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*RESEARCH EXPLORER-International Journal on Economics and Business Management*

*ISSN: 2250-1940 (P) 2349-1647 (O)*

*Impact Factor: 8.276 (12OR), 3.676 (COSMOS)*

*Volume XV, Issue 51*

*April - June 2026*

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## **COMPREHENSIVE STUDY OF BANK AUDIT WITH FOCUS ON LOANS, ADVANCES, AND WORKING CAPITAL**

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### **ABSTRACT**

*This project titled “Comprehensive Study of Bank Audit with Focus on Loans, Advances, and Working Capital” aims to provide an in-depth understanding of the principles, procedures, and practical aspects of bank auditing. Bank audits play a crucial role in ensuring the accuracy, transparency, and reliability of financial statements, while also safeguarding the financial health of banking institutions. The study emphasizes the practical exposure to audit procedures, including audit planning, risk assessment, and the application of sampling techniques in verifying banking transactions. Special attention is given to the audit of loan and advance accounts, which constitute a significant portion of a bank’s assets and involve higher risk. The project examines the classification, documentation, and monitoring of loans, along with the evaluation of non-performing assets (NPAs). Further, the study explores the audit of working capital and business advances, focusing on the assessment of creditworthiness, compliance with sanction terms, and end-use verification of funds. It highlights the importance of internal controls, regulatory guidelines, and proper documentation in minimizing audit risks. The project adopts a practical approach by integrating theoretical concepts with real-world audit procedures, thereby enhancing understanding of challenges faced by auditors in the banking sector. Overall, the study provides valuable insights into effective bank auditing practices and contributes to strengthening financial discipline and accountability within banks.*

**KEY WORDS:** Loan Advance, Working Capital, Non-Performing Assets,

### **INTRODUCTION**

The Bank plays a very important role in functioning of organized financial sector of the economy. A well organized and efficient banking system is a prerequisite for economic growth of the country. The banking system is developing not only geographically but also operationally. It is no more an institution, which used to collect deposits to lend money. Anti-money laundering measures guidelines, submission of different returns of information about excess cash withdrawal, obtaining PAN for certain high value transactions, TDS on interest on Bank deposits and submission of returns, etc. reveal that the Government is thinking of using banking system to streamline and strengthen the economy. The banking sector plays a

major role in the development of the economy, as it mobilizes deposits and provides credit to various sectors across India. The banking sector collects surplus funds from customers/depositors in the form of deposits and channelizes them to borrowers in the form of loans.

The Reserve Bank or RBI is the central banking institution that regulates and operates the banking system in India. It supervises and administers exchange control and banking regulations and administers the government's monetary policy. RBI encompasses commercial banks, co-operative banks and development banks that function according to the guidelines imposed by the RBI. These banks provide various banking services across India from urban and metropolitan areas to the remotest rural areas. Indian banking industry has recently witnessed the roll out of innovative banking models like payments and small finance banks. RBI's new measures may go a long way in helping the restructuring of the domestic banking industry. The digital payments system in India has evolved the most among 25 countries with India's Immediate Payment Service (IMPS) being the only system at level five in the Faster Payments Innovation Index (FPII).

#### **Audit Documentation in Bank Branch Audit**

- SBA should ensure that documentation meet the requirements of SA 230 "Audit Documentation" and specific documentation requirements of other SAs and regulatory norms.
- SBA should prepare audit documentation on a real time basis.
- Maintain Documentation w.r.t to planning & risk assessment (nature, timing and extent of audit), audit strategy (risk based, compliance driven, and data driven) for performing the audit, any special audit considerations for risks due to fraud and related party transactions, applicable legal and regulatory framework, materiality levels, results of audit procedures performed and significant matters arising during audit, conclusions reached and significant judgements made
- Documentation include, Audit plan and programs (assigning responsibility of conduct, review and final authorization), final working papers and analysis, Issue-Memorandum, summaries of significant matters discussed with branch management, letters of confirmations and representations, checklists, correspondences (including e-mail) concerning significant matters with the branch or central office.

#### **OBJECTIVES OF THE STUDY**

The primary objective of this study is to analyse the practical experience gained during the project at an auditor's firm, with special emphasis on statutory bank audits and compliance-related activities. The project seeks to understand how audit procedures are carried out at the branch level and how regulatory guidelines are implemented in operational environments.

Another objective is to gain an in-depth understanding of loan verification and documentation procedures followed by banks, including the audit of various advances such as jewel loans, cash credit accounts, housing loans, and vehicle loans. The study also aims to examine the role of auditors in ensuring compliance with bank policies, identifying irregularities, and facilitating corrective action through structured audit reporting and follow-up processes.

Additionally, the project seeks to document the practical exposure gained in income tax and GST filings, thereby presenting a comprehensive view of professional accounting practices experienced during the internship.

#### **BANK AUDIT – PRACTICAL EXPOSURE AND PROCEDURES**

##### **Introduction to Bank Audit**

The bank audit experience formed the core learning component of my internship and constitutes the central theme of this project. During the internship period, I was introduced to the practical aspects of statutory and concurrent bank audits conducted at various bank

branches. Unlike general audits of business entities, bank audits are highly structured and strictly regulated due to the nature of banking operations and the involvement of public funds. Through direct participation in audit activities, I was able to understand how auditors systematically examine banking transactions, records, and controls to ensure compliance with regulatory requirements and internal policies.

A bank audit involves a comprehensive examination of the financial and operational aspects of a bank branch. During the audit process, auditors focus on evaluating advances and loans, asset quality, documentation standards, internal control mechanisms, and adherence to regulatory guidelines issued by the **Reserve Bank of India**. Each of these areas plays a critical role in determining the financial health and risk profile of the bank. Through the audit work, I learned that bank audits are not limited to checking numerical accuracy, but also involve assessing whether procedures have been followed correctly and whether risks have been adequately identified and managed.

One of the most important areas of focus during branch audits is the verification of advances. Advances represent a major portion of a bank's assets and are also the primary source of credit risk and a major source of revenue. During the audit, I observed that auditors devote significant time and attention to examining loan accounts, as improper sanctioning, weak documentation, or inadequate monitoring of advances can result in financial losses and regulatory non-compliance. The verification of advances involves checking whether loans have been sanctioned in accordance with bank policies, whether the required documents have been properly executed, whether the loans and advances are given based on the creditworthiness of the borrower and whether the security offered against the loan has been correctly created and recorded.

Asset quality assessment is closely linked to the audit of advances. Through the audit process, I learned how auditors examine loan accounts to determine whether they are performing or non-performing, based on repayment behaviour and regulatory norms. Proper classification of assets is essential, as it directly impacts income recognition and provisioning requirements. Any incorrect classification can lead to misrepresentation of the bank's financial position. Observing this process helped me understand the importance of timely identification and management of stressed and non-performing assets.

Documentation verification formed a crucial part of the audit work. During the audit, I was involved in checking whether loan files contained all mandatory documents, such as application forms, sanction letters, security documents, valuation reports, and legal opinions. Proper documentation serves as legal evidence of the bank's claim over the borrower and the security offered. Through this verification, I understood that even if a loan is regularly serviced, missing or improperly executed documents can expose the bank to significant legal and financial risks.

Compliance with regulatory norms was another key area examined during the bank audit. The audit process involved verifying whether lending practices, interest application, fee charging, and account operations were carried out in line with RBI guidelines and internal bank policies. Through this exposure, I learned how regulatory instructions are translated into operational procedures at the branch level, and how auditors assess compliance by examining records, reports, and system-generated data.

Internal control mechanisms were also reviewed as part of the audit. During the audit, I observed how auditors evaluate whether adequate controls are in place to prevent errors, fraud, and unauthorized transactions. This includes checking authorization procedures, segregation of duties, and monitoring systems within the branch. Understanding internal controls helped me appreciate the role of audits in strengthening governance and accountability within banking institutions.

Overall, the introduction to bank audit during the internship provided a comprehensive

understanding of how banks are examined from an auditor's perspective. It highlighted the importance of systematic verification, professional judgment, and regulatory awareness in safeguarding the interests of depositors and ensuring the stability of the banking system. This exposure laid the foundation for my learning in subsequent audit procedures, particularly in the detailed verification of various loan accounts and banking operations.

### **RBI Guidelines and Regulatory Framework Governing Bank Audits**

Bank audits are conducted within the broader regulatory framework prescribed by the Reserve Bank of India (RBI), which functions as the central banking authority responsible for supervising and regulating banking institutions in India. During the course of the internship, I understood that statutory bank audits are not limited to verifying transactions or loan accounts; they are carried out with reference to the regulatory standards and supervisory guidelines issued by the RBI.

RBI guidelines govern multiple dimensions of banking operations, including credit management, asset classification, income recognition, capital adequacy, liquidity maintenance, risk management, and customer service standards. These regulations form the foundation upon which internal bank policies are developed and implemented at the branch level. During audit assignments, compliance with these regulatory instructions is examined to ensure that banking operations are conducted within the prescribed legal and supervisory framework.

In the area of credit and lending, RBI norms influence exposure limits, sanction procedures, asset classification, provisioning requirements, and recognition of income on advances. However, the regulatory scope extends beyond lending activities. RBI guidelines also prescribe norms relating to Know Your Customer (KYC) procedures, Anti-Money Laundering (AML) compliance, maintenance of statutory reserves such as Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), priority sector lending targets, and reporting requirements to regulatory authorities. During the audit process, I observed how these broader regulatory requirements indirectly influence branch-level documentation, customer verification procedures, and compliance reporting systems.

Another important area governed by RBI guidelines is asset classification and provisioning. Banks are required to classify advances as standard assets, sub-standard assets, doubtful assets, or loss assets based on prescribed norms. This classification directly affects provisioning and financial reporting. During audit verification, loan accounts were examined to ensure that asset classification was carried out in accordance with RBI instructions and that income recognition was properly aligned with regulatory norms.

RBI guidelines also play a crucial role in strengthening governance and internal control systems within banks. Norms relating to related-party transactions, transparency in lending, disclosure requirements, and prevention of conflict of interest are embedded within regulatory instructions. Through audit exposure, I understood how adherence to these norms ensures accountability and financial discipline within banking institutions.

Thus, RBI guidelines serve as the regulatory backbone for banking operations and statutory audits. Every verification step during the audit, whether relating to loan documentation, account classification, interest application, or compliance reporting is ultimately assessed with reference to RBI norms and corresponding internal bank policies. This understanding helped me recognize that statutory bank audits are not merely procedural checks but regulatory compliance evaluations conducted within a structured supervisory framework.

### **Audit of Loan and Advance Accounts**

#### **Jewel Loan Verification**

Jewel loans are short-term secured advances granted against the pledge of gold ornaments and constitute a significant component of retail credit portfolios in many banking

institutions. Due to their high transaction volume, liquidity of underlying collateral, and exposure to gold price fluctuations, jewel loan accounts were subjected to detailed scrutiny during the statutory bank audit. During the internship, I actively participated in the verification of jewel loan files to ensure that sanction procedures, valuation mechanisms, documentation standards, custody controls, and monitoring practices were aligned with internal bank policies and regulatory expectations.

The audit of jewel loans was approached from multiple dimensions: borrower documentation, valuation accuracy, compliance with lending norms, authorization controls, physical custody of pledged gold, and post-sanction monitoring.

### **Borrower Documentation and Initial Appraisal**

The verification process commenced with examination of the jewel loan application form. This document serves as the foundational record of the transaction and includes borrower identification details, loan amount requested, purpose of loan (where applicable), description of pledged ornaments, and tenure. During audit, it was ensured that the application form was completely filled, duly signed by the borrower, and supported by required Know Your Customer (KYC) documentation.

Incomplete forms, missing signatures, or inconsistencies between identification documents and application details were treated as audit observations. Proper documentation at this stage is essential because it establishes the contractual relationship between the borrower and the bank and supports enforceability in case of dispute.

In addition, the consent letter executed by the borrower was verified. This letter confirms that the borrower has voluntarily pledged the ornaments and accepts the bank's terms and conditions. Proper execution of this document reduces legal ambiguity and strengthens the bank's right over the pledged asset.

Where applicable, verification extended to reviewing the borrower's source of income and repayment capacity. Although jewel loans are primarily collateral-based, banks still evaluate repayment behaviour and earning capacity to minimize default risk. Documentation often included income proof, photographs of the borrower, and photographs of the pledged ornaments. These records enhance transparency and assist in identification during recovery or dispute resolution.

### **Valuation Mechanism and Appraiser Controls**

The most critical aspect of the jewel loan audit was verification of the gold valuation process. The appraiser plays a central role in determining purity (for example, 22K), net weight after deductions for stones or impurities, and overall quality of the pledged ornaments. The certified valuation directly determines the eligible loan limit.

During audit, the following aspects were examined:

- Presence of the appraiser's signature
- Confirmation that the appraiser was authorized or empaneled
- Accuracy of weight and purity assessment
- Compliance with bank-approved valuation methodology
- Consistency in application of loan-to-value norms

### **Valuation Approaches**

Two principal valuation approaches were observed:

#### **Loan-to-Value (LTV) Ratio Method**

Under this method, the market value of gold is first computed based on prevailing gold prices. The bank then applies a conservative lending percentage, such as 75% of the market value.

For example:

If 40 grams of 22K gold has a market value of ₹5,81,200, Permissible lending at 75% = ₹4,35,900

The borrower may avail up to this limit, but not beyond it. The remaining 25% functions as a margin of safety against gold price volatility and potential recovery costs.

### **Fixed Per Gram Lending Rate Method**

Under this approach, the bank fixes an internal lending rate per gram that is intentionally lower than the prevailing market rate. For example, if the market rate per gram is ₹14,530, the bank may fix its lending value at ₹10,000 per gram.

For 40 grams: Eligible Loan Amount =  $40 \times ₹10,000 = ₹4,00,000$

This conservative internal pricing mechanism acts as a built-in risk mitigation tool, insulating the bank from short-term market fluctuations and ensuring recoverability.

During audit, it was verified whether the branch consistently followed the prescribed valuation method and whether the sanctioned loan amount exceeded permissible limits under either approach. Any deviation in calculation or excessive sanctioning was treated as a significant audit issue.

For high-value jewel loans exceeding ₹5 lakhs, the presence of two independent appraiser signatures was verified. This dual appraisal mechanism reduces the probability of overvaluation and ensures enhanced reliability in high-exposure accounts.

### **Authorization and Sanction Controls**

Beyond valuation, audit procedures included verification of proper sanction authority. Loan files were examined to confirm that the sanctioning officer's signature and official seal were present and that the loan fell within delegated financial powers.

This verification ensures that internal control systems are functioning effectively and prevents unauthorized or irregular lending practices. Absence of proper authorization indicates weaknesses in governance and control.

### **Custody, Locker Management, and Physical Controls**

An essential operational dimension of jewel loan audit involves physical custody verification. Since gold ornaments are tangible and high-value assets, their safe storage is critical.

During the audit, the following were examined:

- Whether pledged gold was stored in designated secure lockers
- Proper labelling and tagging of gold pouches with loan account numbers
- Sealing and packaging standards
- Maintenance of joint custody registers
- Periodic inspection and verification by authorized officers

The adequacy of locker security and dual control mechanisms was reviewed to prevent misappropriation or substitution of pledged ornaments. Proper custody management is essential not only for security but also for maintaining depositor confidence and regulatory compliance.

### **Monitoring, Renewal, and Roll-Over Checks**

The audit also examined whether jewel loans were being improperly rolled over. Roll-over refers to closing and reopening loans without genuine repayment to avoid classification as overdue or non-performing. Such practices distort asset classification and income recognition.

Verification included reviewing repayment history, checking due dates, and confirming whether renewals were supported by fresh valuation where required. This ensured compliance with prudential norms and prevented artificial improvement of asset quality.

### **Risk Assessment and Audit Implications**

Although jewel loans are secured by a liquid asset, they carry specific risks including valuation risk, price fluctuation risk, operational risk, custody risk, and documentation risk. Improper appraisal, weak locker control, or unauthorized sanctioning can expose the bank to financial loss and reputational damage.

Through audit procedures, these risks were assessed and controlled through structured verification of documentation, valuation methodology, authorization hierarchy, and physical security measures.

## **Audit of Working Capital and Business Advances**

### **Introduction**

Apart from jewel loans and retail credit facilities, a substantial portion of the statutory bank audit was dedicated to the verification of working capital and business-related advances. These advances form a critical component of a bank's asset portfolio and generally involve higher exposure amounts, continuous account operations, and dynamic utilization patterns. Unlike fixed-term retail loans, working capital facilities are revolving in nature and directly linked to the operational cycles of businesses. Therefore, they require ongoing supervision, periodic renewal, strict monitoring of security coverage, and careful assessment of financial performance.

During the internship, I was involved in the examination of multiple categories of such advances, including Cash Credit (CC) accounts, book debt-based working capital facilities, Packing Credit Loan (PCLN) accounts extended to exporters, Secured Overdraft (SOD) accounts secured against immovable property, and other open or term loan accounts granted to business entities. Each category of advance differs in structure, risk exposure, documentation requirements, and monitoring mechanisms, and the audit procedures were tailored accordingly.

The verification of working capital and business advances was approached from several perspectives: sanction compliance, operational conduct of accounts, adequacy and validity of security, monitoring of drawing power, renewal discipline, system accuracy, and regulatory adherence.

### **Cash Credit (CC) Accounts**

Cash Credit accounts are among the most commonly used working capital facilities provided to business entities. These facilities are sanctioned to finance day-to-day operational requirements such as procurement of raw materials, payment of wages, maintenance of inventory, and other business expenses. The borrower is permitted to draw funds up to a sanctioned limit, subject to drawing power calculated based on the value of stock and receivables.

During the audit, verification of CC accounts involved examining whether:

- The sanctioned limit was approved by the competent authority in accordance with delegated powers.
- The outstanding balance at any point exceeded the sanctioned limit.
- Any temporary excess was supported by written approval.
- The facility was renewed within the prescribed time frame.
- Financial statements submitted for renewal were recent and duly reviewed.

One of the key observations during the audit was that expired limits or delayed renewals significantly weaken the bank's legal position and may lead to asset classification concerns. Renewal delays indicate deficiencies in credit monitoring and can expose the bank to regulatory and financial risk.

Through this process, I understood that sanctioning a CC facility is only the beginning; continuous supervision and renewal discipline are critical components of working capital risk management.

### **Stock Statements and Drawing Power Calculation**

A fundamental element of working capital lending is the calculation of drawing power based on stock statements and receivable declarations submitted by the borrower. Drawing power determines the maximum amount that can be withdrawn from the sanctioned limit at any given time.

During audit, I was involved in verifying:

- Timely submission of stock statements (usually monthly).
- Review and approval of stock statements by authorized bank officials.
- Application of margin percentage while computing drawing power.
- Exclusion of obsolete, damaged, or non-moving stock.
- Consistency between stock statements and audited financial statements.

In book debt-based facilities, verification also included checking the ageing analysis of receivables to ensure that overdue or doubtful debts were excluded from eligible drawing power. Failure to properly assess receivables may result in over-financing and increased default risk.

This area of audit highlighted how working capital advances rely heavily on accurate reporting by borrowers and vigilant monitoring by bank officials.

### **Book Debt-Based Working Capital Facilities**

Book debt-based advances are extended against the receivables of a business entity. In such facilities, the bank finances a specified percentage of eligible receivables after applying margin requirements.

During the audit, emphasis was placed on:

- Verification of receivable ageing reports.
- Exclusion of receivables older than the permissible period.
- Consistency between receivables declared and actual financial records.
- Regular monitoring of realization patterns.

This verification process demonstrated that quality of receivables is more important than mere quantum, as aged or doubtful debts weaken the security coverage of the bank.

### **Packing Credit Loan (PCLN) Accounts**

Packing Credit Loan accounts are short-term pre-shipment credit facilities extended to exporters for the purchase, processing, and packing of goods before shipment. These facilities are expected to be liquidated upon realization of export proceeds.

During the audit, verification included:

- Examination of export orders or confirmed contracts.
- Compliance with sanction conditions.
- Timely conversion to post-shipment credit where applicable.
- Adjustment of the loan upon realization of export proceeds.
- Monitoring of overdue export bills.

These accounts are sensitive because delays in export realization may lead to classification issues or increased risk exposure. The audit process emphasized strict monitoring and timely adjustment of export-linked advances.

### **Secured Overdraft (SOD) Accounts**

Secured Overdraft accounts, particularly those backed by immovable property, were examined as part of the audit. These facilities allow borrowers to overdraw funds up to a sanctioned limit secured against property.

Verification included:

- Existence and validity of mortgage creation documents.
- Registration and stamping compliance.
- Valuation reports from approved valuers.
- Legal opinion confirming clear and marketable title.
- Timely renewal and review of the facility.

Since these advances involve long-term exposure and legal enforceability risk, deficiencies in documentation or valuation were treated as significant audit observations.

### **Open Loan and Business Term Loan Accounts**

Open loan accounts and business term loans are generally sanctioned for specific business purposes such as machinery purchase, expansion of operations, or capital expenditure.

Audit verification included:

- Comparison of account operations with sanctioned terms.
- Verification of interest rate application.
- Adherence to repayment schedule.
- Monitoring of overdue instalments.
- Adequacy of security documentation.

Any mismatch between sanction terms and actual account conduct was identified and reported.

### **Verification of Charges and System Accuracy**

Across all categories of business advances, the audit included verification of:

- Correct application of interest rates.
- Charging of processing fees and inspection charges.
- Documentation charges and renewal fees.
- Penal interest in case of irregularity.

System-generated interest calculations were cross-verified with sanctioned terms to identify discrepancies. Even minor system errors, when multiplied across several accounts, can result in significant revenue leakage or customer disputes.

### **Risk Perspective and Audit Importance**

Working capital and business advances carry higher operational and credit risk compared to static retail loans. Their dynamic utilization, dependence on borrower declarations, and exposure to market fluctuations require strong internal control systems and vigilant supervision.

Through this audit exposure, I understood that:

- Monitoring of advances is as critical as sanctioning.
- Expired limits and delayed renewals create legal vulnerabilities.
- Drawing power calculations are a key risk control mechanism.
- Weak documentation can severely impact recoverability.
- Auditors play an essential role in identifying weaknesses in credit administration.

### **CONCLUSION**

The audit of the bank provides a comprehensive evaluation of its financial operations, internal controls, and compliance with regulatory requirements. The study highlights that the bank generally maintains proper accounting records and follows established procedures in its day-to-day operations. Internal control systems are largely effective in safeguarding assets, preventing fraud, and ensuring accuracy in financial reporting.

However, certain areas require improvement, such as strengthening risk management practices, enhancing monitoring mechanisms, and ensuring timely reconciliation of accounts. Addressing these gaps will help the bank improve operational efficiency and reduce potential risks.

Overall, the audit confirms that the bank is functioning in a stable and systematic manner, with reasonable assurance of financial reliability. Continuous improvements in internal controls and adherence to regulatory guidelines will further enhance the bank's performance and credibility.

The exposure to bank audits offered valuable insight into the functioning of banking institutions, the importance of regulatory compliance, and the role of auditors in safeguarding public funds. Through verification of loan accounts, documentation, and compliance with regulatory guidelines, I gained a deeper understanding of how risk is identified and managed within banks. The experience also highlighted the importance of structured audit procedures,

professional judgment, and effective communication in ensuring audit quality.

In addition to audit work, exposure to income tax and GST filing provided a broader perspective on professional accounting practice. These experiences helped me understand how statutory compliance is managed across different areas of taxation and reinforced the importance of accuracy, confidentiality, and timeliness in professional work.

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