

Audit of Advances

CA MANU K T BALACHANDRAN

Presented at SIRC KOTTAYAM, on 30.03.2026

What's on the table today?

- **Introduction to Bank Audit**
- **Types of Advances**
- **IRAC & Provisioning**
- **CBS Environment**
- **This year's focus**
- **Audit Procedures**
- **Real life Case Studies**

Introduction to Bank Audit

Bank Hierarchy



Introduction to Bank Audit

Bank Audit

Central Statutory Auditor



- Consolidates Financial Statements
- Oversees Entire Bank
- Gives Final Audit Report



Branch Statutory Auditor



- Audits Individual Branch
- Checks Loans & Advances
- Reports to Central Auditor



Introduction to Bank Audit

Key Banking Terms



IRAC



SMA, EWS & NPA



DP



CBS



LFAR



MOC

Literatures to read

- Banking Regulation Act
- RBI IRAC norms
- ICAI Guidance Note on Audit of Banks
- RBI Master Directions
- **RBI has consolidated all circulars and guidelines. 9445 circulars were withdrawn and consolidated to 244 consolidated master directions (Nov 2025)**

Literatures to read

Bank's Annual Report:

Go through the annual report of the bank. Mainly Accounting Policies

Delegation of Authority:

Get discretionary powers regarding sanctioning of advances by various level of authorities in Bank.

Loan Policy:

Get a copy of loan policy of the bank for all types of loans.

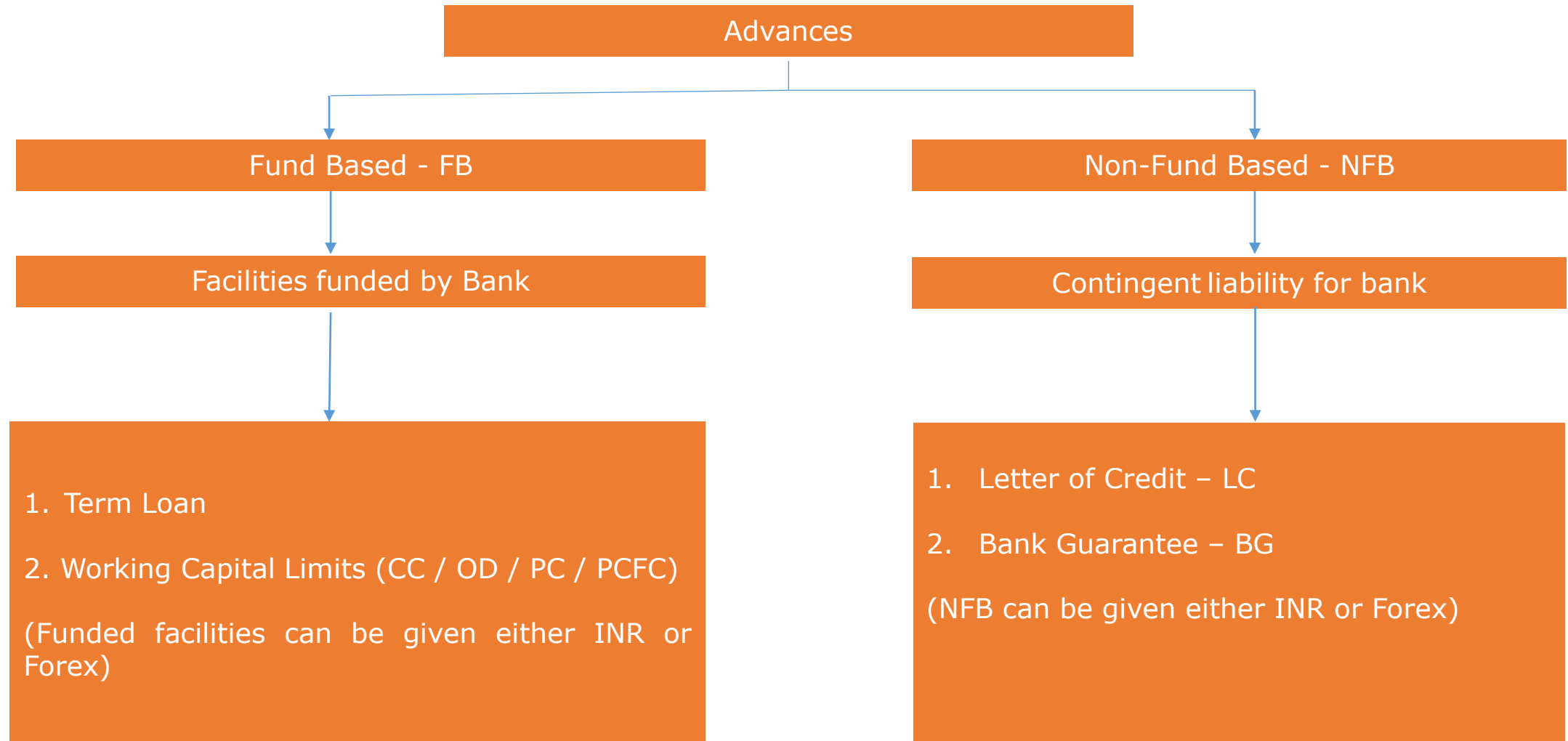
Audit of Advances Pre Audit

- Pre-Audit Documentation like Appointment Letter, Scope, EL, Communication with Previous Auditor.
- Communication from SCAs
- Annual Closure Circular from HO to Branch

Audit of Advances – Planning

- Risk Based Approach – Detailed plan before stepping in to the Branch
- Not necessary to verify all the accounts or have large number of samples. But verify selected accounts thoroughly.
- Have a proper audit strategy/program.
- Get all documents needed for planning prior to going for the audit

Type of Advances



Audit of Advances

Fresh Sanction / Renewal Sanction / Review Sanction:

- Term Loans – One time sanction and subject to review every year (exception retail loans)
- Working capital limits – subject to renewal every year

Rate of Interest – MCLR/EBLR

- MCLR/EBLR is the benchmark rate below which a bank cannot sanction any advances (subject to certain exceptions).
- Card Rates should be known in detail.
- ALCO documents should be verified for the recent rates.

Audit of Advances

Records to be verified:

1. Sanction Order (go through the entire sanction order)
2. Proposal / Processing Note
3. Approval of the authority
4. Ensure loan sanctioned as per the policy.
5. Terms of the Sanction Order (type of facility , quantum, currency, ROI, repayment terms, holiday period, margin, secured/ unsecured) **to be correlated with Core Banking Solutions (CBS)**.
6. Monthly stock statement (ensure it is properly **updated in CBS**)
7. Manager Inspection Report
8. Latest audited Financial statements
9. Insurance Policy of primary as well as collateral securities with bank clause (ensure adequately of insurance value). (ensure it is properly updated in CBS).

Audit of Advances

Records to be verified

10. External Rating (ensure it is properly updated in CBS)
11. Internal Rating (obtain circular on the same)
12. Stock audit report
13. Engineer's valuation on primary as well as collateral securities (dual valuation if the value of a security exceeds the limit fixed by the bank). (ensure it is properly updated in CBS).
14. Documentation (Refer next Slide)
15. Legal opinion from the panel advocate on primary as well as collateral securities.
16. Consortium minutes in case of consortium advances.
17. Review the account operations in CBS + CIF (Customer Information File) in CBS

Audit of Advances

Documentation :

1. Pre vetting report from the panel advocate
2. Loan agreement / Working Capital limit agreement
3. Necessary resolutions in case of corporate borrowers
4. Hypothecation deed
5. Mortgage deed
6. Letter of Guarantee
7. Demand Promissory Note (validity 3 years) –Debt or Revival letter on Expiry
8. Creation of charge with ROC
9. Post vetting Report

Audit of Advances

Income from Advances:

1. Processing charges
2. Review charges
3. Commitment charges
4. Interest

(Revenue audit report can also be obtained and verified.)

Audit of Advances

Drawing Power – In case of Working Capital Limits

In case of Working capital limits , Periodic drawing power statement has to be submitted by the borrower to the bank.

Audit of Advances

The general format of Drawing Power Computation:

	<u>Particulars</u>	<u>Rs.</u>
	i) Inventories	xxx
	ii) Debtors	xxx
	iii) Advances to suppliers	xxx
	Subtotal (A)	<u>xxx</u>
Less:		
	iv) Creditors	xxx
	v) Advance received from Customers	xxx
	vi) Inventories purchased under LC	xxx
	Subtotal (B)	xxx
	A – B (Net Working Capital)	<u>xxx</u>
Less:	Margin @ 25%	<u>(xxx)</u>
	DRAWING POWER	<u>xxx</u>

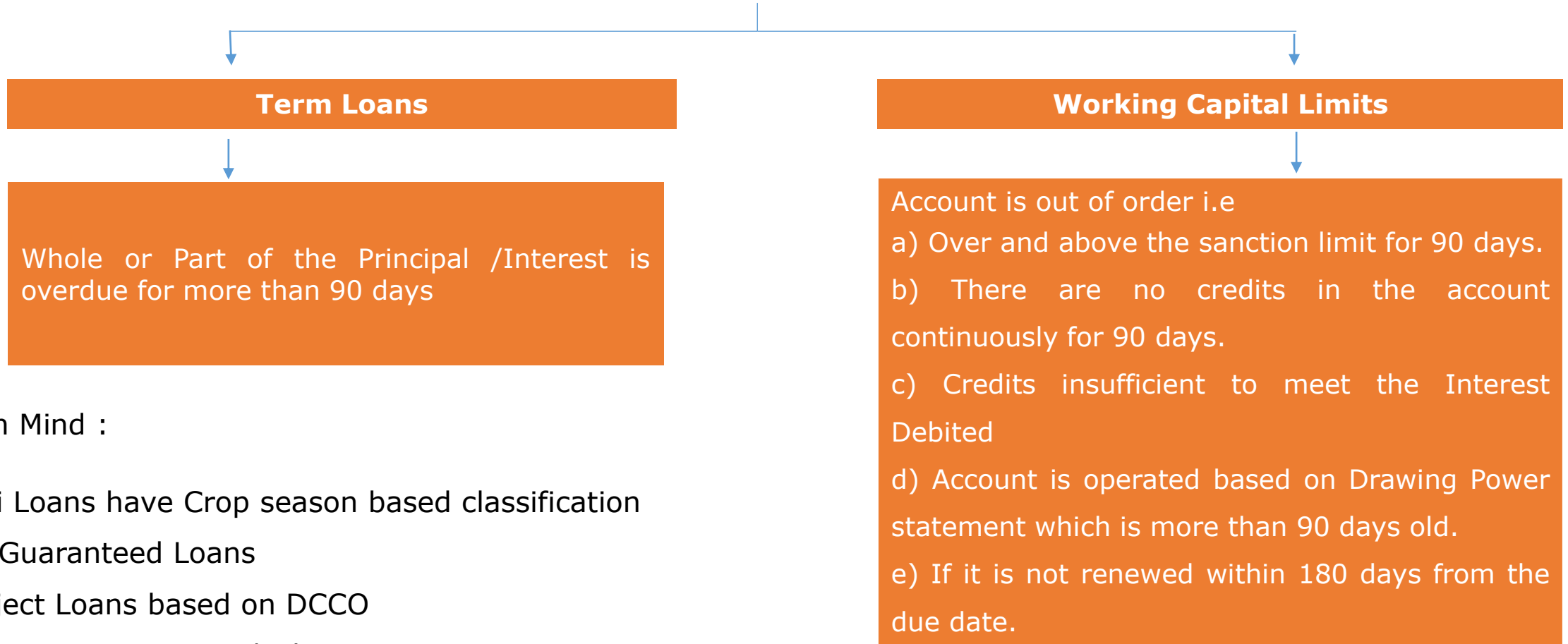
Audit of Advances

How to take the samples for Audit

- Non-Judgemental Random Samples
- All Type of loans are covered
- SMA Report
- EWS Report
- Know Stressed Sector of the Bank and **otherwise.**
- News around you
- Year's Focus – Gold Loans, Micro Finance

Audit of Advances

IRAC Norms – Non-Performing Asset (NPA)



Keep in Mind :

- Agri Loans have Crop season based classification
- CG Guaranteed Loans
- Project Loans based on DCCO
- Loan Against Deposit/Policies

Audit of Advances

Out of Order :

1 Statement for Condition 1

(Outstanding continuously above Sanctioned Limit / DP for 90 days)

CC Limit / DP: ₹10,00,000

Date	Particulars	Debit (₹)	Credit (₹)	Balance (₹)
01 Jan	Opening Balance	—	—	9,80,000
05 Jan	Withdrawal	1,50,000	—	11,30,000
20 Jan	Interest Debited	20,000	—	11,50,000
10 Feb	Interest Debited	22,000	—	11,72,000
05 Mar	Interest Debited	25,000	—	11,97,000
31 Mar	Balance	—	—	11,97,000

Audit of Advances

2 Statement for Condition 2 & 3

(Balance within limit but no credits / insufficient credits)

CC Limit / DP: ₹10,00,000

Date	Particulars	Debit (₹)	Credit (₹)	Balance (₹)
01 Jan	Opening Balance	—	—	8,50,000
10 Jan	Interest Debited	20,000	—	8,70,000
10 Feb	Interest Debited	22,000	—	8,92,000
20 Feb	Cash Deposit	—	5,000	8,87,000
10 Mar	Interest Debited	23,000	—	9,10,000
31 Mar	Balance	—	—	9,10,000

Audit of Advances

Non-Performing Assets(NPA)

1. If any of the conditions regarding NPA is satisfied, then the account should be classified as NPA.
2. The unrealized income in the form of processing charges and interest has to be reversed.
3. Classification of NPA is borrower wise and not account wise. Get representation that the customer is not having any other accounts.
4. In case of recovery, the appropriation of the same between principal / Income depends on the bank policy.
5. Deciding which classification is important (Example : Old Stock audit Report).

Audit of Advances

Provisioning

1. Standard – 0.25% to 1.00%
2. Sub Standard – 15%
3. Doubtful 25% - 100%
4. Loss – 100%

Audit of Advances

Restructuring of Advances

1. If there is change in term of original sanction like
 - a) Change in repayment terms
 - b) Change in holiday period
 - c) Change in date of commissioning (DCCO)
 - d) Funding of Interest (FITL)

2. Then the borrower should be immediately classified as NPA and unrealised income should be reversed.

Audit of Advances

Upgradation of the account from NPA to Standard Assets:

If **all the** arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts.

With regard to upgradation of a restructured/ rescheduled account which is classified as NPA, separate conditions to be complied with.

Audit of Advances

Sectoral Classification – to be verified in CBS:

RBI Master Direction on Priority Sector Lending (updated upto 07th July 2023) (Refer Page 7 to 15).

Priority Sector:

- a. Agri
- b. Micro, Small and Medium Enterprise
- c. Export Credit
- d. Education
- e. Housing
- f. Social Infrastructure
- g. Renewal Energy

Audit of Advances

Non Fund Based – NFB :

1. Letter of Credit – LC (Either INR/Forex)
2. Bank Guarantee – BG (Either INR/Forex)
3. Buyer's Credit – BC (Forex)

The NFB Limits will appear in the Balance sheet of the Bank as Contingent Liability

Audit of Advances

Income from NFB Limits

1. Processing charges
2. Review charges
3. Commission

Recognition of Revenue

Commission will be amortised over the period of Contract.

Audit of Advances

Verification of NFB Limits :

1. Copy of fresh sanction/Renewal sanction
2. Proposal / Process note
3. Ensure sanction is within the discretionary power of sanctioning authority.
4. Documentation
5. Ensure collection of appropriate charges as per the accounting policies of the bank
6. Get detail procedure regarding issue of NFB limits and evaluate the effectiveness of control over it

Audit of Advances

Verification of NFB Limits :

7. Verify the process note at the time of issue of each and every LC/BG/BC
8. Verify the copy of BG issued
9. Verify the copy of LC issued
10. Ensure BG is reversed after the claim period on the receipt of the original from the beneficiary
11. Ensure LC is reversed after the period of LC.
12. Ensure SWIFT is linked to CBS.

Audit of Advances

Documentation :

1. Copy of agreement entered into LC/BG/BC
2. Ensure Lien marked on deposits given as Margin Money.

Audit of Advances

Devolvement of LC :

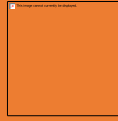
1. Ascertain the reason for devolvement.
2. In case of regular devolvement of LC, Verify the documents relating to those LC.
3. Devolved amount to be credited to the regular CC/OD account of the customer.
4. If the party is already classified as NPA, then the quantum of devolvement should also be classified as NPA from **original NPA date**.

Audit of Advances

Invocation of BG :

1. Ascertain the reason for Invocation
2. Incase of frequent invocation of BG, verify the relevant BG
3. The quantum of BG invoked, to be debited to regular CC/OD account of the customer.
4. If the party is already classified as NPA, then the quantum of invocation, should also be classified as NPA from **original NPA date**.

Audit of Advances – Other Sources



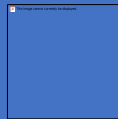
Observations in Concurrent/Other Audit Report



Observations in credit audit report



Observations in RBI audit report



Get Representation from Manager on the other audits conducted at the branch during the year under audit.



Summarised pending Pre and Post Sanction Terms & Conditions

Audit of Advances

CBS Environment :

1. Automated NPA tagging
2. Automated Interest Application
3. Manual Overrides
4. Wrong System Logic
5. Wrong updating of Master Data
6. Understand the reporting capabilities (including MIS)
- 7. "I DON'T KNOW"**

Audit Of Advances – Focus this year - Key fact statement

- Standardised disclosure format prescribed by RBI.
- Annual Percentage Rate (APR).
- All fees/charges disclosed separately (processing, insurance, third-party charges).
- Penal charges, foreclosure charges and contingent charges.
- Floating rate details to include benchmark rate, spread and reset periodicity.
- Amortisation schedule and APR computation sheet to be part of KFS.
- KFS must be provided before execution of loan agreement and acknowledged by borrower.
- KFS to be provided in language understood by borrower.

Audit Of Advances – Focus this year - Key fact statement

What a Branch Auditor should focus on

- Verify KFS issued before sanction/loan agreement execution.
- Check borrower acknowledgement / signature on KFS.
- APR calculation includes all charges.
- All penal, foreclosure, and contingent charges disclosed.
- KFS vs Sanction Letter vs Loan Agreement – terms should match.
- No additional fees charged which are not disclosed in KFS.

Audit Of Advances – Focus this year - Micro Finance

- Collateral-free loan given to a household whose annual household income does not exceed Rs. 3 Lakhs. Often provided through Self-Help Groups (SHG) or Joint Liability Groups (JLG).
- Gross NPAs in the sector rose to around 16% by March 2025, almost doubling from earlier levels. Predominantly in Southern States of India.
- Banks started creating additional provision on this portfolio

Audit Of Advances – Focus this year – Gold Loans

- Gold Loans are two types – Agri Loan with gold as security and Loan against Gold.
- RBI has come up with very stringent rules on gold loan. Later relaxed the same. Currently roll over of Gold loan is permitted only after paying the entire amount of Interest which was not permitted in earlier regulations.
- Interest due must be cleared before renewal. Fresh credit appraisal required for renewal/top-up. Renewal permitted only if LTV remains within limit.
- Renewal/top-up allowed only if the loan is regular.

Audit Of Advances - A Practical Approach

- Internal Office Accounts transaction verification.
- We can't question business decisions of Bank like unsecured loan.
- Pre-approved/ Auto-approved loans – verification Process
- Physical verification of inventory/gold of the borrower.
- Staff loans same branch approved by authority in came branch

Audit Of Advances - A Practical Approach

- Evergreening of Loans.
- Date of stock audit report is relevant. Not submission date.
- Window Dressing during period end.
- Same account debit and credit
- Concept of Co-borrower/Co-Obligant
- Repo rate change.

Audit Of Advances - A Practical Approach

- Understand the concept of Unique Identifier process.
- Direct assignments and Loans where the account resides in outside CBS – One account all account.
- Cash Suspense GLs Verification.

Audit of Advances – Conclusion

- Work not documented is like '**work not done**' – SA 230
- Audit Conclusion Summary
- Due care for LFAR based reporting and Audit Report.
- MOC on concerns and its proper documentation.



Thank you

Manu K T Balachandran
manu@suriandco.com
9884089597

