

**K C Mehta** *& Co* LLP  
Chartered Accountants



# Audit of Advances

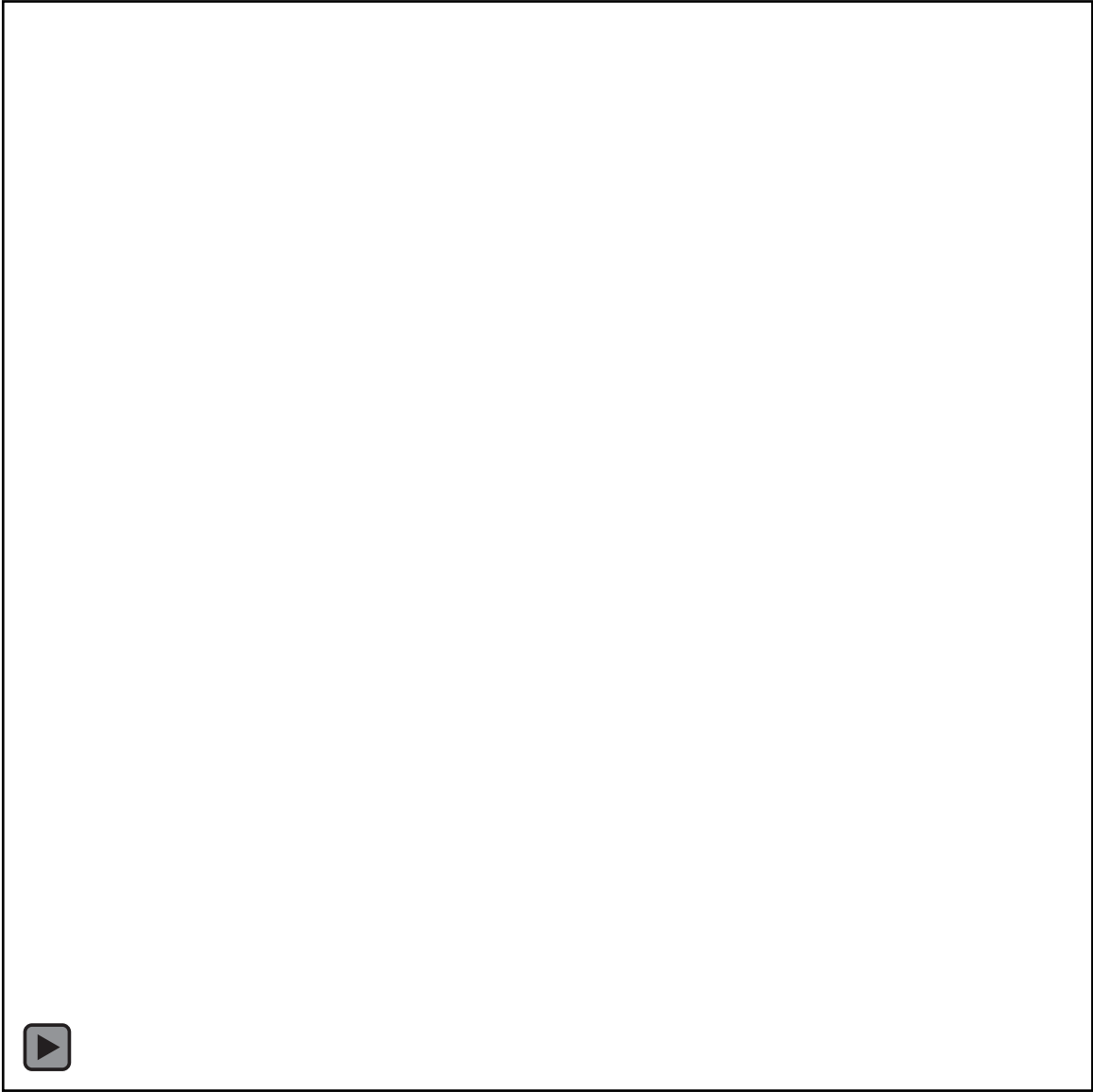
## *Statutory Branch Audit of Banks*

*March 29, 2025*

*Chirag Bakshi*

*([chirag.bakshi@kcmehta.com](mailto:chirag.bakshi@kcmehta.com))*







# Sequence of discussion

- » Objective of extending Credit
- » Preparing for the Audit
- » Life cycle of an Advance
- » Audit Procedure
- » LFAR – reporting requirement
- » Expectations from Regulators
- » This presentation will not deal with IRAC provisions. we will scrupulously avoid it



00

## Objective of extending Credit

*Bank Branch Audit- FY 2024-25*



# Objective

- » **Business or social service?**
- » **Income or recovery?**
- » **Creating Asset or Provision?**
- » **Banking Business v/s others business**
- » **Banking Company v/s Public sector Bank (PSB)**

# Laws, Rules and Regulations

## » Applicable to Entities

- » Banking Regulations Act 1949 (Section 20, 20A, 21, 21A)
- » Banking Companies Acquisition Act
- » Reserve Bank of India Act 1934 – Regulations under RBI Act (Notifications, Circulars, Master Circulars, Master Directions)
- » SEBI Act – Regulations under SEBI Act to the extent applicable to PSB
- » ICAI – Accounts Standards (iGAAP)
- » State Bank of India Act 1955, State Bank of India (Subsidiary Banks) Act 1959

## » Applicable to Members of ICAI

- » Auditing and Assurance Standards
- » Accounting Standards
- » [Guidance note on Audit of Banks \(2025\)](#)
- » Reporting requirements under SEBI Act and Regulations
- » Reporting requirements under RBI Act, BR Act, and regulations under those act

## » [Regulations at A Glance – Handbook by RBI](#)



# Assurance Objective

- » Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- » Advances represent amount due to the bank.
- » Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
- » There are no unrecorded advances.
- » The stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation.
- » Advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- » Appropriate provisions towards advances are made as per the RBI norms, Accounting Standards and Generally Accepted Accounting Practices.
- » Advances given, are within the powers of the bank
- » Adherence to Section 20, 20A, 21 and 21A of Banking Regulation Act





01

# Preparing for Audit

*Bank Branch Audit- FY 2024-25*



# Preparation

- » Planning
- » Reports of previous years – LFAR, Audit reports, MOC
- » Inspection reports
- » Business data of the branch
- » Types of Advances, number of accounts.
- » Top 100 advances (borrowerwise)– CC? TL? We can add top NPA accounts for our review
- » NFB top 100 – Bills, LC, BG by outstanding borrowerwise
- » Sample borrowers – ensure coverage of FB and NFB – 80/20 rule
- » Include special accounts like SMA 2, RFA, highvalue unsecured, high risk borrower, reported in previous LFAR
- » Annual Report of the Bank
- » Resolution of SLBC of the state for crop duration



## RBI Penalty to Banks

- » The Statutory Inspection for Supervisory Evaluation (ISE) of the bank was conducted by RBI with reference to its financial position as on March 31, 2019 and the examination of the Risk Assessment Report, the Annual Review of implementation of Exposure Management Measures for Financial Year 2019-20 carried out by RBI during July 2020 and all related correspondence pertaining to the same, revealed, inter-alia, **contravention of sub-section (2) of section 19 of the Act to the extent the bank held shares in borrower companies, as pledgee, of an amount exceeding thirty per cent of paid-up share capital of those companies.** In furtherance to the same, a notice was issued to the bank advising it to show cause as to why penalty should not be imposed on it for contravention of the aforesaid provisions of the Act, as stated therein.
- » The Statutory Inspection for Supervisory Evaluation of the bank was conducted by RBI with reference to its financial position as on March 31, 2020, and the examination of the Risk Assessment Report, Inspection Report and all related correspondence pertaining to the same, **revealed non-compliance with the directions issued by RBI, inter-alia, to the extent the bank linked certain floating rate retail loans and floating rate loans to Micro and Small Enterprises, extended by it on or after October 01, 2019, to MCLR instead of an external benchmark.** In furtherance to the same, a notice was issued to the bank advising it to show cause as to why penalty should not be imposed on it for failure to comply with the directions issued by RBI, as stated therein.



## RBI Penalty to Banks

- » The Statutory Inspection for Supervisory Evaluation (ISE 2022) of the bank was conducted by RBI with reference to its financial position as on March 31, 2022. The examination of the Risk Assessment Report/Inspection Report pertaining to ISE 2022, and all related correspondence in that regard, revealed, inter alia, that it (i) held shares as pledgee of an amount exceeding thirty per cent of paid-up share capital of certain companies and (ii) failed to credit eligible amount to Depositor Education and Awareness Fund within the period prescribed in the BR Act. Consequently, a notice was issued to the bank advising it to show cause as to why penalty should not be imposed on it for contravention of the provisions of the BR Act, as stated therein.
- » The Statutory Inspection for Supervisory Evaluation (ISE 2022) of the bank was conducted by RBI with reference to its financial position as on March 31, 2022. The examination of the Risk Assessment Report/Inspection Report pertaining to ISE 2022, and all related correspondences in that regard, revealed, inter alia, non-compliance with the aforesaid directions by the bank, to the extent it (i) failed to rectify the rejected data and upload the same with the Credit Information Companies (CICs) within seven days of receipt of such rejection report from the CICs and (ii) restructured certain accounts which were not standard assets as on March 31, 2021 under the extant directions. Consequently, a notice was issued to the bank advising it to show cause as to why penalty should not be imposed on it for failure to comply with the said directions, as stated therein.

## RBI Penalty to Banks

- » The Statutory Inspection for Supervisory Evaluation of the bank was conducted by RBI with reference to its financial position as on March 31, 2021 (ISE 2021) and March 31, 2022 (ISE 2022). Based on supervisory findings of non-compliance with regulatory instructions/ statutory provisions and related correspondence in that regard, a notice was issued to the bank advising it to show cause as to why penalty should not be imposed on it for its failure to comply with the instructions. After considering the bank's reply to the notice, oral submissions made during the personal hearing and examination of additional submissions made by it, RBI found *inter alia* that the following charges against the bank were sustained warranting imposition of monetary penalty. The bank i) did not pay interest in certain term deposit accounts as per the schedule of interest rates disclosed in advance; (ii) had levied SMS alert charges from customers based on invalid mobile numbers and not on actual usage basis; (iii) failed to reset interest rates in MCLR and external benchmark linked advances at prescribed periodicity; (iv) failed to benchmark the interest on certain floating rate retail loans and floating rate loans to MSME, to an external benchmark rate; (v) failed to report or inaccurately reported data pertaining to certain large borrowers to CRILC and (vi) failed to furnish accurate information to Credit Information Companies (CICs).

# RBI Penalty to Banks

- » The Reserve Bank of India (RBI) has, by an order dated February 24, 2025, imposed a monetary penalty of ₹66.60 lakh (Rupees Sixty Six Lakh Sixty Thousand only) on \*\*\*\*\* (the bank) for non-compliance with certain directions issued by RBI on 'Know Your Customer', 'Reporting of Information on Unhedged Foreign Currency Exposures of the Borrowers to Credit Information Companies' and 'Interest Rates on Deposits'. This penalty has been imposed in exercise of powers conferred on RBI under the provisions of Section 47 A(1)(c) read **with Section 46(4)(i) of the Banking Regulation Act, 1949 and Section 25 (1) (iii) read with Section 23 (4) of The Credit Information Companies (Regulation) Act, 2005.**
- » The statutory Inspection for Supervisory Evaluation of the bank was conducted by RBI with reference to its financial position as on March 31, 2023. Based on supervisory findings of non-compliance with RBI directions and related correspondence in that regard, a notice was issued to the bank advising it to show cause as to why penalty should not be imposed on it for its failure to comply with the said RBI directions.
- » **After considering the bank's reply to the notice, additional submissions and oral submissions made during the personal hearing, RBI found, inter alia, that the following charges against the bank were sustained, warranting imposition of monetary penalty:**
  - The bank had outsourced the disposal / closure of AML alerts to a Group company;**
  - The bank did not report Unhedged Foreign Currency Exposures of certain borrowers to CICs; and**
  - The bank had opened savings deposit accounts in the name of certain ineligible entities.**
- » The action is based on deficiencies in statutory and regulatory compliance and is not intended to pronounce upon the validity of any transaction or agreement entered into by the bank with its customers. Further, imposition of monetary penalty is without prejudice to any other action that may be initiated by RBI against the bank.



# Guidance Note – Audit of Banks 2025

## » Useful References

### » Chapter 10 Agriculture – Pages 395 to 432

Entire advance cycle is clearly explained. Audit process, checklist, reports, are all described. It also gives the specialised knowledge that is required to understand this sector. Agriculture advances run on a different level and has a completely separate evaluation criteria.

It also gives Priority Sector Lending related regulations, verification and audit procedure

### » Chapter 11 Advances- Pages 433 to 555

### » Pages 554 and 555 give guidance how to best set up a criteria to select the borrower account.

### » Make it a point to refer to it and encourage your team to check with the guidance in the book.



# Sequence of discussion

- » Objective of extending Credit
- » Preparing for the Audit
- » Life cycle of an Advance
- » Audit Procedure
- » LFAR – reporting requirement
- » Expectations from Regulators
- » This presentation will not deal with IRAC provisions. we will scrupulously avoid it





# 02

## Life Cycle of Advances

*Bank Branch Audit- FY 2024-25*



# Banking Regulation Act 1949

## » Section 20 – Restriction on Loans and Advances

- » Prohibition on granting Loan against own shares
- » Entering into commitment of granting loans or advances on behalf of
  - › Director or any firm in which Director is interested
  - › Any company in which Director is interested or is a Director (other than subsidiaries)
  - › Any individual for whom a Director is guarantor or partner

## » Section 20A – Restriction on Remission of Debt

- » Prohibition on Remission of Debt – of any director, any firm in which director is partner of guarantor, any individual who has director as guarantor or partner



# Banking Regulation Act 1949

## » Section 21 – Power to Control Advances

- » RBI to make policy of granting Advances of Banks in General or it may make policy for a particular Bank
- » Purpose of Advance
- » Margins
- » Maximum Advance that can be made
- » Maximum guarantees that can be given
- » Rate of interest that can be charged



# Life Cycle of Advances

- Credit Evaluation
  - Sanction
  - Disbursement
  - Monitoring
- 
- Does an Advance die? Ever?
- 
- In Slide 4 we have pledged to avoid NPA discussion and in slide 10 we are going to add top 100 NPA. Is this ironical?



03

## Credit Evaluation

*Bank Branch Audit- FY 2024-25*



# Process of Audit

## » Process walk through

- » Receipt of proposal
- » Evaluation and data entry into approval application
- » Checklist of guidelines given by HO for accepting proposals
- » Circulars and manuals for the loan

## » Data Analysis

## » Sample Selection

## » Verification

## » Data sharing restrictions

## » DIGITAL BANKING????

- » Any difference between digital banking and banking digitally?



# Credit Evaluation – 1

## » Loan policy of the bank

- » Permissions and Restrictions within the RBI regulations

## » RBI circular on statutory and regulatory restriction on Loans and Advances

### » Statutory restrictions

- » Advance against bank's own shares
- » Advance to bank's Directors
- » On holding shares in companies
- » Extending credit to Companies for Buy-back of shares

### » Regulatory restrictions

- » Advances to relatives of Directors of Bank
- » Advances to officers and relatives of Senior officers
- » Advance to industries producing ozone depleting substances
- » 27 More restrictions which may not be directly applicable at Branch



## Credit Evaluation - 2

- » Authority and Delegation matrix
- » KYC
- » Reports of inspection at the borrower to confirm the genuineness
- » CRILC/CFR
- » Secured or unsecured?
  - » Nature of security
  - » Adequacy of security
  - » Guarantees if any
  - » unsecured advance must follow the rules
- » Terms of proposed Sanction





## Credit Evaluation - 3

### » Reporting requirement

### » LFAR – 2 details about large advances in the branch – History of the Borrower

### » Significant Questions that a Branch auditor will have to answer

- » Whether credit appraisals have been done within the power of bank and delegated power of the branch?
- » Have you come across cases of quick mortality in accounts, where the facility became non-performing within a period of 12 months from the date of first sanction? Details of such accounts may be provided in following manner:-
  - Account No.
  - Account Name
  - Balance as at year end





# 04

## Sanction

*Bank Branch Audit- FY 2024-25*



# Conditions of Sanction

## » Standard conditions

- » Interest Rate
- » Security – applicable charge
- » Repayment schedule
- » Documents to be submitted
- » External Credit Rating
- » Moratorium

## » Special Conditions

- » Holding on operations
- » Additional security
- » Bring equity in ratio as per sanction terms



# Conditions of Sanction

## » Waiver of standard conditions

- » Credit rating
- » Security
- » Larger moratorium
- » Lower interest rate
- » Submission of stock statement and stock audit
- » Submission of valuation report for security
- » Mandatory verification of security
- » Advance outside consortium
- » Margin requirements



# LFAR questions

- » In the cases examined by you, have you come across instances of:
  - (a) credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch?
  - (b) Are such cases promptly reported to higher authorities?
- » Whether advances have been disbursed without complying with the terms and conditions of the sanction? If so, give details of such cases.
- » Similarly we have to also answer whether the necessary documents were available, any deficiency in documents.



# 05

## Disbursement

*Bank Branch Audit- FY 2024-25*



# Disbursement

- » Nature of project
- » Nature of Advance
- » Schedule of funding requirement
- » Sanctioned method of disbursement
  - » To the vendor
  - » To the borrower
  - » Bullet
  - » In phases
  - » Against actual progress
  - » Against delivery of equipment



# 06

## Monitoring

*Bank Branch Audit- FY 2024-25*





# Monitoring

- » Compliance with sanction terms
- » Process of escalation for non-compliance
- » Early warning system for delinquency – SMA 0-1-2
- » Restructuring CDR/Non CDR
- » MSME circular
- » Value of security
- » Periodical submission of reports like FFR, Stock statement, Stock audit, Valuation of Security, inspection of site, plant borrower activity
- » CRILC/CFR to ascertain whether the borrower has any other facility without permission
- » Consortium meetings and sharing of critical information
- » Operation in principal account, other borrower facility. Weakness in any facility
- » Group, associate, subsidiary borrowing.
- » Indepth review of the annual reports of all entities in the group



# 07

## Audit Procedure

*Bank Branch Audit- FY 2024-25*



# Audit Procedure

- » Examining loan documentation and it's vetting by the legal department;
- » Reviewing the operation of the accounts especially of accounts held and operated with other banks;
- » Examining the existence, enforceability and valuation of the security from time to time especially for loans given on a standalone basis;
- » Checking compliance with RBI norms including appropriate classification and provisioning;
- » Carrying out appropriate analytical procedures; and procedure for loan balance confirmations.



## Sample (80 % in value and diversity)

- » Top Advances
- » List of Stressed accounts, RFA
- » List of restructured accounts
- » List of Unsecured Advances. Specifically those above 1 crore
- » List of accounts NPA within 12 months of sanction. Aka Quick mortality
- » List of accounts identified as high risk in RFIA
- » List of accounts upgraded in Last year, specifically in last month
- » List of advance given in March, specifically last week of march
- » Accounts declared as fraud during the year
- » List of Advances which are in SMA-2 for last 4 quarters



# Data Analysis

- » How many advances have outstanding more than DP (CC limits)
- » How many advances have security less than outstanding. Whether there is waiver in sanction? Whether this waiver is as per the loan policy and RBI regulations?
- » How many advances are irregular on 31<sup>st</sup> March, whether they are irregular on 31<sup>st</sup> March of previous year
- » Which borrowers have maximum number of days in SMA-2
- » Which borrowers have maximum default in KYC
- » Which borrowers have renewal date more than 12 months from previous renewal or sanction.
- » Which borrowers have more than one renewal within 180 days
- » How many Agri loans are crop loans and how many have gold as security
- » How many gold loans are monitored like crop loans.



# Verification - 1

- » Compliance with terms of sanction and end use of funds should be ensured.
- » Sufficient margin specified in the sanction letter should be kept against securities taken to cover for any decline in the value thereof. Availability of sufficient margin needs to be ensured at regular intervals.
- » Controls over custody and storage of documents and their removal for verification.
- » If the securities taken are in the nature of shares, debentures, etc., the lien should be marked in the name of the bank and effective control of such securities be retained as a part of documentation.
- » All securities requiring registration should be registered in the name of the bank or accompanied by documents sufficient to give clear title to the bank.
- » In the case of goods in possession of the bank, contents of the packages should be test checked at the time of receipt. The godown should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.



## Verification - 2

- » Surprise checks should be made in respect of hypothecated goods not in physical possession of the bank.
- » Drawing Power Register should be updated every month to record value of securities hypothecated. These entries should be separately checked by an independent officer.
- » Accounts should be kept within the drawing power and the sanctioned limit.
- » Policy related with valuation of primary and collateral securities including periodicity of the same.
- » Policy related with internal and external rating of borrowers which includes frequency of such rating.
- » Policy related to review of CIBIL rating of the borrower and its periodicity.
- » All accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
- » Operation of each advance account should be reviewed at least once a year, and at more frequent intervals in case of large advances.

# Loan parameters

- » Interest Rate master – should be updated with the latest sanction. The spread is decided on case to case basis and therefore is not centralised.
- » Where there is lower or special interest rate, the branches may have to work manually every month to ensure correct debit. Auditor is expected to verify on sample basis by independent calculation that this process is correct.
- » Interest charged and debited to be manual verified in few accounts
- » Penal interest working and auto debit. Waiver of penal interest must be verified with proper letter or sanction
- » No debit is permitted in NPA accounts. Auditor must verify this.
- » Stock statement date must be entered
- » Last review / renewal data must entered
- » Pan is must. More than one CIF/custID needs to be merged





# RBI circulars

- » Master Circular – Exposure RBI/2015-16/70 DBR.No.Dir.BC.12 /13.03.00/2015-16
- » Master Circular – Guarantees and Co-acceptances RBI/2022-23/10 DOR.STR.REC.8/13.07.010/2022-23
- » Master Circular – Housing Finance RBI/2022-23/16 DOR.CRE.REC.No.06/08.12.001/2022-23
- » Master Circular – Interest Rates on Advances RBI/2015-16/37 DBR.No.Dir.BC.9/13.03.00/2015-16
- » Master Circular- Loans and Advances – Statutory and Other Restrictions RBI/2015-16 /95 DBR.No.Dir.BC.10/13.03.00/2015-16
- » Master Circular- Rupee / Foreign Currency Export Credit and Customer Service To Exporters RBI/2015-16/47 DBR No.DIR.BC.14/04.02.002/2015-16
- » Master Circular on Wilful Defaulters RBI/2015-16/100 DBR.No.CID.BC.22/20.16.003/2015-16
- » Master Circular – Kisan Credit Card (KCC) Scheme RBI/2018-19/10 FIDD.CO.FSD.BC.No.6/05.05.010/2018-19
- » RBI circular RBI/2016-17/280 DBR No. FSD. BC.62/24.01.040/2016-17 dated April 18, 2017 Prudential Guidelines – Banks' investment in REITs and InvITs

# Thank you



## Ahmedabad

Level 11, Tower B, Ratnaakar  
Nine Square, Vastrapur, Ahmedabad,  
India - 380 015 Phone: +91 79 4910  
2200

**K C Mehta & Co LLP**

Chartered Accountants



## Bengaluru

Rudra Chambers, First floor,  
#95, 11<sup>th</sup> Cross, 4th  
Main road,  
Malleswaram, Bengaluru 560003



## Mumbai

315, The Summit Business Bay,  
Nr. WEH Metro Station, Andheri  
East, Mumbai, India - 400 069  
Phone: +91 22 2612 5834



## Vadodara

Meghdhanush, Race  
Course, Vadodara, India - 390  
007 Phone: +91 265 2440 400

**K C Mehta & Co LLP**

Chartered Accountants