

ADVANCES

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Advances

Audit of advances – most important areas covered in bank audit

Advances comprise of:

- Money lent by bank to its customers including interest accrued and due
- Debit balances in depositor accounts
- Inter-Bank Participation Certificates.

Types of Advances

Types of Advances

- Funded & Non Fund Based Facilities (Guarantees - Letters of Credit)
- Cash credits & loan repayable on demand - Bills discounting - Term Loans
- Priority Sector
- Secured - Covered by Bank Guarantees - Unsecured
- Rupee Credit - Foreign Currency Credit
- Wholesale & Retail Loans
- Centralized vs Decentralized lending

Types of Securities

- **Primary Security** – Goods, Stock, Gold, FDs, Shares & Policies
- **Collateral Security** – Moveable/ Immoveable property.

Mode of Creation of Security

- Hypothecation
- Mortgage
- Pledge
- Assignment
- Set-off
- Lien

Statutory Restrictions

- Advances against Bank's own Shares
- Advances to Bank's Directors
- Granting Loans and Advances to relative of Directors
- Restrictions on Advances against Sensitive Commodities under Selective Credit Control (SCC)
- Restrictions on offering incentives on any banking products
- Loans and Advances against Shares, Debentures & Bonds
- Advances against FDs issued by Other Banks
- Loans Against Certificate of Deposits(CDs)

Audit Approach

- Top large/Top Exposure accounts
- List of stressed accounts
- List of restructured accounts
- Unsecured exposures > Rs. 1 Crore
- Quick Mortality Cases
- Evaluation of Internal Controls

Important Terms

- Drawing Power
- Restructuring / Rescheduling
- Fund diversion – Siphoning
- Willful Defaulters
- Priority sector lending
- Reporting to credit rating agencies

Evaluation Of Overall Bank

- Credit Policy
- Organisation Structure- Authority Level & Powers
- Risk Based Product Pricing
- Marketing

Sanctions

- Loan application
- Credit appraisal
- Pre-Sanction
- Acceptance
- Sanctioning Authority
- Processing fees

Documentation & Disbursement

- Sanction letters
- Disbursement release orders
- Legal/ Title clearance reports
- Title deeds – registered
- Stock statements - for DP calculation
- End use certificates
- CERSAI records/ Registration of charges
- Insurance of security
- Due diligence reporting
- Checklist of documentation

Monitoring & Supervision

- Regular inspection
- Actuals V/S Projections
- End utilization of funds
- Scrutiny of stock statements
- Status of Statutory payments
- Periodic reviews
- Monitoring early warning signals- red flags
- SMA classification
- Multiple/ Consortium banking

Recovery Mechanism

- Through SARFAESI Act 2002
- Through Recovery of Debt dues to Banks & Financial Institutions Act, 1993
- Recovery using Lok Adalats
- Recovery through Insolvency & Bankruptcy Code (IBC)

Income Recognition & Asset Classification (IRAC)

- Identification of NPA
- Single – Group Borrowers
- Automation of NPA system
- Income recognition – NPA
- Upgradation of NPA loans – Movement
- Provisioning requirements – Provision coverage ratios
- Gross NPA – Net NPA ratios

COVID-19 Regulation Relief

- Resolution Framework 2.0 to MSME & Individual & Small Business-
 - Borrower having Exposure up to Rs. 50 crores
 - Account was Standard on March 31,2021
 - Resolution plan - rescheduling payments, Conversion of interest into FITL or granting moratorium
 - Provision @ 10% shall be made on residual debt of borrower

Other Considerations

- Litigations
- Settlement, compromise & Write-offs
- Sales of assets to ARCs
- Auctions
- Stock audits – Advances > 2 Crores
- Valuations
- Credit ratings/ scores
- Issues raised by concurrent auditors/ internal auditors RBI/ Previous auditors/ Stock Auditors

Other Considerations

- Feeding/ updating interest rates in CBS – revenue leakage
- Interest Subvention
- Proper risk weightages – Performance / Financial Guarantees
- MOC for divergence in NPA
- Frauds – Identification & Reporting / Staff Accountability
- Reporting in LFAR
- Qualification in main audit report
- Window dressing
- External confirmations

Agriculture

- Backbone of Indian economy
- Contributes around 18 % of GVA (Gross Value Added)
- Provides employment to 55 % of the population
- Source of raw materials to major industries

★ NABARD

Objective - promote health & strength of credit institutions, in the forefront of delivering agriculture credit namely, cooperatives, commercial & regional rural banks.

State Level Bankers' Committee ('SLBC')

- Agriculture finance - supervised & monitored by SLBC.
- Every state has its own SLBC & guidelines.
- SLBC of respective State decides crop season for each crop.
- Auditor to verify that Banks have requisite mechanism to map crop season(s) defined by each state SLBC as any discrepancies will directly impact NPA identification

Priority Sector Lending (PSL)

- RBI has classified lending to agriculture & allied activities under PSL
- Encourage credit flow from commercial banks to priority sector
- RBI issues directives from time to time applicable to all scheduled commercial banks & foreign banks > 20 branches in India

Priority Sector Lending - Targets

- 18% of - Higher of
ANBC – Adjusted Net Banking Credit
or
CEOBE – Credit equivalent of off balance sheet exposures
(9% of above should be to Small & Marginal Farmers in 21-22 going
up by a % each over the next 2 years)
- Domestic banks lending to non-corporate farmers
 - ◆ Not less than 12.73% of ANBC or CEOBE – target of 13.5%

Agriculture Credit

Lending to agriculture sector includes-

- Farm Credit - Individual farmers
- Farm Credit - Corporate farmers, Farmer producer Organizations (FPOs)
- Agriculture Infrastructure
- Ancillary Services.
- Small and Marginal Farmers (SMFs)
- Lending by banks to NBFCs and MFIs for on-lending in agriculture

Farm Credit

- Individual farmers short-term crop, medium/long-term credit
- Dairy, fishery, animal husbandry, poultry, bee-keeping & sericulture.
- Loans for pre and post-harvest activities
- Loans to distressed farmers indebted to non-institutional lenders
- Small & marginal farmers for purchase of agricultural land
- Installation of solar power plants on barren/fallow land

Farm Credit

Farm credit - Corporate farmers, Farmer producer Organisations (FPOs)/(FPC) Companies of Individual Farmers, Partnership firms & Co-operatives of farmers engaged in Agriculture & Allied Activities

- Up to 2 Crore per entity
- Up to Rs. 75 lakh against pledge of agricultural produce for 12 months
- Up to Rs. 50 lakhs against warehouse receipt other than NWR's
- Up to Rs. 5 crore per borrowing entity to FPOs/FPCs
- UCBs are not permitted to lend to co-operatives of farmers

Agriculture Infrastructure

- Storage facilities
- Soil Conservation/ vermicompost/ biogas/ biotech projects
- Plant tissue culture and Agri bio-technology, seed production, production of bio-pesticides, bio-fertilizer
- Up to Rs.100 Crore (aggregate)

Ancillary Services

- Loans up to Rs. 5 crore to co-operative societies of farmers
- Loans for setting up of Agri-clinics and Agri-business centers
- Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies
- Loans sanctioned by banks to registered NBFCs
- Loans sanctioned by banks to MFIs for on-lending to agriculture sector
- Loans to Custom Service Units which maintain a fleet of tractors, bulldozers, well-boring equipment, threshers, combines etc.
- Loans up to Rs. 50 crore to agriculture start-ups
- Loans for Food & Agro-processing up to Rs. 100 crore

Small & Marginal Farmers (SMFs)

Small & Marginal Farmers will include the following:

- Farmers with landholding of up to 1 hectare(Marginal Farmers)
- Farmers with a landholding of more than 1 hectare and up to 2 hectares (Small Farmers).
- Landless agricultural laborer's, tenant farmers, oral lessees
- Loans to Self Help Groups (SHGs) or Joint Liability Groups (JLGs)
- Loans up to Rs.2 lakhs to individuals solely engaged in Allied activities

Kisan Credit Card (KCC)

- Aims at providing adequate & timely credit support
- Master Circular KCC dated 04/07/2018
 - ◆ Eligibility
 - ◆ Credit limit
 - ◆ ROI
 - ◆ Repayment period
 - ◆ Security & margin (up to Rs.1.60 lakhs - primary hypothecation of crops - no collateral)
 - ◆ Simple documentation
 - ◆ NPA Norms

Interest Application

- Interest on agricultural advances is not charged at monthly rests
- No interest compounding till repayment due date
- For Kharif & Rabi Crop - compounding starts after due date - penal interest from date of overdue
- For Dairy/Poultry - Repayment & Interest application Quarterly - compounding

Interest Subvention

- Scheduled Commercial Bank - 2% subvention for loan given at 7% short term crop loans up to Rs. 3 lakh per farmer
- Additional 3% to farmers who pay promptly
- Aadhaar linkage made mandatory for availing short-term crop loans
- ★ Audit Procedures
 - verify book credit entries not passed to avail interest subvention
 - Verify interest is first credited & then claim made
 - Inquire rejections & reasons thereof

NPA Identification

- Finance to Individual Farmers or Joint Liability Group for Agriculture & Allied Activities (Diary, Fishery , Poultry, Bee-Keeping etc.)-
 - Long duration crops - overdue for 1 crop season.
 - Short duration crops - overdue for 2 crop seasons.
- Loan under Agri Finance other than above specified category –
 - Interest/instalments remain unpaid for more than 90 days.
- Where natural calamities impair repaying capacity –
 - Banks to decide relief measures on their own
 - Convert of short-term production loan to term loan
 - Re-schedule repayment period; &
 - Sanction fresh short-term loan

Audit Procedure

- Sanctioned amount as per applicable scale of finance
- No dues certificates while sanctioning
- Evidence of loan utilisation - Pre/ Post sanction visit

- Documentation
 - ◆ Copy of land revenue extracts, with bank charge recorded.
 - ◆ Land Tax Assessment & payment receipt.
 - ◆ Copy of record with sub registrar
 - ◆ Original copies of title deeds. & search of title deeds
 - ◆ Legal opinion from Bank's approved panel advocate.
 - ◆ Valuation of land from Bank's approved panel valuer

Advances affected by Natural Calamities

- Additional finance granted on natural calamities - Standard asset
- Different dues from borrower (e.g. current dues, dues not restructured etc.) classified under different asset classification norms.
- In such cases of conversion or re-scheduling, term loan as well as fresh short-term loan treated as current dues & not NPA.

Debt Relief

Various CG & SG debt waiver / relief schemes implemented for providing relief.

Audit Procedures

- Obtain copy of relevant schemes & bank's circular
- Obtain list of eligible borrowers
- Verify accounting of interest & other charges to be borne by the lending institution as per the scheme.
- Obtain written representation from management about scheme & its applicability.

Asset Recovery Branches

- Banks have designated branches/ departments for recovery of NPA
- Audit Approach & Procedures-
 - Policy of transferring NPA accounts to these branches
 - Recognition of interest income on receipt basis
 - Recovery- valuation reports
 - Classification & Provisioning

Guidelines on Sale / Purchase of NPAs

- Policy on Sale/Purchase of NPA
- Asset classification Norms for Sale/ Purchase of NPA
- Provisioning Norms
- Disclosure requirements

Reporting Under LFAR

Borrowers with outstanding of Rs. 10.00 Crs or more auditor needs to-

- To obtain a list & information of borrowers having outstanding of Rs.10.00 Crores & above.
- To review movement during the year in those accounts.
- Review each account & give comments on adverse feature
- Reporting in LFAR is not substitute for qualification or modification in audit report
- If the observation having impact on financial the auditor should get the same rectified

Reporting Under LFAR

Accounts upgraded from NPA to Standard with outstanding in excess of Rs. 10.00 Crores

- To obtain a list & information
- Analyse the reason of upgrade
- Checking entries for recovery in CBS
- Ensure there is full recovery of all dues before upgrade of account

Reporting Under LFAR

Branch system of updating valuation of security-

- Obtain details of Security charged by the Bank
- Understand & review the process of updating security in the system
- Enquire the existence of system & periodicity for updating the same
- Comment on Valuation report older than 3 years
- Ensuring the Realizable Value of security updated in system for advance above Rs. 10 crs or more from two or more different valuation report

Reporting Under LFAR

Recovery suits filed and pending-

- Obtain the list of all recovery suits filed & pending as at reporting date.
- Age-wise details of recovery suits for the last 3 years along with latest status thereof

Reporting Under LFAR

Execution of decrees obtained for recovery from the defaulting borrowers auditor needs-

- Comment on Promptness for execution of decree
- Time barred decree
- Age-wise analysis of decrees obtained and not executed

Reporting Under LFAR

Recoveries-

- Recoveries and their appropriation against the interest and the principal
- Accounts settled / written off / closed
- Recoveries which are pending for appropriation as on year-end with reasons

Reporting Under LFAR

New borrower accounts transferred to the branch during the year

- Obtain List of accounts transferred
- Ensuring documentation is complete
- Confirmation that all the accounts of the borrower have been transferred

Guidance Notes on Bank Audit 2022

Reference to Guidance notes on Bank Audit 2022-

- Illustrative list of Basis of Selection of Advances account in case of Bank Branch Audit
- Appendix X- Reasons observed for the divergence in asset classification
- Illustrative List of Exception Reports in CBS
- Appendix VII Format of Written Representation Letter to be obtained from Branch Management
- Appendix IX- Bank Branch Audit Programme
- Audit Documentation in Bank Branch Audit

Golden Rules for Statutory Audit of Banks

- **Rule 1:** What you did? How you did? To what extent you did?
- **Rule 2:** LFAR:- State you were there for only last 7 days and next 15 days
- **Rule 3:** If you are relying on any Concurrent/Stock Audit or other representation state so
- **Rule 4:** Discuss with Concurrent/Stock Auditors and PY Statutory Auditors and minute the discussions
- **Rule 5:** Sign LFAR before signing accounts, Sign documents checklist as per SA before signing LFAR

Golden Rules for Statutory Audit of Banks

- **Rule 6:** LFAR should not be a substitute for Audit Report. It can only supplement. Qualifications will be only in audit report.
- **Rule 7:** Audit report as per compliance with SA's and not a cut paste
- **Rule 8:** When in doubt clarify with peers, CSA's, faculties, experts, framed by ICAI
- **Rule 9:** Please read Guidance Note, Journals, etc.
- **Rule 10:** Qualify or Disclaim if you don't have necessary information which to the best of our knowledge & belief were necessary.

Master Rule: Please be in NO HURRY



Thanks!