Seminar on Bank Branch Audit
Jalgaon Branch of WIRC Of ICAI

Audit of Loans & Advances in Bank Branch (Fund & Non Fund Based)

CA. Pankaj B Dara
darapankaj@gmail.com

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Today’s Agenda:

1.Important Circulars/ Notifications issued by RBI

2.Due Diligence in case of Advances

Importance and objectives of Audit of Advances

3. Various Other allied laws impending audit

- Classification & Types of Advances

Early signals of fraud detection in advances

Verification/ Audit of Advances

- Pre-Sanction
- Sanction & Disbursement
- Post Sanction - Documentation
- Review , Monitoring & Renewal

Audit Approach & Reporting Responsibility

Applicability of Auditing standards

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Important Circulars issued by RBI

Relevant Circulars applicable for FY 2017-18:

Master Circular/ Master Directions:

- Master Circular- Loans and Advances – Statutory and Other Restrictions dated July 1,2015
- Master Circular – Exposure Norms dated July 1,2015
- Master Circular - Guarantees and Co-acceptances dated July 1,2015
- Master Direction - Lending to Micro, Small & Medium Enterprises (MSME) Sector dated July 1,2016
- Master Direction- Priority Sector Lending- Target & Classification dated July 7,2016

Other Circular/ Notifications:

- Review of Prudential Guidelines - Revitalising Stressed Assets in the Economy dated February 25,2016
- Framework for Revival and Rehabilitation of Micro, Small and Medium Enterprises (MSMEs) dated March 17,2016
- Sanction of Additional Working Capital Limits to Micro and Small Enterprises (MSEs) dated December 29,2016

Importance of Audit of Advances:

Lending constitutes major activity of the bank

Advances generally constitute the largest item of the assets in the Bank Branch Balance Sheet (60% to 90% of Balance Sheet)

Intrerst income and Fee income on advances (Retail as well as Corporate Loans)

Close Monitoring of Lending Activity of the Bank by the Reserve Bank of India

Important area of reporting in Long Form Audit Report, Tax Audit Under Income Tax Act in Bank Branch Audit .

Probable Area of Fraud, Income Leakages etc.

INCOME RELATED TO ADVANCES

The Advances Co-related income to be checked and cross verified

Type of Advances	Co-related income
Advances	Interest income
Bank gurantee/letter of credit (non funded)	Fees
Advances to be classified (funded)	Processing fees
Housing/car /educational advances	Exempt / Taxable Charges

BASIC INFORMATION OF BRANCH/DUE DILIGENCE OF ADVANCES

Before Verification of Advances

1. Basic Information Related to Branch Whether It is Which Type Of branch . Agricuterist branch/ Education loan/ Housing Loan/ real estate branch .

2. Form opinion And extent of verification On type of branch and supported by head office circular for operation of branch lending activities.

3. Rotation Of Staff Followed or not , it would give smell of misutilisation of authority and centralization of advances to particular section of borrower class/ specific business activity/

BASIC INFORMATION OF BRANCH/DUE DILIGENCE OF ADVANCES

Verify Details Of Budget And target Critrie Set – This Would Provide The Ability Of The staff And routine borrower whose accounts utilize at the month end or year end to make up target and inflate the finical background to achieve target and do as month end or year end exercise

Diagnose Pattern of Advances As monthly follow and compare with previous year- major eruption , variation, change in classification from non-priority to priority, fund to non fund and vice verse.

Observe common reasons cited for enhancement of borrowing limits, if commonly same narration/reasons cited, sense the perfumes there and follow the path.

BASIC INFORMATION OF BRANCH/DUE DILIGENCE OF ADVANCES

Observe The Advances file handling Pattern which provide sense the person handling is from branch staff / handled by outside staff/ outside consultant.

OTHER ALLIED LAWS.

1. Banking Regulation Act.

2. Companies Act.

3. neogeoable Instrument Act.

4. Income Tax Act.

5. Goods And Services Act.

6. Foerign exchange management act.

7.Other allied laws. – As Per state Act. Profession Act Still persist in State Of Maharastra.- Laws May Vary As per State.

8. Applicable Stamp Duty Laws As per State .- Eg Nazarana TO Be Paid on B Satta Tenure Land As per Sttae of Maharastra- Different For Dissrent District In state of Maharastra – 75 % in jalgaon Ditrict and different of district of Nagpur and Amravati i.e 15 to 25 %.

Classification & Types of Advances

Classification of Advances:

Based on	Description	Example of Facility
Funds	Funded and Non-Funded	Term loans, CC/ OD, BG LC etc.
Geography	Inland and Export	Domestic TL, Packing/Pre-shipment Credit, Post-shipment Credit
Security	Secured and Unsecured	Mortgage, Hypothecation, pledge, clean, credit card
Sector	Priority sector and Non-Priority Sector	Agricultural, Home loans, Educational, small & medium enterprises

Types of Fund Based Facility:

Type	Description
Demand Loan	Repayable on demand in a single or pre-determined instalments generally up to 3 years (36 months)
Term Loan	If demand loan's repayment exceeds 36 months, it is called Term Loan
Cash Credit (CC)	Credit Facility is generally granted against security of stock/ book debts- Renewal every year
Overdraft (OD)	Credit Facility similar to cash Credit but No Security or other security like FD's, NSC receipts, Lien on LIC policies
Bill Purchased / Discounted	Advance against a sale bill after the buyer has received the goods

Types of Non-Fund Based Facility:

Type	Description
Letter of credit	Undertaking by the bank to the payee(supplier of goods & services), on behalf of the buyer as per the terms of the LC
Bank Guarantee (Financial / performance)	To guarantee the performance of contractual obligations
Letter of comfort	Financial guarantee issued by bank to the beneficiary on behalf of borrower

Types of Security for Advances:

Primary Security

Refers to security acquired by the borrower with bank finance or the one against which credit facility has been sanctioned by the bank

Collateral security

Collateral security is an additional security provided to bank in case of need. For eg, Insurance policy, FD's etc

Personal Guarantee

It is a guarantee by a third party for payment of outstanding in the event of default by the borrower

Fixed & Floating charge

Fixed charge is a charge on some specific and ascertained assets. Floating charge is an equitable charge on the assets, present as well as future

DIFFERENCE BETWEEN PRIORITY SECTOR AND PRIORITY SECTOR ADVANCES.

Is there any difference between

Priority sector

And

Priority sector advances

Sector wise Advances:

Priority Sector:

Priority sector refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation.

Priority Sector advances includes the following categories

In terms of RBI Master Direction- RBI/ FIDD/ 2016-17/ 33 Master Direction FIDD.CO.Plan.1/04.09.01/2016-17 “Master Direction- Priority Sector Lending- Targets and Classification” dated July 7, 2016 the categories under priority sector are as follows:

(i) Agriculture
(ii) Micro, Small and Medium Enterprises
(iii) Export Credit
(iv) Education
(v) Housing
(vi) Social Infrastructure
(vii) Renewable Energy
(viii) Others

AGRICULTURE ADVANCES

Hitherto the agriculture advances were bifurcated into direct / indirect

agriculture advances, however, in terms of revised guidelines issued by

Reserve Bank of India (RBI-2014-15/573 FIDD.CO.Plan.BC.54/04.09.01/2014-

15 dated April 23, 2015), the present distinction has been dispensed with and the lending to agriculture sector has been defined to include (i) Farm Credit (which will include short-term crop loans and medium/long-term credit to farmers) (ii) Agriculture Infrastructure and (iii) Ancillary Activities.

FARM CREDIT

A. Loans to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs), i.e. groups of individual farmers, provided banks maintain disaggregated data of such loans] and Proprietorship firms of farmers, directly engaged in Agriculture and Allied Activities, *viz.*, dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture

B. Loans to corporate farmers, farmers' producer organizations/companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities, viz., dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture up to an aggregate limit of Rs. 2 crore per borrower.

AGRICULTURE INFRASTRUCTURE

a. Loans for construction of storage facilities (warehouses, market yards, godowns and silos) including cold storage units/ cold storage chains designed to store agriculture produce/products, irrespective of their location.

b. Soil conservation and watershed development.

c. Plant tissue culture and agri-biotechnology, seed production, production of bio-pesticides, bio-fertilizer, and vermi composting. For the above loans, an aggregate sanctioned limit of Rs. 100 crore per borrower from the banking system, will apply

ANCILLARY ACTIVITIES

a. Loans up to Rs. 5 crore to co-operative societies of farmers for disposing of the produce of members.

b. Loans for setting up of Agriclinics and Agribusiness Centres.

c. Loans for Food and Agro-processing up to an aggregate sanctioned limit of Rs. 100 crore per borrower from the banking system.

d. Loans to Custom Service Units managed by individuals, institutions or organizations who maintain a fleet of tractors, bulldozers, well-boring equipment, threshers, combines, etc., and undertake farm work for farmers on contract basis.

ANCILLARY ACTIVITIES

e. Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi-Purpose Societies (LAMPS) for on-lending to agriculture.

f. Loans sanctioned by banks to MFIs for on-lending to agriculture sector as per the conditions specified in paragraph 19 of these Master Directions.

g. Outstanding deposits under RIDF and other eligible funds with NABARD on account of priority sector shortfall

KISAN CREDIT CARD (KCC)

a) In terms of RBI Cir. No. RPCD:F.S.D. BC No. 77/05/09/2011-12 dt.

11.05.2012 revised scheme for issue of Kisan Credit card was introduced by

RBI which was subsequently modified vide cir. No. RBI/2012-13/162

ROCD:FSD.BC. No. 23/05.05.09/2012-13 dt. 07.08.2012.

KISAN CREDIT CARD (KCC)

b) The scheme was simple and hassle free for both the farmers and bankers.

The scheme was aimed at providing adequate & timely credit support under single window to the farmers for their cultivation and other needs as indicated below:

Ø Short term credit limits

i. To meet the short term credit requirement for cultivation of crops

ii. Post harvest expenses

iii. Produce marketing loan

iv. Consumption requirement of farmer household

v. Working capital for maintenance of farm assets & activities allied to agriculture like dairy, inland fishery etc

.

KISAN CREDIT CARD (KCC)

Long term Credit Limit: Investment credit requirement for agriculture &

allied activities like pump sets, sprayers, dairy animals etc

c) It may be noted that KCC is not a type of loan, but is a channel for granting

either short term or long term agricultural finance.

INTEREST APPLICATION

a) Unlike normal loans, the interest on agricultural advances is not charged at

monthly rests but is charged normally at half yearly or annual rests.

b) Compounding of Interest is generally not permitted in respect of an

Agricultural advance, unless it turns out to be a non performing advance.

COMPUTATION OF ACHIEVEMENT OF THE SUB-TARGET, SMALL AND MARGINAL FARMERS WILL INCLUDE

☐ 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 labourers, tenant farmers, oral lessees and sharecroppers,

whose share of landholding is within the limits prescribed for small

and marginal farmers.

COMPUTATION OF ACHIEVEMENT OF THE SUB-TARGET, SMALL AND MARGINAL FARMERS WILL INCLUDE

☐ Loans to Self Help Groups (SHGs) or Joint Liability Groups (JLGs), i.e. groups of individual Small and Marginal farmers directly engaged in Agriculture and Allied Activities, provided banks maintain disaggregated data of such loans.

☐ Loans to farmers' producer companies of individual farmers, and cooperatives of farmers directly engaged in Agriculture and Allied Activities, where the membership of Small and Marginal Farmers is not less than 75 per cent by number and whose land-holding share is also not less than 75 per cent of the total land-holding

AGRICULTURE ADVANCES

The credit needs of cultivators fall into three broad categories:

i**. Crop Loan or Short Term** - mainly for financing current expenditure in connection with the raising of crops.

ii**. Medium Term** - for meeting outlay relating to the replacement and maintenance of assets and for capital investment designed to increase the output from land. Such loans are generally repayable in 3 to 5 years. They are sanctioned for purposes such as deepening of wells, sinking of new wells, installation of pump sets, purchase of agricultural machinery or a pair of bullocks, etc.

AGRICULTURE ADVANCES

. Long Term - for capital investments in agriculture such as sinking of new

wells, construction of tube wells, land levelling, bunding, terracing, purchase

of tractors, power tillers and other costly machinery, electrical motors,

purchase of land, etc. Such loans are generally repayable over a period of 5

to 15 years and in exceptional cases in 20 years

AGRICULTURE ADVANCES

As per the extant RBI guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State depending upon the duration of crops raised by an agriculturist.

STATE LEVEL BANKER'S COMMITTEE (SLBC)

The Agriculture finance is supervised and monitor by State Level

Banker's Committee ('SLBC') and its decisions are implemented by all banking sector having branches in the state. **Every state has its own SLBC** and guidelines have been issued to banks to develop agricultural finance.

Harvesting Season is defined differently by SLBC in different states

*As per RBI guidelines, the SLBC has to determine crop season for each crop so

as to decide the NPA norms to be followed in the State for asset classification

under Agriculture Advance. Based on the sowing , harvesting period prevailing in

the State & looking to the crop pattern, Agro Climatic condition, the Crop season

for Kharif & Rabi season was proposed as under, which was unanimously

approved by the house

STATE LEVEL BANKER'S COMMITTEE (SLBC)

For rajasthan

approved by the house

Kharif Crop - April – Dec - Due date of repayment may be fixed 31st March

Rabi Crop - Oct – April - Due date of repayment may be fixed 30th June

(*Excerpts from minutes of 108th meeting of SLBC Rajasthan held on

16.03.2011)

STATE LEVEL BANKER'S COMMITTEE (SLBC)-MAHARASTRA

Based on the resolution and minutes of 71st steering committee

meeting of SLBC held on Sep 6, 2004 following guidelines have been framed for identification of NPA's in respect of Farm credit (erstwhile Direct Agricultural Advances) and come into effect from Sep 30, 2004.

It was decided that in Maharashtra State except sugarcane and

banana, all other crops would be reckoned as Short duration crops.

STATE LEVEL BANKER'S COMMITTEE (SLBC)-MAHARASTRA

Short Duration Crops:

1. Kharif / Rabi crops: A loan granted for Kharif / Rabi crop will be treated as NPA if the instalment of principal or interest thereon remains overdue for a period of 21 months from repayment due date.
2. Horticulture Crops: A loan granted for Horticultural crop will be treated as NPA if the instalment of principal or interest thereon remains overdue for a period of 24 months from repayment due date.

STATE LEVEL BANKER'S COMMITTEE (SLBC)-MAHARASTRA

. Long Duration Crops:

1. Perennial Crop Sugarcane (Adsali): A loan granted for sugarcane (Adsali) will be treated as NPA if the instalment of principal or interest remains overdue for a period of 18 months from repayment due date. Advances-Agriculture

2. Perennial Crop Banana (Mrig Bahar): A loan granted for banana crop will be treated as NPA if the instalment of principal or interest remains overdue for a period of 21 months from repayment due date.

3. Repayment due date means the date fixed at the time of sanction of loan for repayment of crop loan or instalments/interest of term loan.

STATE LEVEL BANKER'S COMMITTEE (SLBC)- MAHARASTRA

Agricultural term Loan:

Depending upon the duration of crops raised (i.e., short duration, long duration or both), by an agriculturalist, respective overdue period as applicable to the crops mentioned above in (A) and (B) will be applicable for identification of NPAs in agricultural term loans availed by the borrower.

STATE LEVEL BANKER'S COMMITTEE (SLBC)-MAHARASTRA

While identifying NPAs following points may be noted:

a. Term loan/s availed with crop loan/s: Where an agriculturist has availed

loans both for short duration as well as long duration crops along with

Term loan/s, such term loan/s will be classified as NPA if either of the

loans for short duration or long duration crops is classified as NPA.

STATE LEVEL BANKER'S COMMITTEE (SLBC)-MAHARASTRA

Example 1: An agriculturist avails following loans

i) Crop loan for kharif crop (a short duration crop) is availed on 1.6.2004 for which repayment due date prescribed is 31.03.2005.

ii) Crop loan for Adsali sugarcane (a long duration crop) is availed on 1.7.2004 for which repayment due date prescribed is 30.06.2006.

iii) A term loan for deepening of well is availed on 01.05.2004 for which first repayment instalment is due on 30.06.2006.

If crop loan for Kharif crop remains overdue up to 31.12.2006 (i.e. overdue for 21 months after repayment due date of 31.03.2005) this crop loan along with the crop loan for sugarcane and term loan for deepening of well, will be classified as NPA with effect from 31.12.2006

KEY POINTS WHILE AUDITING AGRICULTURE ADVANCES

The audit approach for agriculture advances has to be on the similar lines as that of other advances. The following is a summary of few Key aspects in the audit of Agricultural Advances:

a. Sanctioned amount of Agriculture Loans should be as per scale of finance applicable to the land under cultivation and the crop being cultivated. Further, necessary securities should be obtained as per the guidelines framed by the bank.

b. Auditors should verify that the agricultural credit is extended only after obtaining 'No dues/ No objection certificates' from the existing credit agencies in the area of finance.

KEY POINTS WHILE AUDITING AGRICULTURE ADVANCES

c. Disbursement of agricultural finance is required to be carried out in various ‘stages’ based on the requirements of farming activity. This needs to be ensured strictly. In some cases, the expenditure is incurred by farmer from his/her own sources or from non institutional lenders and subsequently banks are requested to reimburse the same. In such cases, auditors have to carefully verify the facts from the documents/evidences available on record. Under all situations, auditors should verify that the bank holds documents evidencing the utilisation of loans for agricultural activities.

KEY POINTS WHILE AUDITING AGRICULTURE ADVANCES

. For crop loans, primary security is normally the standing crops under

cultivation, as such pre and post sanction visits by the officers of bank, who

are experts in Agriculture finance and adequate documentation of visit report

is a key control

KEY POINTS WHILE AUDITING AGRICULTURE ADVANCES

While verifying the security offered for agricultural loans, it is to be confirmed that the security is legally enforceable. Standing crops and agricultural machinery and implements are secured by a hypothecation charge, while the agricultural land is secured by a mortgage charge. Auditors have to ensure that amongst others, the following has been duly taken on record by the banks:

☐ Copy of the land revenue extracts.

☐ Land Tax Assessment and payment receipt.

☐ Copy of record with sub registrar (wherever applicable)

☐ Original copies of the title deeds

☐ Search of title deeds and Legal opinion from the advocate on the Bank's approved panel

☐ Valuation of land from a valuer on the Bank's approved panel.

KEY POINTS WHILE AUDITING AGRICULTURE ADVANCES

f. Loans granted to farmers against the security of NSC, KVP or Fixed Deposits of Banks, which has been utilised for agricultural purposes, is allowed to be classified under the category of finance to agriculture. However, auditors should carefully verify the loan documents and other supporting documents to ensure that non-agricultural loans are not classified as Agricultural Finance.

g. Agricultural Advances are required to be serviced through realisation of sale proceeds to crop. Auditors should be skeptical about the nature and timing credits coming in to service the agricultural loans and ensure that they are from genuine sources

AGRICULTURAL ADVANCES AFFECTED BY NATURAL CALAMITIES

. Banks maydecide on their own relief measures, *viz.*, conversion of the short term production loan into a term loan or re-schedulement of the repayment period and the sanctioning of fresh short-term loan, subject to the guidelines contained in RBI's latest Master Circular on "Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances" dated July 1, 2015 and directions contained in RBI Master Direction FIDD.No.FSD.BC.02/05.10.001/2016-17 dated July 1, 2016 on "Master Direction - Reserve Bank of India (Relief Measures by Banks in Areas Affected by Natural Calamities) Directions, 2016". In such cases the NPA classification would be governed by such rescheduled terms

NATURE OF BORROWINGS ARRANGEMENTS

1. sole banking

2.Consortium Arrangements

3.Multiple banking.

RBI Circular No. DBOD.No.BP.BC.94

/08.12.001/2008-09 dated December 08, 2008 on “Lending under

Consortium Arrangement/Multiple Banking Arrangements”.

RESTRICTIONS ON ADVANCES.

The Master Circular no. RBI/2015-16/95 DBR.No.Dir.BC.10/13.03.00/2015-16 dated July 1, 2015, on "Loans and Advances - Statutory and other Restrictions" issued by the RBI contains detailed requirements and guidelines in respect of statutory and other restrictions on loans and advances by banks

RESTRICTIONS ON ADVANCES.

Statutory Restrictions

1. Advances Ahganist Bank Own Share Section 20(1) OF The Banking Regulation Act 1949 A bank Cannot grant Any loan or Advances ganist The security of its own Shares.

2.Advnaces to Bank Directors- Section 20(1) of the banking Regulation Act.

3.Rsetriction on Power to remit Debts- Section 20A Of The banking Regulation Act 1949

4. Restriction on Holding Shares in Companies- Section 19(2) Of the Banking Regulation Act 1949

REGULATORY RESTRICTIONS.

Granting Loans And advances to relatives of directors.

Restrictions on grant Of loans And Advances to officers And The relatives of senior officrs of banks .

Restrictions on Grant of Financial Assistance to Industries Producing /

Consuming Ozone Depleting Substances (ODS)

Restriction on Advances against Sensitive Commodities under Selective

Credit Control (SCC)

Restriction on payment of commission to staff members including

Officers

Restrictions on offering incentives on any banking products

RESTRICTION ON ADVANCES AGAINST SENSITIVE COMMODITIES UNDER SELECTIVE CREDIT CONTROL (SCC)

With a view to prevent speculative holding of essential commodities with

the help of bank credit and the resultant rise in their prices, in exercise of powers

conferred by Section 21 & 35A of the Banking Regulation Act, 1949, the Reserve

Bank of India, issues, from time to time, directives to all commercial banks,

stipulating specific restrictions on bank advances against specified sensitive

commodities.

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RESTRICTION ON ADVANCES AGAINST SENSITIVE COMMODITIES UNDER SELECTIVE CREDIT CONTROL (SCC)

Commodities presently under the Selective Credit Control include:

a) food grains i.e. cereals and pulses,

b) selected major oil seeds indigenously grown, viz. groundnut, rapeseed / mustard, cottonseed, linseed and castor seed, oils thereof, vanaspati and all imported oils and vegetable oils,

c) raw cotton and kapas,

d) sugar/ gur / khandsari,

e) Cotton textiles which include cotton yarn, man-made fibres and yarn and fabrics made out of man-made fibres and partly out of cotton yarn and partly out of man-made fibres.

RESTRICTIONS ON OFFERING INCENTIVES ON ANY BANKING PRODUCTS

Banks are also not permitted to offer any banking products, including

online remittance schemes etc., with prizes /lottery/free trips (in India and/or abroad), etc. or any other incentives having an element of chance, except inexpensive gifts costing not more than Rs. 250/-, as such products involve nontransparency in the pricing mechanism. Such products, if offered, by banks are considered as violation of the extant guidelines and the banks concerned are liable for penal action.

ADVANCES AGAINST FIXED DEPOSIT RECEIPTS ISSUED BY OTHER BANKS

There have been instances where fake term deposit receipts, purported

to have been issued by some banks, were used for obtaining advances from

other banks. In the light of these happenings, RBI has advised the banks to

desist from sanctioning advances against FDRs, or other term deposits of other

banks.

ADVANCES TO AGENTS/INTERMEDIARIES BASED ON CONSIDERATION OF DEPOSIT MOBILISATION

Banks should desist from being party to unethical practices of raising

of resources through agents/intermediaries to meet the credit needs of the

existing/prospective borrowers or from granting loans to the intermediaries,

based on the consideration of deposit mobilisation, who may not require the

funds for their genuine business requirements

BANK FINANCE TO NON-BANKING FINANCIAL COMPANIES (NBFCS

NBFC Finance to be divided into Registered With RBI And Not Registered With RBI.

The RBI, vide its Master Circular No. DBR.BP.BC.No.5/21.04.172/

2015-16 on Bank Finance to Non-Banking Financial Companies (NBFCs) dated July 1, 2015 – those who are registered with RBI .

BANK FINANCE TO NON-BANKING FINANCIAL COMPANIES (NBFCS

In respect of NBFCs which do not require to be registered with RBI,

viz.:

i) Insurance Companies registered under Section 3 of the Insurance Act, 1938;

ii) Nidhi Companies notified under Section 406 of the Companies Act, 2013;

iii) Chit Fund Companies carrying on Chit Fund business as their principal business as per Explanation to Clause (vii) of Section 45-I(bb) of the Reserve Bank of India Act, 1934;

BANK FINANCE TO NON-BANKING FINANCIAL COMPANIES (NBFCS

Stock Broking Companies / Merchant Banking Companies registered under Section 12 of the Securities & Exchange Board of India Act; and v) Housing Finance Companies being regulated by the National Housing Bank (NHB) which have been exempted from the requirement of registration by RBI], banks may take their credit decisions on the basis of usual factors like the purpose of credit, nature and quality of underlying assets, repayment capacity of borrowers as also risk perception, etc

ADVANCES AGAINST NR(E) AND FCNR(B) DEPOSITS

Grant of advance against NR(E) and FCNR(B) deposits would be subject to the guidelines issued under Foreign Exchange Management Act, 1999.

ADVANCES AGAINST BULLION/PRIMARY GOLD

Banks are prohibited from granting any advance against bullion/

primary gold. However, specially minted gold coins sold by banks are not

treated as “bullion” or “primary gold” and hence the same is acceptable as

security upto 50 gms per customer. Such loans to be granted by the bank, may

be covered under the policy framed by the bank’s Board, in terms of RBI

circular DBOD.No. BC. 138/21.01.023/94 dated November 22, 1994.

ADVANCES AGAINST BULLION/PRIMARY SILVER

cases wherein advances have been granted against the gold coins it should be ensure that the end use of funds is for approved, non-speculative purposes. Banks are also required to desist from granting advances to silver bullion dealers which are likely to be utilised for speculative purposes.

LOANS FOR ACQUISITION OF KVPS

The grant of loans for acquiring/investing in KVPs does not promote

fresh savings and, rather, channelises the existing savings in the form of bank deposits to small savings instruments and thereby defeats the very purpose of such schemes. Banks should therefore ensure that no loans are sanctioned for acquisition of/investing in Small Savings Instruments including Kisan Vikas Patras.

ADVANCES AGAINST GOLD ORNAMENTS & JEWELLERY

The RBI *vide* its Master Circular No. RBI/2015-16/95

DBR.No.Dir.BC.10/13.03.00/2015-16 dated July 1, 2015 provides that

hallmarking of gold jewellery ensures the quality of gold used in the jewellery as to carat fineness and purity.

that loans (including bullet repayment loans) sanctioned by banks against pledge of gold ornaments and jewellery for non-agricultural purposes should not exceed 75 per cent of the value of gold ornaments and jewellery.

ADVANCES AGAINST GOLD ORNAMENTS & JEWELLERY

In order to standardize the valuation and make it more transparent to the borrower, gold ornaments and jewellery accepted as security / collateral will have to be valued at the average of the closing price of 22 carat gold for the preceding 30 days as quoted by the India Bullion and Jewellers Association Ltd. [Formerly known as the Bombay Bullion Association Ltd. (BBA)]. If the gold is of purity less than 22 carats, the bank should translate the collateral into 22 carat and value the exact grams of the collateral. In other words, jewellery of lower purity of gold shall be valued proportionately.

The period of the loan shall not exceed 12 months from the date of sanction.

GOLD (METAL) LOANS

Presently, nominated banks can extend Gold (Metal) Loans to exporters of jewellery who are customers of other scheduled commercial banks, by accepting stand-by letter of credit or bank guarantee issued by their bankers in favour of the nominated banks subject to authorised banks' own norms for lending and other conditions stipulated by RBI. Banks may also extend the facility to domestic jewellery manufacturers, subject to the conditions as specified by RBI's Master Circular RBI/2015-16/95 DBR.No.Dir.BC.10/13.03.00/2015-16 dated July 1, 2015 on Loans and Advances- Statutory and Other restrictions

LOANS AND ADVANCES TO MICRO AND SMALL ENTERPRISES (MSES)

MSE units having working capital limits of up to Rs. 5 crore from the

banking system are to be provided working capital finance computed on the basis of 25 percent of their projected annual turnover. The banks should adopt the simplified procedure in respect of all MSE units (new as well as existing)

WORKING CAPITAL FINANCE TO INFORMATION TECHNOLOGY AND SOFTWARE INDUSTRY

Following the recommendations of the “National Taskforce on

Information Technology and Software Development“, Reserve Bank has

framed guidelines for extending working capital to the said industry. Banks are, however, free to modify the guidelines based on their own experience without reference to the Reserve Bank of India to achieve the purpose of the guidelines in letter and spirit.- Grey area guideline to be framed by the respective banks kindly check the policy formed in this respect .

FINANCING HOUSING PROJECTS

The Master Circular

No.DBR.No.DIR.BC.13/08.12.001/2015-16 dated July 1, 2015 on Housing Finance provides guidance in respect of the housing finance provided by the banks. Banks could deploy their funds under the housing finance allocation in any of the three categories as per the norms provided in the Master Circular, i.e.

☐ Direct Finance.

☐ Indirect Finance.

☐ Investment in Bonds of NHB/HUDCO, or combination thereof.

2.166 The Master Circular also contains a number of guidelines for this purpose, including conditions wherein a bank cannot extend credit for housing purposes.

FINANCING HOUSING PROJECTS

Loan to Value (LTV) ratio

In order to prevent excessive leveraging, the LTV ratio in respect of

housing loans should not exceed 80 per cent. However, for small value housing loans, i.e., housing loans up to Rs. 20 lakh (which get categorized as priority sector advances), the LTV ratio should not exceed 90 per cent.

The Master Circular RBI/2015-16/46/DBR.No.DIR.BC.13/08.12.001/

2015-16 dated July 1, 2015 on Housing Finance, lays down that the following LTV ratios have to be maintained by banks in respect of individual housing loans

FINANCING HOUSING PROJECTS

Category of Loan	LTV Ratio (%)
(a) Individual Housing Loans	
Upto Rs. 20 Lakh	90
Above Rs. 20 lakh & upto Rs. 75 lakh	80
Above Rs. 75 lakh	75
b) CRE-RH	NA

INNOVATIVE HOUSING LOAN PRODUCTS – UPFRONT DISBURSAL OF HOUSING LOANS

It has been observed that some banks have introduced certain innovative Housing Loan Schemes in association with developers / builders, e.g. upfront disbursal of sanctioned individual housing loans to the builders without linking the disbursals to various stages of construction of housing project, interest / EMI on the housing loan availed of by the individual borrower being serviced by the builders during the construction period / specified period, etc. This might include signing of tripartite agreements between the bank, the builder and the buyer of the housing unit.- Grey Area During The course of Audit . kIndly vefify stages during same project different stages allowed to borrowers of same scheme.

FINANCING OF INFRASTRUCTURE PROJECTS

The RBI has revised the definition of Infrastructure Lending *vide* Master

Circular on Loans and Advances – Statutory and Other Restrictions dated July 1,2015 read with Circular No. RBI/2012 13/297/DBOD.BP.BC.No

58/08.12.014/2012-13 dated 20/11/2012 on “Second Quarter Review of Monetary Policy 2012-13

GUIDELINES ON RESTRUCTURING OF ADVANCES BY BANKS

The RBI, vide its Master Circular No.DBR.No.BP.BC.2/21.04.048/2015-

16 dated July 1, 2015 issued prudential guidelines on restructuring of advances

by banks. The Guidelines also contain the organisational framework for

restructuring of advances under consortium/ multiple banking/ syndication

arrangements, i.e., the CDR mechanism

SINGLE AND GROUP BORROWER LIMITS*

The Master Circular No. RBI/2015-16/70 DBR.No.Dir.BC.12/13.03.00/2015-16 dated July 1, 2015 on “Exposure Norms”, lays down the ceiling on credit exposure to individual/group borrowers in relation to bank’s capital fund as defined under capital adequacy standards (Tier-I and Tier-II Capital). The ceiling on exposure to individual borrowers is 15 per cent of capital funds and 40 per cent in the case of a borrower group. However, exposure to borrowers belonging to a group may exceed the exposure norms of the 40 per cent of the bank’s capital funds by an additional 10 per cent, provided the additional credit exposure is on account of extension of credit for infrastructure projects.
Exposure to single borrower may also exceed by 5 per cent, provided the additional exposure is on account of infrastructure projects.

SECTOR SPECIFIC LIMIT

Apart from limiting the exposures to an individual or a borrower group

as indicated above, banks may also consider fixing internal limits for aggregate commitments to specific sectors, e.g. textiles, jute, tea, etc., so that the exposures are evenly spread over various sectors. These limits could be fixed by the banks having regard to the performance of different sectors and the risks perceived. The limits so fixed may be reviewed periodically and revised,as necessary.--- Kindly verify the Circular issued in respect in the aspect .

LENDING FOR REAL ESTATE

RBI has also required that the banks' Boards may also consider

incorporation of aspects relating to adherence to National Building Code (NBC) in

their policies on exposure to real estate.

Banks are required to frame comprehensive prudential norms relating to

the ceiling on the total amount of real estate loans, single/group exposure limits

for such loans, margins, security, repayment schedule and availability of

supplementary finance and the policy should be approved by the banks' Boards.

The disbursements in case of these loans should be made only after the

borrower has obtained requisite clearances from the government authorities.- grey area for audit

FINANCING OF JOINT VENTURES

Banks are allowed to extend credit/non-credit facilities (*viz.* letters of credit and guarantees) to Indian Joint Ventures/Wholly-owned Subsidiaries abroad and step-down subsidiaries which are wholly owned by the overseas subsidiaries of Indian Corporates. Banks are also permitted to provide at their discretion, buyer's credit/acceptance finance to overseas parties for facilitating export of goods and services from India. The above exposure will, however, be subject to a limit of 20 percent of banks' unimpaired capital funds (Tier I and Tier II capital)and would be subject to the conditions laid down in this regard in the Master Circular on 'Loans and Advances – Statutory and Other Restrictions' dated July 1, 2015.

SECTORAL DISTRIBUTION

Priority sector advances include

Advances to minority communities.

☐ Advances to micro/small/medium scale enterprises5.

☐ Advances to small road transport operators.

☐ Advances to retail traders and small business enterprises.

☐ Advances to professionals and self-employed.

☐ Advances sanctioned to State sponsored organisations for scheduled castes/scheduled tribes.

☐ Educational loans upto the prescribed limit – RBI, *vide* its circular no. RPCD.SME & NFS.BC.No. 69/06.12.05 /2009-10 dated April 12, 2010 on "Collateral Free Loans - Educational Loan Scheme", clarified that banks must not, mandatorily, obtain collateral security in the case of educational loans upto Rs. 4 lakh.

SECTORAL DISTRIBUTION

Housing loans upto prescribed limits6.

☐ Funds provided to RRBs.

☐ Micro credit7.

☐ Any other priority sector advances, such as SEPUP (Self-Employment Programme for Urban Poor), PMRY (Prime Minister's Rozgar Yojana), SEEUY (Self-Employment Scheme for Educated Unemployed Youth) SGSY (Swarna jayanti Gram swaraj Swarojgar Yojana)8, SJSRY (Swarna jayanti Sahakari Rozgar Yojana).

SYSTEM OF BASE RATE AND INTEREST RATE

The RBI *vide* its Circular No. DBR.No.Dir.BC.9/13.03.00/2015-16

dated April 1, 2015and DBR.No.Dir.BC.67/13.03.00/2015-16 dated December17, 2015 on “Interest Rates on Advances” required the banks to freely determine the lending rates on the advances as per their Board approved policy subject to the guidelines contained in the circular.- Kindly Check Rate of interest of long term loans whether conerted to base rate from prime rate, separate aggrerate made or old continued.

SECURITISATION AND RECONSTRUCTION OF FINANCIAL ASSETS AND ENFORCEMENT OF SECURITY INTEREST (SRFAESI) ACT, 2002

After the enactment of the Securitization and Reconstruction of

Financial Asset and Enforcement of Security Interest Act, 2002, banks have

got significant power to possess the securities of defaulting borrower. Banks can now take possession of the assets from borrower and convert the same in Security Receipts. In the process of securitisation, assets are sold to a bankruptcy remote special purpose vehicle (SPV) in return for an immediate cash payment.

Important Standard on Auditing: Bank Branch Audit

SA 230 – Audit Documentation

SA 320 - Materiality

SA 500 – Evidence

SA 520 – Analytical Procedures

SA 530 – Audit Sampling

SQC 1 – Quality Control

List of Requirement @ commencement of Audit:

RBI Master Circulars/Directions

ICAI Material – Guidance Note 2018

Bank’s Internal Policies (HO circulars etc.)

Annual Closing circular

RBI inspection Report

Internal Inspection and Concurrent audit Reports

Previous year’s AR & LFAR

Significant accounting policies of the bank with respect to interest and Fee Income

Sanction Power and Other limits with the Branch Manager

Other information about branch (Major Advances, NPA etc)

Audit Approach for Advances:

- Verification of the Internal Control System in the branch
- Inspection, Observation and Inquiry- Basics of Audit
- Identify the risk areas- Large Advances, Smaller Advances
- More of Analytical procedures – On New & Old Advances
- Materiality - Sample Checking to be done
- Full verification of certain advances- Reported in IA, CA Report
- Review of internal, concurrent, RBI inspections reports etc.

Evaluation of Internal Control System:

Discussion with management & any operating manuals

Level of implementation of the IC system

Sanctioning process in the Bank

- Sanctioning Authority and Powers
- Extent of computerization & Documentation
- Internal Communication with RO/ HO
- Quality and trained Staff

External Inspection done by expert

Existence of IT systems and its effectiveness

Reports on Potential/Automatic NPAs and whether any parameters can be changed by manual intervention

Actual Verification of Controls

Extent of Checking & Materiality Level:

New Sanctions during Financial Year

All Large Advances (Lower of 5% of Advances or 2crs)

Adverse Remarks in

- Concurrent Audit/IA Report
- PY LFAR & Audit report
- RBI Inspection
- Internal Inspection
- Special Audit

Major movements (upgrades & down grades) in NPA / Restructured advances

Type of Branch (Advances, Deposits)

Stages of Verification of Advances:

Credit Appraisal and Sanction of Advances

Disbursement of Advances

Review of Operations in Accounts

Renewal/Enhancement/Re-schedulement/Balance Confirmations

Physical Inspection of Securities & Valuations

Stages of Verification of Advances: Flow Chart

1 - Appraisal

↓

2 – Pre-Sanction

↓

3- Documentation

↓

4 - Disbursement

↓

5 – Post Sanction Compliances

↓

6 – Periodical Assessment

Credit Appraisal and Sanction of Advances

Application / renewal in prescribed form/KYC Compliance

Other documentations like project report, audited FS, cash flows etc

Loan Application Scrutiny – Competent authority

Review of credit appraisal system- Credit Checks

Purpose of the loan- either business or personal

Eligibility criteria & Repayment capacity of Borrower

Verify that sanction is within the power of authority-(Branch or HO)

Report any discrepancy noted during verification

Credit Appraisal and Sanction of Advances:

In this stage, the branch has the following functions:

- Adequacy of Security & credit rating of borrower
- Standing of promoters/ guarantors
- Preliminary inspection of the business unit or residence of the borrower.
- Inspecting the nature of the securities offered particularly Immovable properties.
- Preparing report after such inspection stating specific reasons for either sanctioning/rejecting the loan.

Documentation before Disbursement:

Adequate documentation – as per sanction note/bank's policy

Regularly updated

Enforceable by law

Any short comings observed

Maintenance and safe custody

Documentation before Disbursement:

Auditor should examine the loan documents obtained & compare with the list specified in the documentation manual.

Auditor should verify whether:

- All the particulars in the documents have been filled in.
- All the particulars filled in are correct.
- Signature and acceptance from the borrower has been obtained including the sanction letter.
- Branch official concerned have verified & authorized that all the documents have been duly obtained.
- Creation of charge – ROC site
- Board resolutions – authorizing signatory
- Borrower and Guarantors papers

Disbursement of Loans:

Verification of security – (title and valuation)

NOC from previous banker – Take Over Advances

Title clearance – search report – legal clearance

All the terms of sanction are complied (quotations / proforma invoices)

Direct disbursements to vendor/third party

Verification of own contribution

Pre disbursement inspection

In case of draw down facility – stage of completion to be verified

Follow up with original documents, registration etc.

Post Disbursement Compliance:

After the disbursement of the loan, the branch should monitor and comply all the term and conditions specified in Loan sanction letter.

This compliance includes the following:

Verification of end-use of the funds- Whether they are utilized for intended purpose with a certificate from a CA.

In case of Immovable property offered as security:

Mortgage has created & registered.

Valuation report, Legal opinion report, Latest encumbrance certificate has been obtained.

Creation of charge & lien

Insurance

Review of Operation in Accounts:

Important stage in verification of advances- Regular Health Check-up

Intelligent Scrutiny of Operations in accounts

- transfer from/ transfer to other accounts
- Frequent cheque returns, excessive withdrawal
- Turnover in account is disproportionate to sale in business
- Transfer of funds to group concern

Comparison of sales and purchase with the month wise stock statement submitted by the borrower

Computation & Recomputation of DP limits on the basis of Stock statement by the borrower

Reconcilation of balance of Advances with the General Ledger- unreconciled items needs attention

Renewal of Advances:

Reneawal only at the end of one year- unless ad-hoc advances or otherwise prescribed in sanction letter- Non Renewal-NPA

Limit realigned/enhanced- necessary documents are executed for such enhancement

Reschedulement/Restrcturing as per IRAC Norms

Obtain "Letter of Acknowledgement of Debt" from borrower – to avoid documents becoming time barred

Factors considered at time of renewal- History of Accounts, Future Projects etc.

Physical Inspection of Security & Valuations:

Examine stock audit report for any adverse comments with special attention to non moving/obsolete stock.

Demat papers, physical shares, TDR, NSC usually in custody of bank and should be physically verified.

Loan against shares- Periodic statement of valuation of shares pledged to ensure margin is maintained.

NPA A/cs- Valuation report for all immovable properties mortgaged to the bank at least once in 3 years.

Factory/ Property visit by the Branch Manager on regular basis

Assesement of Impact of Change in Government Rules & Regulations (Cancellation of Coal mines by SC)

Reporting/ Rectification:

Auditors to report discrepancies noted in advances in - Statutory Audit Major/Critical discrepancies report & Long Form Audit Report (LFAR)

If the discrepancy has to be rectified, it has to be through Memorandum of Changes (MOC)

Adeqaute documentation for the discrepencies observed and rectified through MOC

Docmentation of Issues reported in LFAR to avoid any dispute in future

DOs

– To the point
– Avoid words generally / normally
– Avoid blanket affirmative statements
– Write basis of comment like
• based on walkthrough,
• based on sample verification of 8 accounts in 2 accounts namely
– Use simple English
– Give Example
– Check cross Referencing (LFAR to MOC, Certificates, etc. & Vice – Versa)
– Maintain all working papers

Shortcoming/weaknesses/reservations
adverse comments with reasons
Discuss contents with branch head.
Make correct representation of facts
Give bank's point of view

DO

Give specific disclosures on nature and extent of work done and limitations

Give disclaimer for non-availability of records

Beyond Delegated Authority

DON'T'S

Don'ts

– Avoid descriptive Report

– Be Vague

– Use shortforms/ terms not defined

– Refer General Practices

-Don't just copy from previous year report which will create complicated siyution without verifying the facts with the current year relavacne information

EARLY SIGNALS OF FRAUD IN BANKING SECTOR.

Operations of Account

1 Bouncing of high value cheques

2 Foreign bills remaining outstanding with the bank for a long time and tendency for bills to remain overdue.

3 Delay observed in payment of outstanding dues

4 Frequent invocation of BGs and development of LCs

5 Under insured or over insured inventory

6 Invoices devoid of TAN and other details

EARLY SIGNALS OF FRAUD IN BANKING SECTOR

Operations of Account

7 Funding of the interest by sanctioning additional facilities

8 Frequent request for general purpose loans.

9 Frequent ad hoc sanctions

10 Heavy cash withdrawal in loan accounts

11 Significant increase in working capital borrowing as percentage of turnover

EARLY SIGNALS OF FRAUD IN BANKING SECTOR

Concealment or Falsification of documents

12 In merchanting trade , import leg not revealed to the bank

13 Concealment of certain vital documents like master agreement , insurance coverage

14 Frequent change in accounting period and/or accounting policies

15 Claims not acknowledged as debt high

16 Substantial increase in unbilled revenue year after year

17 Material discrepancies in the annual report

18 Significant inconsistencies within the annual report (between various section)

19 Poor disclosure of materially adverse information and no qualification by the statutory auditors

EARLY SIGNALS OF FRAUD IN BANKING SECTOR

Diversion of Funds

20 Frequent change in the scope of the project to be Undertaken by the borrower

21 Not routing of sales proceeds through consortium/ member bank/ lenders to the company

22 High value RTGS payment to unrelated parties

23 Increase in borrowings , despite huge cash and cash

equivalents in the borrower’s balance sheet

- Issues in Primary/Collateral Security

24 Dispute on title of collateral securities

25 Request received from the borrower to postpone
the inspection of the godown for flimsy reasons

26 Exclusive collateral charged to a number of lenders
Without NOC of existing charge holders

27 Critical issues highlighted in the stock audit report

28 Liabilities appearing in ROC search report , not reported
By the borrower in its annual report

29 Non- production of original bills for verification upon
request.

EARLY SIGNALS OF FRAUD IN BANKING SECTOR

30 Significant movement in inventory , disproportionately

Differing vis-à-vis change in the tuenover

31 Significant movements in receivables , disproportionately

differing vis-à-vis change in the turnover and/or increase in

ageing of the receivables

32 Increase in Fixed Assets , without corresponding increase

In long term sources (when project is implemented)

33 Costing of the project which is the wide variance with

standard cost of installation of the project

EARLY SIGNALS OF FRAUD IN BANKING SECTOR

- Inter-Group/Concentration of Transaction

34 Funds coming from other banks to liquidate the outstanding loan amount unless in normal course

35 Floating front/associate companies by investing Borrowed money

36 LCs issued for local trade/rlated party transaction without underlying trade transaction

37 Large number of transaction with inter-connected Companies and large outstanding from such companies

38 Substantial related party transaction

EARLY SIGNALS OF FRAUD IN BANKING SECTOR

Regulartory Concern

39 Default in undisputed payment to the statutory bodies

As declared in the Annual report

40 Raid by Incomes tax/sale tax/ central excise duty officials

EARLY SIGNALS OF FRAUD IN BANKING SECTOR

Other Signals

41 Disproportionate change in other current assets

42 Resignation of the key personal and frequent changes

In the management

43 Significant reduction in the stake of promoter/director or

increase in the encumbered shares of promoter/director

Bills discounted are paid on due dates every time and there are no delays or return of bills.

Heavy incomes from other sources, shown in the financial statement of accounts , unrelated to the Normal business of the customer.

Heavy borrowings of fund for short term in quarter/half year/year ending months for a few days and being used for deposits of similar or lesser period in the market

Customer starts operating accounts in other bank without intimation to the main bank.

The customer accounts may be having a lot of cash deposits and withdrwals.

Misuse of funds , money laundering ,multiple mortgagees of same property to different banks/institutions and deposits kept in various bank.

THANK YOU –

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