based on Funds

- ❖ Funded - where actual money is given by the bank
- ❖ Non Funded – Bank Guarantee/ Letter of Credit/ Commitment/ Co-acceptance

Based on Geography

- ❖ Inland and Export (Packing/ Pre-shipment credit, Post-shipment credit)



Classification of Advances

Based on Security

- ❖ Secured and Unsecured

Based on Security

- ❖ Priority Sector and Non Priority Sector

Based on Segment

- ❖ Commercial & Industrial
- ❖ Small Scale Industries
- ❖ Small Business Finance
- ❖ Agricultural
- ❖ Retail



Type of Advances

Cash Credit

- ❖ Facility provided for working capital requirement
- ❖ Facility provided against security of stock of goods, standing crops, bills/book debts representing genuine sales
- ❖ Most common form of collateral security are immovable properties, movable fixed assets, deposits receipts etc.

Overdrafts

- ❖ Facility is granted to Current Account holders
- ❖ No repayment schedule.



Type of Advances

Loans

- ❖ **Demand loans** with repayment period up to 36 months.
- ❖ **Term loans** with repayment periods beyond 36 months.
- ❖ Both loans are similar in many respects, such as predetermined repayment schedule, disbursal by way of limited number of debits
- ❖ Term Loan is for acquisitions of capital assets which then become the security for the loan i.e. end use of funds is fixed
- ❖ The demand loans are granted against the existing securities e.g. term deposits, gold and shares.



Type of Advances

Bills

- ❖ Cash credit finance - pre sales stage and finance against bills - post sales stage.
- ❖ Purchase / discount bills may be under letter of credit.
- ❖ Bills may be documentary i.e. accompanied by the original documents of title to the goods or clean i.e. without the original documents.
- ❖ The finance against bills may be in form as:
 - Purchase of bills if payable on demand
 - Discounting of bills if usance or time bill
 - Advance against bills under collection from drawees



Type of Advances

Export Credit

- ❖ Exporters granted facilities in form of cash credit and bills but termed as pre-shipment credit and post shipment credit
- ❖ Pre-shipment credit, advance required to finance the production cycle
- ❖ Pre-shipment credit has to be liquidated out of export proceeds only and can not be adjusted out of rupee funds
- ❖ Post shipment credit relates to financing of bills raised on overseas buyer upon shipment of goods / services
- ❖ The export proceeds to be received within 180 days from the date of shipment. The period can be extended in genuine case.
- ❖ Pre-shipment credit granted in a foreign currency is called 'Packing Credit in Foreign Currency'



AUDIT APPROACH AND PROCEDURES



Audit Approach

In Audit of advances, auditor is concerned with obtaining evidence about..

- ❖ Major accounting policies and rules given in the Annual Closing Guidelines have been followed
- ❖ Amounts included in Balance sheet in respect of advances
- ❖ Amounts due to the bank are appropriate supported by loan documents
- ❖ There are no unrecorded advances
- ❖ Advances are disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory and regulatory requirements



Details to be called for

- ❖ Facility-wise/party-wise list of accounts outstanding, along with the outstanding balance
- ❖ Sanctioning powers of the branch officials and the higher authorities
- ❖ List of accounts where the regular facility or the adhoc facility is due for renewal
- ❖ Stock/ book debt statements are in arrears



Details to be called for

- ❖ No insurance or inadequate insurance has been taken
- ❖ Accounts are overdrawn beyond the sanction/DP (drawing power) limit
- ❖ Stock audit is due, but has not been done
- ❖ Inspection has not been carried out in the last three or six months
- ❖ For CC (Cash Credit)/OD (Overdraft) accounts, month wise details of debit and credit transactions (turnover)



Extent of verification

- ❖ Depend on existence and efficacy of the internal control procedures
- ❖ Report given by various auditors, especially the concurrent auditors/ credit auditor
- ❖ Verify all large advances – constitutes more than 5% of the aggregate outstanding advance of that branch or ₹ 2 Crores, whichever is lower
- ❖ If NPAs are high or extensive problem is identified, percentage of check should be increased



Process of verification

- ❖ **Credit appraisal and sanction**
 - ❖ Sanction Letter
 - ❖ Credit appraisal report
 - ❖ Borrowers financial statements
 - ❖ Ratio analysis
 - ❖ Visit report by the branch, valuation report
 - ❖ Net worth of the borrower and guarantors
 - ❖ Confidential report from other banks, etc.



Process of verification

❖ **Disbursements**

- ❖ Execution of documents as per terms and conditions laid down in sanction letter
- ❖ Joint documents in case of consortium
- ❖ Any deviation in complying terms and conditions, prior approval from sanctioning authority
- ❖ Ensure end use of fund at the time of disbursement

❖ **Review of Operations**

- ❖ To identify any abnormal transactions in bank account



Process of verification

❖ **Renewal of Advances**

- ❖ Cash credit to be renewed on a yearly basis

❖ **Reschedulement**

- ❖ Reschedulement/restructuring has been done in accordance with the norms prescribed by RBI

❖ **Balance Confirmation**

- ❖ “Letter of Acknowledgement of Debt and Securities” (LAD or ADS) or “Balance confirmation certificate”



Process of verification

- ❖ **Physical inspection of securities & valuation**
 - ❖ Perusal of stock audit report
 - ❖ Demat papers, physical shares, TDR, NSC, etc can be verified

- ❖ **Verification of charges due on the advances**
 - ❖ Interest on advances
 - ❖ Loan processing fees
 - ❖ Charges for delay in submission of periodical statements



Audit Methodology

- ❖ Examining sanctioning of advances
- ❖ Examining disbursement of account as per terms and condition mentioned in sanction letter
- ❖ Examining Loan documents
- ❖ Examining existence, enforceability and valuation of security
- ❖ Checking compliance with RBI guidelines relating to classification
- ❖ Reviewing exceptional reports
- ❖ Carrying out appropriate analytical procedures, etc.



Few Common Irregularities

- ❖ Appraisal/ Sanction on the basis of inadequate documents
- ❖ Disbursement without execution of all documents
- ❖ Over drawings beyond sanctioned limit/ drawing
- ❖ Non receipt of monthly/ quarterly data/information
- ❖ Inspection of unit/ security not done periodically as per terms of sanction
- ❖ Insurance coverage over security not taken/ inadequate



Few Common Irregularities

- ❖ Copy of minutes of Consortium banks meeting not available
- ❖ Incorrect interest rate application



Long Form Audit Report (LFAR)

Reporting requirements under LFAR



LFAR

Credit Appraisal

- ❖ Compliance of the procedures/instructions of the controlling authorities of the Bank regarding loan applications, preparation of proposals for grant/renewal of advances, enhancement of limits, etc.

Sanctioning/Disbursement

- ❖ Sanctioning beyond delegated authority or limit fixed for the branch.
- ❖ Disbursement without complying with the terms and conditions of the sanction.



LFAR

Documentation

- ❖ Credit facilities released without execution of all the necessary documents.
- ❖ Deficiencies in documentation, non-registration of charges, non obtaining of guarantees, etc.
- ❖ Renewal of documents on due date by following appropriate renewal procedures.
- ❖ Marking of lien on advances against deposits



LFAR

Review/Monitoring/Supervision

- ❖ Follow up procedure laid down by the controlling authorities of the Bank for periodical review of advances including periodic balance confirmation/ acknowledgement of debts, etc.
- ❖ Receipt of stock/book debt statements and other periodic operational data and financial statements etc.
- ❖ Systems of obtaining reports on stock audit
- ❖ Obtaining Audit Report in cases of advances to non-corporate entities with limits beyond ₹ 25 Lakhs



LFAR

Review/Monitoring/Supervision

- ❖ Inspection or physical verification of securities charged to the Bank as per the procedure laid down by the controlling authorities of the Bank.
- ❖ Deficiencies in value of securities and inspection thereof or any other adverse features such as frequent/unauthorized overdrawing beyond limits, inadequate insurance coverage
- ❖ Identification and classification of advances into Standard / Sub-standard / Doubtful / Loss assets in line with the norms prescribed by the Reserve Bank of India.



LFAR

Review/Monitoring/Supervision

- ❖ Obtaining valuation reports from approved valuers for the fixed assets charged to the bank, once in three years in case of NPA accounts.
- ❖ List the major deficiencies in credit review, monitoring and supervision.
- ❖ Compliance with the Recovery Policy prescribed by the controlling authorities of the bank with respect to compromise/settlement and write off cases.



LFAR

Guarantees and Letters of Credit

- ❖ Details of outstanding amounts of guarantees invoked and funded by the Branch to be given in prescribed format.
- ❖ Details of the outstanding amounts of LCs and co-acceptances funded by the Branch at the end of the year may be reported in the prescribed format.



Questions?



Thank you

