

Inside the Audit: Part 6 - Borrowings

Objective:-

The objective of auditing borrowings is to ensure that all types of loans are completely recorded, exist as at the reporting date, are accurately measured including interest and related costs, are correctly classified based on their nature, are utilised for approved purposes, and are appropriately disclosed in the financial statements including compliance with CARO reporting requirements.

Identify Types of Borrowings:

Before testing, first understand what type of loan you are auditing.

Common Types of Borrowings in Audit

Type of Loan	Meaning / Purpose	Key Points for Audit Understanding
Term Loans	Long-term loans taken for assets or specific projects	Used for plant, machinery, building, etc.; usually repaid over several years
Cash Credit / Overdraft (CC/OD)	Short-term working capital facility from banks	Balance changes daily; linked to drawing power and limits
Working Capital Loans	Loans taken to finance day-to-day operations	Used for inventory and receivables; generally short-term
Debentures	Loans raised from investors	Can be secured or unsecured; repayment as per redemption terms
Inter-Corporate Borrowings (ICD)	Loans taken from group or other companies	Often related-party in nature; requires proper approvals and disclosure
Foreign Currency Loans (ECB / FC Loans)	Loans taken in foreign currency	Subject to exchange rate fluctuation; exchange differences applicable
Unsecured Loans	Loans without any collateral or security	Commonly taken from promoters or related parties

I. COMMON AUDIT PROCEDURES (APPLICABLE TO ALL TRADE PAYABLES)

A. Understanding of Process & Controls

- Understand how each type of loan is sanctioned.
- Check who approves Term loans, CC/OD limits and ICDs.
- Understand how repayments are tracked.
- Check how interest is calculated for Fixed rate loans and Floating rate loans
- Verify whether loan balances are reconciled with lender statements.

B. Substantive Procedures

1. Existence & Occurrence

For All Loans

- Obtain loan schedule from management.
- Match balances with sanction letters and agreements.
- Obtain external confirmations from lender directly.

Additional Focus

- Term loans - verify disbursement date for the purpose of recognition.
- CC/OD - verify limit sanction and outstanding balance
- ICDs - verify board approval and agreement

2.Completeness

- Verify the bank statements for loan inflows.
- Check CC/OD statements for year-end balances.
- Match confirmations with books.
- Enquire whether loans were taken to support Subsidiaries, Associates and Joint ventures

3.Accuracy & Valuation

Term Loans / ICD / Unsecured Loans

- Recalculate interest using agreement terms.

CC / OD

- Verify interest calculation using bank statements.

Foreign Currency Loans

- Check closing rate conversion.
- Verify exchange difference accounting.

4.Rights & Obligations

- Confirm loan is in company's name.
- Verify security for term loans and debentures
- Check charge registration.
- For ICDs, confirm lender has authority to lend.

5.Cut-off

- Check loan receipts near year end.
- Check repayments made just before and after year end.
- Verify interest accrued till reporting date.

6.Classification & Presentation

Term Loans

- Split current and non-current portions.

CC / OD

- Usually current borrowing.

Debentures

- Classify based on redemption terms.
- Assess impact of default on classification.
- Ensure Schedule III presentation.

7.Covenant & Compliance

- Read covenant clauses for Term loans and Working capital limits
- Check DSCR, debt-equity, turnover conditions.
- Verify compliance certificates.
- Assess whether any breach results in recall of loans, reclassification of liabilities, or additional disclosures.
- Evaluate whether the entity has been classified as a wilful defaulter based on lender confirmations and correspondence.