

Verification of Advances

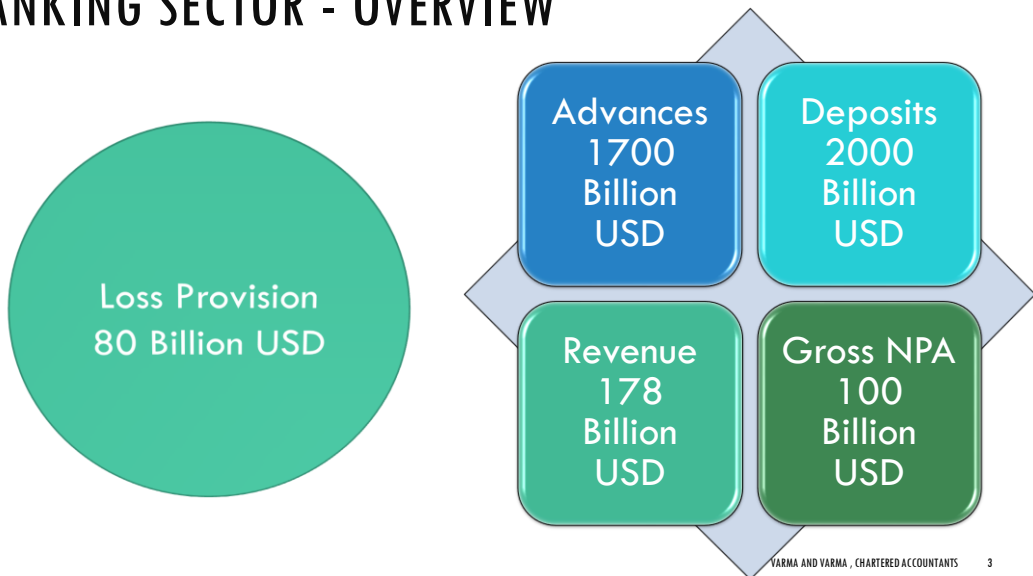
Organised by
SICASA , Bengaluru Branch of SIRC of ICAI

Presented by
CA Govind Sekhar , FCA
Partner ,
Varma and Varma , CAs

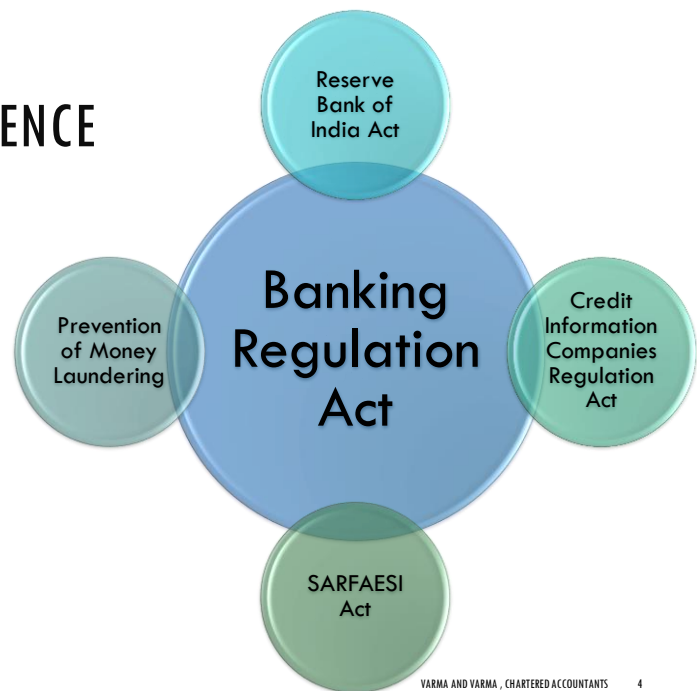


INTRODUCTION

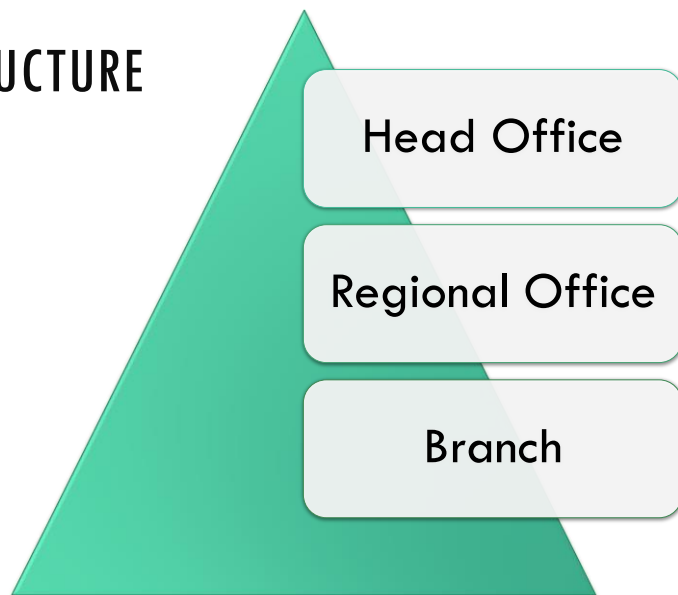
BANKING SECTOR - OVERVIEW



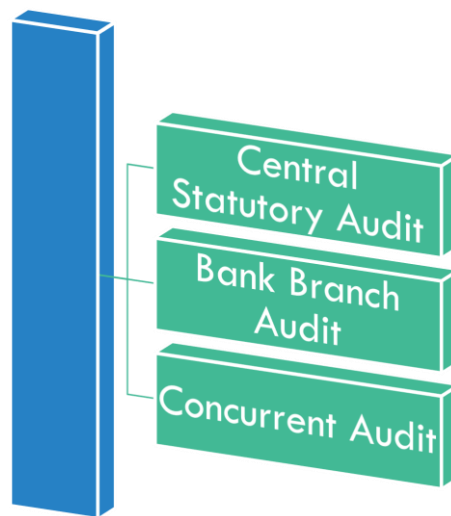
REGULATORY INFLUENCE



BANK STRUCTURE



TYPES OF BANK AUDIT



KEY AUDIT CONCERNS

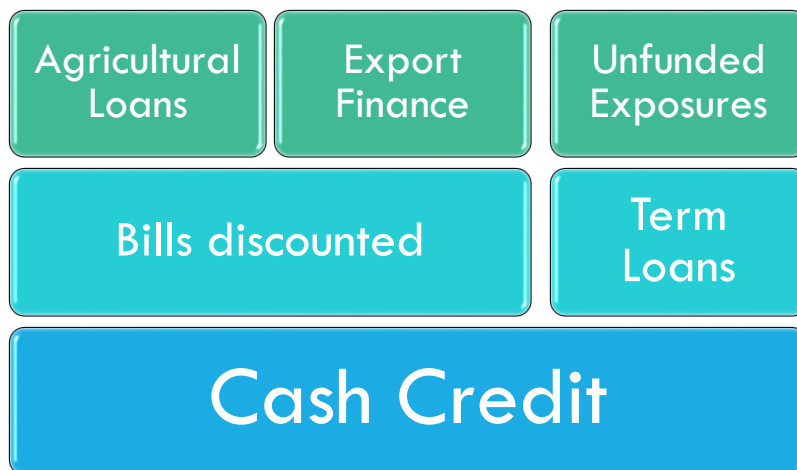


VARMA AND VARMA, CHARTERED ACCOUNTANTS 7



ADVANCES

TYPES



CASH CREDIT

Working Capital Loans
Short Term
Repayable on Demand
Secured by Inventory / Trade Receivables

TERM LOANS

Project Loans
Fixed Repayment Schedule
Secured by Fixed Assets
Long Term

BILLS DISCOUNTED

Bill of Exchange
Short duration – Demand / Maturity Date
Supported by Invoice

AGRICULTURAL LOAN

Specified Agricultural activities
Other Agricultural activities
Short duration crops
Long duration crops
Interest Subvention Benefits

EXPORT FINANCE

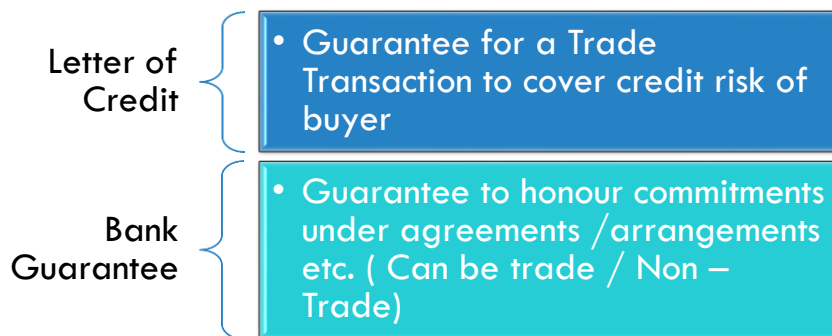
Pre shipment finance : To fund working capital requirement from sourcing to shipment (e.g. – Packing Credit Loan

Post shipment finance : To facilitate early debtor realisation (e.g. Export Bills discounted)

Both facilities to be repaid out of export proceeds

Concessional Rates of Interest

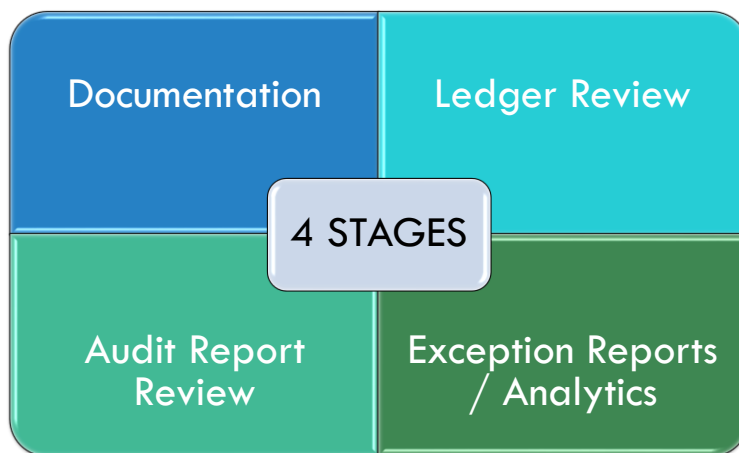
UNFUNDED EXPOSURES





REVIEW OF ADVANCES

STAGES

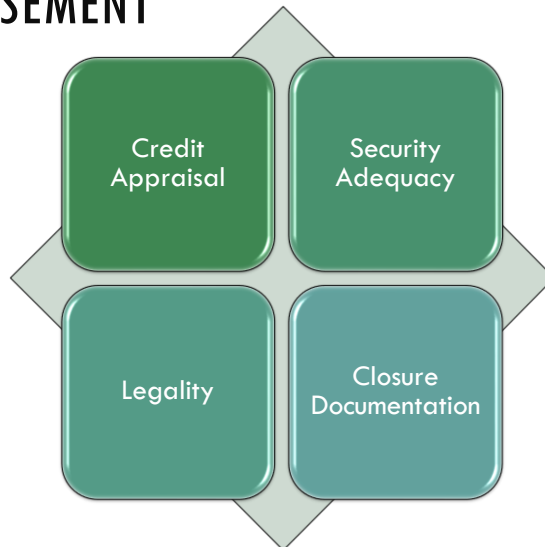


DOCUMENTATION

Pre
Disbursement

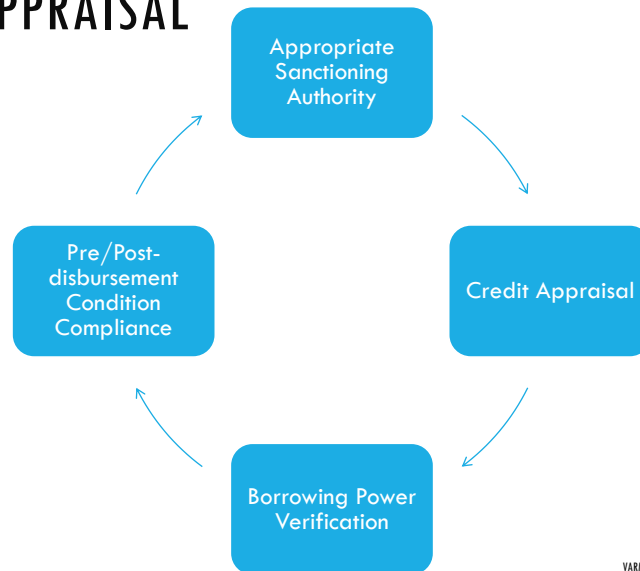
Post
Disbursement

PRE-DISBURSEMENT



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CREDIT APPRAISAL



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CREDIT APPRAISAL - KEY ASPECTS

A. Whether Loan is sanctioned by the appropriate sanctioning authority as per the delegation of authority manual of the Bank ?

B. Whether Credit Appraisal has been carried out prior to Loan Sanction -

1. Integrity of Management
2. Management Competence
3. Past Track Record
4. Financial Ratios
5. Audit Report Qualifications
6. Project Report
7. Earnings Projections
8. CIBIL Report
9. Credit Rating
10. CRILIC Report

C. Whether Borrowing Power of the Company / Non corporate has been ensured – Compliance with Section 180 / Resolution copy?

D. Compliance with other pre-disbursement conditions – e.g.- Guarantee from Directors / Net worth certificate / Promoter Contribution / No statutory dues certificate etc.

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SECURITY — KEY ASPECTS

1. Adequacy of Security – Whether margin is in accordance with Bank policy.
2. Whether Valuation Report obtained to determine security adequacy .
3. Whether Insurance has been obtained for security.
4. Whether Title deed has been obtained.
5. In case of Intangible assets – Basis of valuation.
6. In case of valuation report – Whether valuer duly competent.
7. Whether Security value correctly entered in system.
8. Physical Inspection of Security – Photographs of security visits
9. Field Investigation

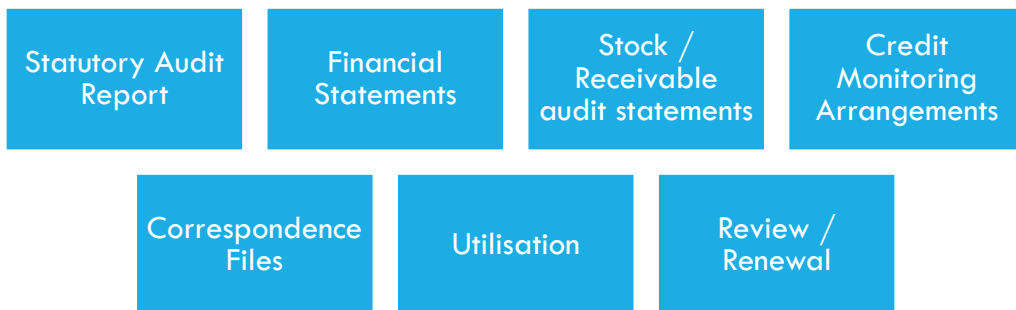
LEGALITY — KEY ASPECTS

1. Whether Encumbrance certificate has been obtained ?
2. Whether Legal Vetting report has been obtained ?
3. Whether Loan agreement has been executed ?
4. Whether Loan Hypothecation agreement has been executed?
5. Whether agreements signed by authorised signatories of the borrower?
6. Whether charge creation document filed with ROC ?
7. Whether Cheques / Promisor notes duly obtained ?
8. Whether NOC for charge creation obtained from other bankers wherever applicable ?
9. Whether Promotor Guarantee Agreement duly executed?
10. Land Tax assessment slips

CLOSURE DOCUMENTATION — KEY ASPECTS

1. Whether checklist for compliance with pre-disbursement conditions duly prepared by branch and approved by the competent authority
2. Whether checklist / form for compliance with post disbursement conditions have been duly prepared by branch and approved by competent authority

POST DISBURSEMENT — DOCUMENTATION



POST DISBURSEMENT DOCUMENTATION – KEY ASPECTS

Area	Remarks
Statutory Audit Report	<ol style="list-style-type: none"> 1. Audit Qualifications 2. Last available audit report 3. Stock as per Audit report v/s Stock as per DP statement 4. CARO comments
Financial Statements	<ol style="list-style-type: none"> 1. Financial Health of Borrower – Turnover ratio/ Profitability ration/ Current Ratio etc. 2. Significant disclosures in notes to account
Stock / Receivable Statements	<ol style="list-style-type: none"> 1. Whether obtained on monthly basis ? 2. Adverse remarks in Stock audit report? 3. Stock audit report data v/s financial statement data ? 4. Reasonability of Stock / Receivable levels – based on operation cycle of borrower 5. Whether creditors reduced from stock for DP computation
Credit Monitoring Arrangements	<ol style="list-style-type: none"> 1. CRILIC Report Review 2. Fraud List / Will full defaulters list / Red flagged list – RBI

LOAN DOCUMENTATION – POST DISBURSEMENT —STEPS

Area	Remarks
Correspondence files	<ol style="list-style-type: none"> 1. Existence of information having adverse effects on borrowers financial health ? 2. Consortium loan – Minutes adverse comments 3. Promoter share pledge 4. Act of God Events 5. Strike
Utilisation	<ol style="list-style-type: none"> 1. End use certificate ? 2. Date of Commencement of Project? 3. Physical Inspection visits by branch?
Review / Renewal (Working capital facilities)	<ol style="list-style-type: none"> 1. Whether loans have been reviewed and renewed on yearly basis 2. Whether such renewals based on proper credit appraisals

LOAN DOCUMENTATION - TEMPLATE

Particulars	Remarks
Name of the Borrower	ABC Ltd
Nature of facility	Cash Credit facility
Balance outstanding	1000 lakhs
Nature of Business	Auto dealer
Sanctioning Authority	Regional Office
Credit Rating	ICRA – AA (Valid till 31.3.2020)
Fresh issue / enhancement	Fresh
Purpose of loan	Working Capital
Whether loan within borrowing power	Yes . Resolution of Board of directors seen (dt 2/10/2018) . Total Borrowings along with proposed borrowing within limit under section 180

LOAN DOCUMENTATION - TEMPLATE

Particulars	Remarks
CIBIL Default / RBI Default party/ CRILIC Default	No
Sanction terms	Purpose – Working capital Tenure – One year Interest – Base rate + 3% Limit - 1250 lakhs Margin – 25% Security – Receivable and paid inventory (less than 90 days)
Sanction Conditions	1. Director guarantee 2. Half yearly stock audit 3. Half yearly Statutory dues certificate
Legal Opinion	Seen . No discrepancies.
Valuation Report	Seen . Security value coverage is adequate . No qualifications.

LOAN DOCUMENTATION - TEMPLATE

Particulars	Remarks
ROC charge creation	1. Filed . Form verified.
Documents inspected	1. Loan Agreement 2. Net worth certificate 3. Guarantee Agreement 4. Hypothecation Agreement 5. Board Resolution 6. Borrowing Power certificate 7. Legal Audit Report 8. Valuation Report 9. Promissory note 10. Financial Statement 11. Title Deed

ADVANCES — ACCOUNT REVIEW



NPA -INTRODUCTION

- Rule based classification as per RBI guidelines
- Asset Provisioning to be done based on NPA category
- Income recognition to be done on cash basis
- Borrower wise classification (exception – Central Government Guarantee loans / Loans backed by Fixed Deposit / Bills backed by external bank LC)

NPA NORMS – CLASSIFICATION

Type of Advance	NPA norm
Cash Credit	<ul style="list-style-type: none"> ➤ Account Overdue for more than 90 days (lower of Drawing Power / Sanctioned Limit) ➤ Account pending renewal for more than 180 days ➤ Stock statements on which DP is computed not received for more than 180 days ➤ Credits in the account not sufficient to cover Interest debited during the period ➤ DP Computation – Concerns <ul style="list-style-type: none"> a. Stock against bills purchased / lc b. Aged receivables and Inventory not reduced c. Trade Creditors not reduced (In excess of proposed limit at the time of initial assessment / as per Sanction terms) d. Comparison with financial statements

VARMA AND VARMA, CHARTERED ACCOUNTANTS

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DRAWING POWER COMPUTATION TEMPLATE

Particulars	Amount (Rs)
Total Inventory	100,000/-
Total Receivable	100,000/-
Less : Aged receivable (above 90 days)	25,000/-
Less : Aged Inventory (above 180 days) and Trade Creditors	25,000/-
Total Assets	150,000/-
Less : Margin 25%	37,500/-
Drawing Power	1,12,500/-
Total Sanctioned limit	1,50,000/-

NPA NORMS – CLASSIFICATION

Type of Advance	NPA norm
Term Loan	<ul style="list-style-type: none"> ➤ Interest / Principle overdue for more than 90 days ➤ Project Loans – Compliance with RBI circular (DCCO / Infrastructure Loans / Non Infrastructure loans)
Bills Purchased	<ul style="list-style-type: none"> ➤ Overdue for more than 90 days
Agricultural loans	<p>Specified Agricultural Activities – Long duration crops : 1 crop season</p> <ul style="list-style-type: none"> - Short duration crops : 2 crop season - State Level Bankers committee <p>Other Agricultural Activities</p> <ul style="list-style-type: none"> - Normal norms

NPA NORMS – CLASSIFICATION

Grade	Provision %
Substandard (12 months)	15% (Secured and Unsecured)
Doubtful 1 (24 months)	25% (Secured) 100% (Unsecured)
Doubtful 2 (24-48 months)	40% (Secured) 100% (Unsecured)
Doubtful 3 (48 months<)	100% - Secured / Unsecured
Loss - Secured / Unsecured	100% - Secured / Unsecured

ACCOUNT REVIEW

Area	Key Points
Working Capital	<ol style="list-style-type: none"> 1. Active debit / credit summations commensurate with nature of business / volume of operations 2. Source of credits – Evergreening out of borrowed funds 3. Interest Income – Whether accounted and accrued 4. Source of Large credits ? 5. Penal Interest – Whether accounted for non- compliances with sanction terms 6. Circuitous Transactions – Accommodation cheques / transactions within group entities ? 7. Source of repayment of discounted cheques 8. Frequent exceeding in drawing power – Reasons 9. Letter of credit devolvement – Reasons 10. NPA guideline compliance

ACCOUNT REVIEW

Area	Key Points
Term Loan	<ol style="list-style-type: none"> 1. Regular repayments ? 2. Repayment schedule as per system – whether as per sanction terms 3. Change in repayment schedule – Restructuring ?? 4. DCCO Status – Project Loans 5. DCCO Extension – Compliance with RBI circular / Viability study etc.
Export Finance	<ol style="list-style-type: none"> 1. Pre-shipment finance – Active account and whether amount funded replenished within the credit period as per Bank's policy 2. Post Shipment finance - Status of export bills outstanding ; Instances of overdue bills 3. Concessional rate of interest – Utilisation of funds for sanctioned purposes 4. Source of Credits

ACCOUNT REVIEW — TEMPLATE

Name	Account Number	Nature	Sanctioned limit	Balance O/s	Remarks on Review
ABC Ltd	123456	CC	100 lakhs	99 lakhs	<ol style="list-style-type: none"> 1. Account balance within drawing power / sanctioned limit during last 90 days 2. Account not pending renewal for more than 180 days 3. DP / Stock statement seen updated within the last 180 days 4. Credits are sufficient to cover interest debited

ACCOUNT REVIEW — TEMPLATE

Name	Account Number	Nature	Sanctioned limit	Balance O/s	Remarks on Review
ABC Ltd	123456	Term Loan	100 lakhs	75 lakhs	1. Interest / Principle are not remaining unpaid for more than 90 days 2. Repayment schedule verified with sanction letter
ABC Ltd	123456	Bills Purchased	100 lakhs	75 lakhs	1. Bills are not overdue for more than 90 days (Latest expired bill date is 25.03.2019 , which was cleared on 02.04.2019)

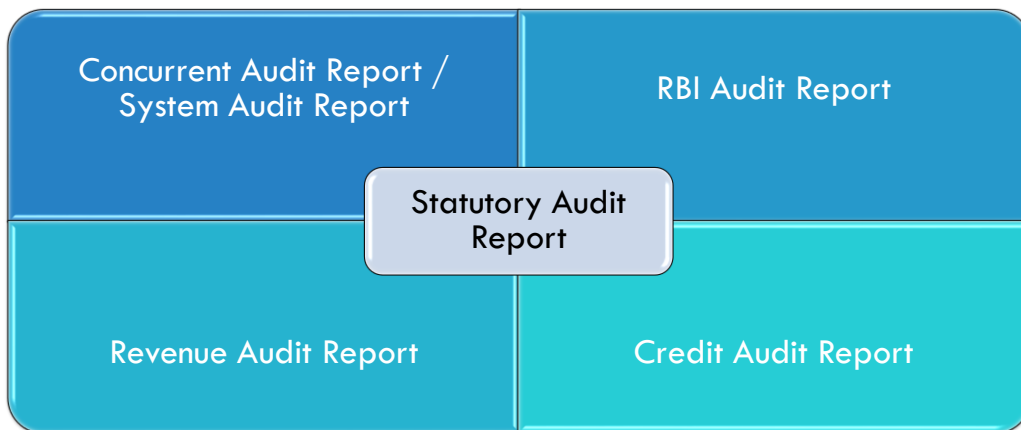
AUDIT FACILITATORS - EXCEPTION REPORTS

- Overdue report
- Credit rating not updated report
- Dormant account report
- Stock statement not obtained report
- Letter of Credit devolved report
- SMA report (SMA 0 : 0-30 DAYS , SMA 1 : 30-60 DAYS , SMA 2 : 60-90 DAYS)

AUDIT FACILITATORS - EXCEPTION REPORTS

- Bills overdue report
- Guarantee expired report
- Low credit / debit summation report
- Huge credit / Debt summation report
- Insurance expired report
- Account not renewed report
- Quick mortality accounts
- RBI – Fraud / Red flagged account report

AUDIT REPORT REVIEW



EXTERNAL INFORMATION

Credit Repository
of Information on
Large Advances
(CRILIC)

Credit
Information
Bureau of India
Ltd (CIBIL)

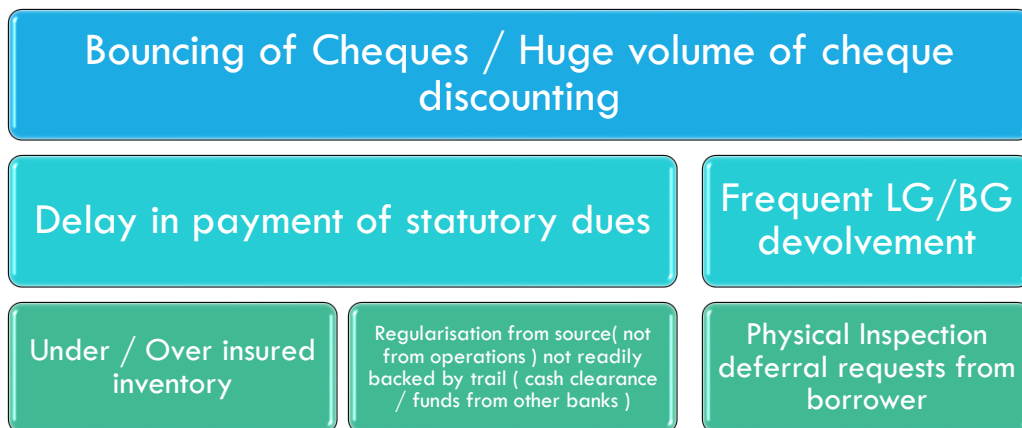
CERSAI

MCA

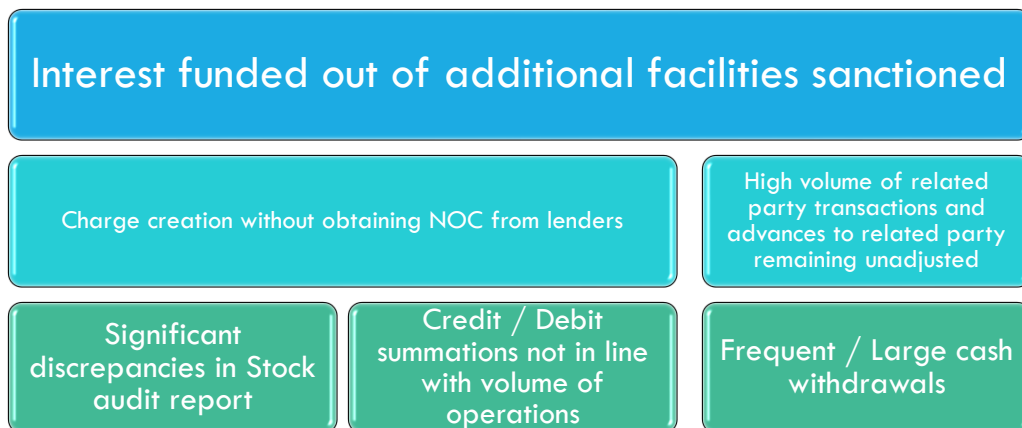
UDIN

VAHAN

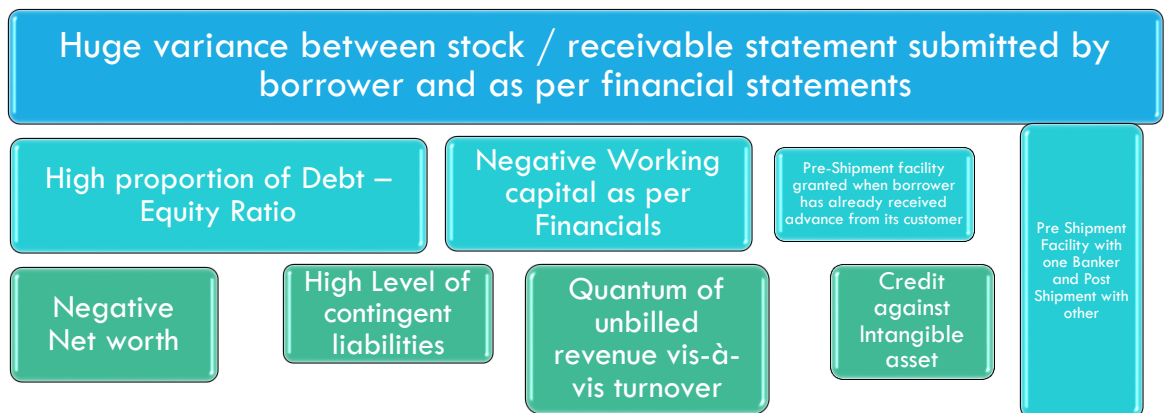
ADVANCES -STRESS SIGNALS



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ADVANCES -STRESS SIGNALS

Different Customer ID to same borrower

Security Value as per System not matching
with underlying records

Teaming and Lading
between borrower
accounts scattered
across different
branches

Term Loans not
directly
released to
suppliers

Sundry Creditors
and Aged
receivable not
reduced for DP

Down-gradation
of External
Credit Rating

Adverse
information in
public domain

ADVANCES -STRESS SIGNALS

Significant variations between turnover as per records submitted/ financial statements vis a vis GST returns

Original Invoice not submitted for verification

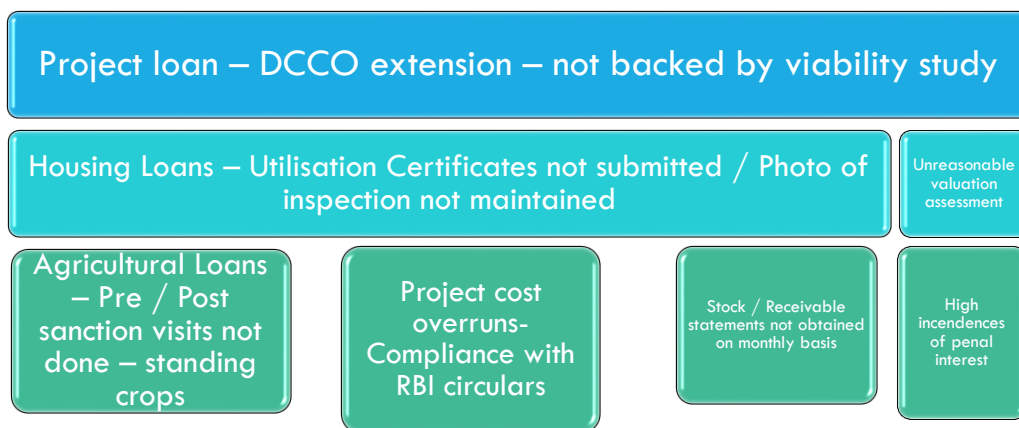
CARO qualifications

Key Management person resignation / Auditor Resignation

Promoter reducing stake

Significant portion of Assets due from Related Parties

ADVANCES -STRESS SIGNALS



PRINCIPLE REASONS OF LOAN LOSS

Security
Valuation

Account
operations vis-à-
vis operating
cycle

End Use

Business Pressures

Management
Integrity

Professional
Scepticism

RBI — FOREWARNING

Gross NPA could increase from 7.5% to 13.5% in a 'Baseline Stress Scenario' by Sep 21

Public Sector bank
NPAs could rise to
16% by Sep 21

CAR could drop from
15.6% to 14%

OTHER ASPECTS

Restructuring

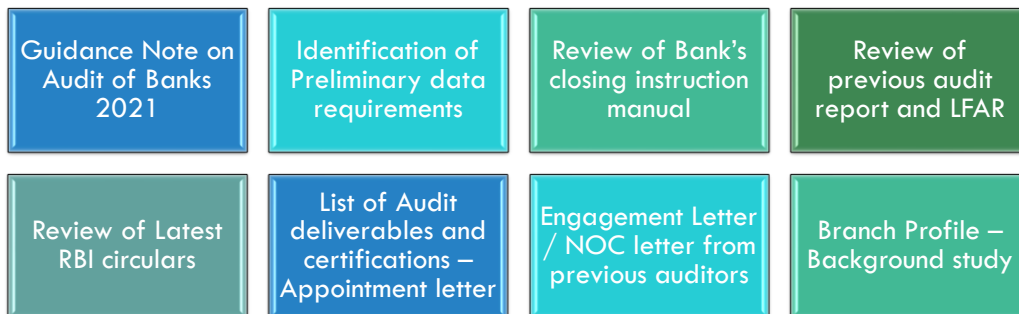
Moratorium –
COVID 19

Ex-Gratia
Payments –
COVID 19

COVID 19 –
Supreme Court
Judgement

New LFAR

PREPARATION FOR AUDIT — ALL THE BEST!



SAMPLE PRELIMINARY DATA REQUIREMENT LIST

High Risk Account Identification – Watch List Accounts / LCs devolved / BG invoked	Account Upgradation from NPA	Audit aides - External Audit / Inspection & Exception report lists	Limit / Party wise breakup of Advances / Bills / LCs / BGs
Fresh loan sanctions	Contingent Liability details	LFAR reporting information requirements – Quick mortality etc.	Unsecured Advances List



RECAP

RECAP

Banking
Sector

Key
Audit
Areas

Types of
Advances

RECAP

Review of
Advances

Documentation
Review

Account
Review

RECAP

Exception
reports
and
external
report

Stress
Signals

Other
Aspects

WORD OF ADVICE

*“YOUR EYES CANNOT SEE WHAT YOUR
MIND DOES NOT KNOW”*



ALL THE BEST!!!!



Thank you!

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