

# LOANS & ADVANCES

AUDIT & VERIFICATION FRAMEWORK

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# Question

1 Why to audit Loans & Advances?

2 Where to go?

3 What is the Purpose of Verification? - Do we know the Verification Criteria?

## OUR JOURNEY TODAY

▶ Understanding WHY we audit loans & advances

▶ LFAR Requirements & Examination criteria

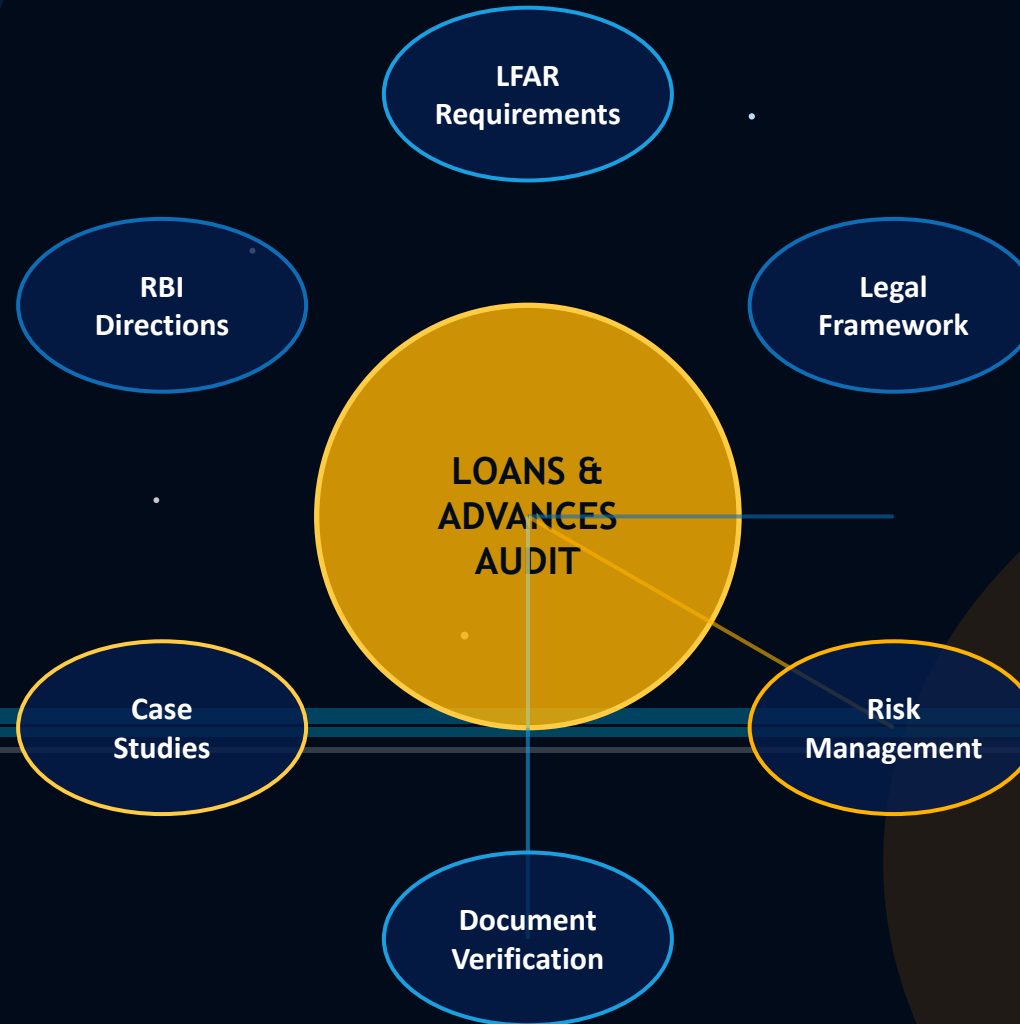
▶ Expected Verification Framework

▶ Documents required for audit

▶ Case Studies — Real-world audit scenarios

▶ Legal & Regulatory Framework

# Loans & Advances – Audit Overview



# LFAR — Requirements

## Large Advances Definition

Outstanding amount in excess of 10% of outstanding aggregate balance of fund based and non-fund based advances of the branch OR Rs. 10 crores — whichever is LESS

The transaction audit / account specific details to be seen and commented

Comments of the branch auditor on advances with significant adverse features, which might need the attention of the management / Statutory Central Auditors, should be appended to the LFAR

Details of Accounts Examined to be provided in a Chart

# Expected Verification Criteria

- 1 Branch Compliance with loan applications, preparation of proposals for grant / renewal of advances
- 2 Enhancement of limits; adequate appraisal documentation in respect thereof
- 3 Major shortcomings in credit appraisal
- 4 Cases of quick mortality in accounts, where the facility became non-performing within a period of 12 months from the date of first sanction
- 5 Applicable interest rate is correctly fed into the system
- 6 Interest rate is reviewed periodically as per the guidelines applicable to floating rate loans
- 7 Frequent renewal / rollover of short-term loans
- 8 Correct and valid credit rating
- 9 Loan Sanction Letter with Key Fact Statement

# Expected Verification Criteria (Continued)

## Delegated Authority

Credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch?

## Disbursement Compliance

Whether advances have been disbursed without complying with the terms and conditions of the sanction?

## Document Execution

Credit facilities released by the branch without execution of all the necessary documents?

## Documentation Deficiencies

Deficiencies in documentation, including non-registration of charges, non-obtaining of guarantees, etc.?

## Lien on Deposits

Advances against lien of deposits have been granted without marking a lien on the bank's deposit receipts?

# Expected Verification Criteria (Continued)

## Periodic Balance Confirmation

Periodic balance confirmation / acknowledgement of debts

## Stock Audits

System of obtaining reports on stock audits periodically?

## Stock & Financial Statements

Stock / book debt statements and other periodic operational data and financial statements received regularly from borrowers and duly scrutinized?

## Due Diligence Report

The branch has on its record, a due diligence report?

## DP Computation

Drawing Power (DP) properly computed

## Physical Verification

Physical verification of securities charged

## Latest Audited Financials

Latest audited financial statements are obtained for accounts reviewed / renewed during the year?

# Documents Required for Verification

List of new sanctions made during the year

List of accounts referred for restructuring

List of stressed advances (SMA-2) as on 15th March — indicates advances overdue for more than 60 days

Accounts wherein process under IBC is mandated but not initiated by branch

Borrowers wherein process of IBC initiated by any of the creditors including bank

Review of Red Flagged Accounts

Critical review of accounts flagged under the Early Warning Signals mechanism

List of Bank Guarantees and Letter of Credit

List of Bank Guarantees invoked and Letter of Credit devolved

List of borrowers where external rating is downgraded during the audit period

List of TODs / Adhoc sanctions sanctioned by the branch during the audit period

# Important Aspects

## Account Listing

List accounts / exposures along with all details such as status, classification, overdue amounts, days past due and security etc.  
— year of sanction — any

## Early Mortality

List of Accounts with Early Mortality

## Unsecured Accounts

Unsecured Accounts > Rs. 25 Lacs

## Stressed Accounts

List of Stressed Accounts — SMA Classification

## Restructured Accounts

Restructured Accounts

## Evergreening

Evergreening of Accounts

# Knowledge Base

## FINANCE CATEGORIES

- Finance to NBFC
- Export Finance
- LTV Ratio
- Priority – Non Priority Sector
- Micro Finance
- MSME Finance
- Agriculture Finance
- Project Finance
- Digital Lending – LSP – DLG

## OPERATIONAL KNOWLEDGE

- Legal Provisions Specific to Loans & Advances
- Regulatory Provisions
- Bank Specific Policies
- Working with CPC – CPU
- Limit Split
- Consortium Finance
- Margin Maintenance – Margin Contribution

# Legal Framework

1 Banking Regulation Act 1949

3 IBC 2016

5 The Indian Stamp Act 1899

7 Limitation Act 1963

2 Benami Transaction Act (1988) — Amended 2016

4 Indian Contract Act 1872

6 Transfer of Property Act 1882

8 The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002

# RBI Directions

1 Credit Facilities — 2025

3 Credit Risk Management

5 Transfer and Distribution of Credit Risk

7 Interest Rates on Advances

9 Priority Sector Lending

2 Resolution of Stressed Assets — 2025

4 Concentration Risk Management

6 Treatment of Wilful Defaulters and Large Defaulters

8 Credit Information Companies Direction

10 Ad-hoc / Short Review / Renewal of Credit Facilities 2020

# Credit Risk

## Section 20(1)(a) – BR Act, 1949

A bank CANNOT grant any loans and advances on the security of its own shares.

## Section 20(1)(b) – BR Act, 1949

A bank is PROHIBITED from entering into any commitment for granting any loans or advances to or on behalf of any of its directors, or any firm in which any of its directors is interested as partner, manager, employee or guarantor etc.

## Officer Sanctions – Conflict of Interest

No officer or any Committee comprising an officer as member, shall, while exercising powers of sanction of any credit facility, sanction any credit facility to their relative. Such a facility shall ordinarily be sanctioned only by the next higher sanctioning authority.

## Country Risk

Appropriate systems to move over to internal assessment of country risk.

# Credit Risk – Legal Entity Identifier (LEI)

## Definition

LEI is a 20-digit unique code to identify parties to financial transactions worldwide.

## Applicability

Borrowers with aggregate exposure of ₹5 crore and above from banks must obtain LEI codes.

## Consequence of Non-Compliance

Borrowers who fail to obtain LEI codes from an authorised LOU shall NOT be sanctioned any new exposure nor shall they be granted renewal / enhancement of any existing exposure.

## Obtaining LEI

Entities can obtain LEI from any of the LOUs accredited by GLEIF — Legal Entity Identifier India Ltd (LEIL) by CCIL.

20

DIGIT  
CODE

A bank has sanctioned Rs. 2,30,000 as Bullet Gold Loan with Interest Rate 10% on 12 December 2025.

Which is the specific aspect an Auditor should verify?

Consider: Bullet repayment structure, LTV ratio compliance, interest accrual, maturity period, and regulatory caps on Bullet Gold Loans.

## Gold Loan – Joint Borrowers

Bank has sanctioned Consumption Gold Loan to joint borrowers (Husband & Wife — both working in a company) of Rs. 8 Lac.

The valuation of Gold Ornaments is Rs. 10 Lac.

What should be the Observation of the Statutory Auditor?

Consider: LTV ratio (80% → Rs. 8 Lac on Rs. 10 Lac valuation), purpose as consumption loan, joint borrower KYC, eligibility for consumption vs. agri gold loan.

## Housing Loan – Second House

Mr. P is working in a reputed I.T. Company in Pune with a good salary.

- Mr. P (Pune) obtained Housing Loan from XYZ branch for Purchase of first house in Pune — all installments paid without default.
- Mr. P purchased a Second House in Pune and applied for a Housing Loan for Second House to the same XYZ branch.
- Salary is sufficient to repay both EMIs. All legal, valuation, purchase, and insurance documents submitted.
- Rent Agreement attached — second house rented out; Bank suggested rent to be deposited directly in loan account.
- Bank has sanctioned the second housing loan.

As Statutory Auditor — what are your verification points and observations?

A bank has sanctioned a loan as an Infrastructure Loan / Infrastructure Project Finance for construction of a Three Star Hotel in Pune City.

- Sanctioned Loan Amount: Rs. 35 Crore
- Interest Rate: 11%
- All required documents have been submitted.

What are the Auditor's Observations?

Consider: Classification criteria for Infrastructure vs. Commercial Real Estate, applicable RBI prudential norms, LTV, DSCR, repayment schedule, moratorium period, and project appraisal adequacy.

# Project Loan – Pragati Engineering Limited (PEL)

## COMPANY PROFILE

### Pragati Engineering Limited (PEL)

- Established manufacturing company — 18 years in industrial chemicals
- Strong balance sheet, profitable operations
- Regular debt servicing track record, adequate net worth

*Expansion: New production line for specialty chemicals within existing campus*

**Total Project Cost: ₹300 Cr | Debt: ₹210 Cr | Promoter: ₹90 Cr**

Repayment Period: 8 years including moratorium

## REPAYMENT SOURCES

47%

Cash flows from new specialty chemical project

38%

Cash flows from existing profitable business

15%

Internal accruals / additional cash support from parent operations and reserves

# Term Loan – Factory Construction

A bank has sanctioned a Term Loan of Rs. 60 Crore for a period of 8 years with Interest Rate 11%.

The security offered is a real estate property and valuation is done by a Valuation Professional empanelled with IBBI.

The Valuation Report states the valuation of Rs. 90 Crore.

What are the Auditor's Observations?

Consider: LTV ratio (Rs. 60 Cr loan vs. Rs. 90 Cr security = 66.67% LTV), IBBI empanelment verification, independent valuation requirement, type of mortgage (equitable/registered), title search report, and whether factory construction satisfies end-use monitoring norms.

# Minimum Loan Component – ABC Infrastructure Ltd.

Total Sanctioned Fund-Based Working Capital Limit (WCL): ₹200 crore

1 Cash Credit (CC)

2 Working Capital Demand Loan (WC DL)

3 Ad hoc Limits

4 Temporary Overdrafts (TOD)

5 Export Credit — Rs. 20 Cr

6 Bills Discounting — Rs. 10 Cr

# ✓ SOLUTION – Minimum Loan Component Calculation

$$\text{Net WCL} = 200 - 20 (\text{Export Credit}) - 10 (\text{Bills}) = ₹170 \text{ Crore}$$

Minimum Loan Component (60% of Net WCL) =  $60\% \times 170 = ₹102$  Crore from WCDL | Balance ₹68 Crore from CC / OD

Component	Amount (₹ Crore)
WCDL (Loan Component)	110
CC / OD	60
Export Credit	20
Bills Limit	10
<b>Total WCL</b>	<b>200</b>

## COMPLIANCE SCENARIOS

**Borrower Requires ₹150 Cr**

✓ WCDL  $\geq$  ₹90 Cr (60% of 150)

**Borrower Requires ₹120 Cr**

✓ WCDL  $\geq$  ₹72 Cr (60% of 120)

**Borrower Requires ₹90 Cr**

✓ WCDL  $\geq$  ₹54 Cr (60% of 90)

# THANK YOU

**CA. UDAY KULKARNI**

Loans & Advances — Audit & Verification Framework

Questions · Discussion · Insights