

BANK AUDIT

PRACTICAL GUIDE FOR STATUTORY BRANCH AUDITORS



CA ATUL AGRAWAL (M. No. 077293)
B.Sc, LL.B., FCA,
Certificate Course on Concurrent Audit of Banks
Founder Partner – AAAM & Co., Chartered Accountants
+91-9990057390 | atul@aaaca.in





BANK

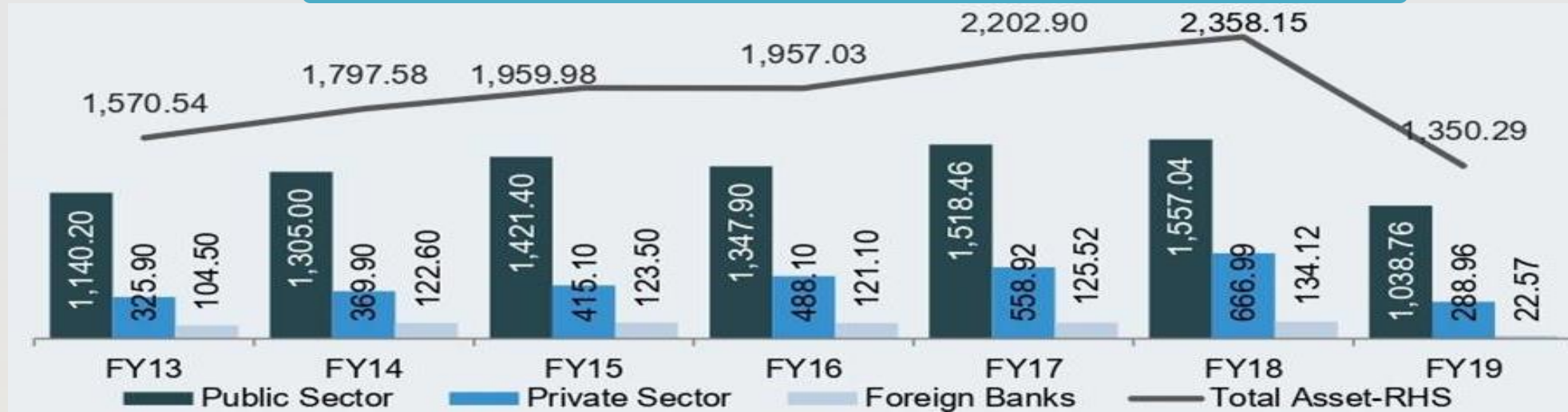
AN OVERVIEW OF THE BANKING INDUSTRY

BANKING

2

TOTAL BANKING SECTOR ASSETS US\$ BILLION

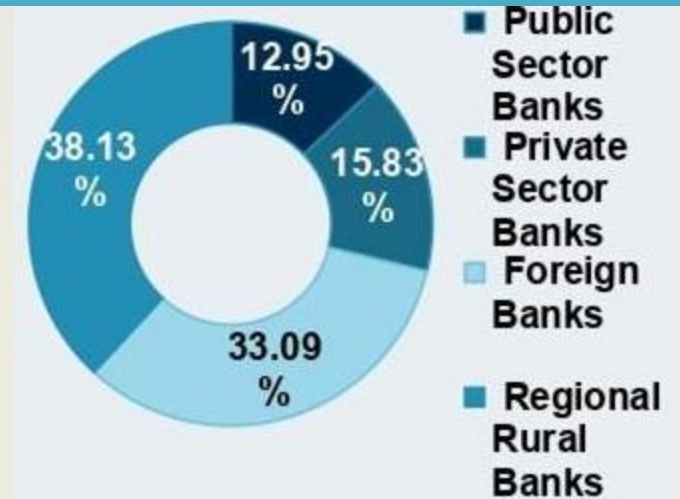
Market Size



Interest Income Growth (US\$ BN)



Breakup Of Banks In India (FY 20)



Sector Composition

Note: Figures given for breakup are exclusive of 1,542 Urban Cooperative Banks and 94,384 Rural Cooperative Banks operational in India.

GROWTH IN CREDIT OFF-TAKE

CAGR 5.76%

1180.19

FY 17

1347.18

FY 18

1400.03

FY 19

1421.48

FY 20**

US \$ Billion

Key Trends

GROWTH IN DEPOSITS

CAGR 11.11%

1599.34

FY 17

1781.12

FY 18

1866.22

FY 19

1875.21

FY 20**

Government Initiatives



**Pradhan Mantri Jan
Dhan Yojana**

**Atal
Pension
Yojana**

Atal Pension Plan



**Pradhan Mantri
Jeevan Jyoti Bima
Yojana**

DIFFERENT TYPES OF BANKING INSTITUTIONS PREVAILING IN INDIA

Commercial Banks

Regional Rural Banks

Co-operative Banks

Development Banks

Foreign Banks

Payment Banks

Small Finance Banks

EXIM Bank

A hand is shown from the right side, holding a glowing rectangular box. The box is light purple and contains the title text. The background is a dark blue gradient with a bright light source behind the box, creating a lens flare effect.

BANK BRANCH AUDIT PLANNING

BIRD'S EYE VIEW

AUDIT PLAN

- ✓ UNDERSTANDING SCOPE
- ✓ TRAINING
- ✓ ROLE MAPING

AUDIT EXECUTION

- ✓ PHYSICAL
- ✓ SYSTEM

REPORTING

- ✓ CERTIFICATION
- ✓ AUDIT REPORT
- ✓ LFAR

DOCUMENTATION

- ✓ WORKING PAPERS
- ✓ RECONCILATION

PRE-COMMENCEMENT OF AUDIT

In the present scenario of Statutory Bank Branch Audit, the most important aspect is proper planning. As they say, well begun is half-done. Documentation of the audit Plan is a must. SBA must have sound and complete knowledge of the business of the Bank.

Auditor needs to study :

Appointment Letter

It is necessary to read the appointment Letter carefully and duly consider all the terms and conditions mentioned therein, that are required to be followed during the process of the audit.

RBI Guidelines and Circulars

SBA must read and study RBI Circulars, master directions, notifications and the Banking Regulation Act, 1949.

Bank's Closing Circular

With appointment letter, Banks also issue closing guidelines. This Circular covers the process and policies followed by Bank. Basic understanding of these circulars is necessary.

Others

SBA also needs to have basic knowledge of allied applicable laws to carry out effective audit. For example, Indian Contract Act 1872, The Bombay Stamp Act 1958, Negotiable Instruments Act 1881 etc.

Steps to be followed for **BANK BRANCH AUDIT**



APPOINTMENT OF AUDITORS



ICAI invites applications from CA's to be empanelled for Bank Audit.



After due verification approved list of CA's is submitted to RBI.



RBI circulates the list to banks for appointment.



Banks confirm with CA Firm about their willingness.



The final list is submitted with RBI by all nationalized Banks.

Auditor

Understanding Business of the Banks



Auditor should understand the nature of activities carried out at branch. Auditor should consider requirements of SA 315 “Identifying and assessing the risks of Material Misstatement through understanding the entity and its environment”.



Newer Banking products are being periodically introduced by the Banking industry; Auditor should have complete knowledge about these products. Auditor should study the financial implication of these products. Types of facilities provided to Borrowers and the Standard Operating Procedures (SOP) should be studied. Authority levels should be understood. Based on features of the products, Auditor should draw up a suitable audit plan to verify the transactions of the activities being provided by the Bank. Risk Assessment is to be carried out based on clear understanding of business profile of the Bank.



Auditor should find out the role and responsibilities of branch officials and the internal controls in operation. Most of the Banks have converted their branches as Customer facing point of Contact and Sales and almost all processing / decision making is centralised. Depending on the functions being carried out at the branch, the auditor should design his audit plans.

P L A N

Plan the audit as per SA 300 "Planning an Audit of Financial Statements".

Document the audit plan prepared.

Conduct preliminary enquiry to know nature, size of bank branch to be audited.

Make overall audit strategy for execution of audit.

Assess the risk involved in branch being audited.

Audit Plan to be prepared as per the nature of transaction executed at the Branch.

Assess resource requirements for audit to be completed in stipulated timelines.

staff to be deployed as per volume, nature of transactions at branch.

Updated knowledge of banking law and regulations and RBI Guidelines.



SA 320

- Auditor should carry out analytical and substantive audit procedures to verify True & fair view of the financial statements.
- Auditor should set materiality level in accordance with SA 320, “Materiality in Planning and Performing an Audit” and carry out substantive audit procedures for all material transactions.



CERTIFICATION

- Various closing forms and certificates are to be certified by statutory auditors. Understanding objective of such forms and certificates is very essential.
- Auditor should read relevant RBI circulars and guidelines before verifying the forms and certificates. Auditor should understand the process followed in making such forms / certificates.



REPORTING

- Final auditor’s report and Long form Audit Report are two documents that are issued by statutory auditor to the bank management.
- During the course of audit, auditor should note down observations which have come across which requires attention of the management and various points need to be reported in Long Form Audit Report.

SA 230

Audit Documentation requires the auditor to duly prepare and maintain audit documentation for an audit of financial statements.

Latest RBI Master Directions/Circulars.

Closing Guidelines/Circulars issued by Bank.

Powers & Responsibilities at various levels.

Policies, Processes and procedures followed.

Financial statements of the previous year and current year.

Trial Balance for the year.

Management Representation Letter.

Audit documentation may be recorded on paper or on electronic or other media.

Various Audit Reports such as Internal inspection report, Concurrent audit reports, previous year statutory audit reports.

Statement of advances with classification along with various fields duly filled such as security, sanction limits, date of sanction/renewal, outstanding balance etc.

Copies of supporting documents that are verified during the audit.

Old outstanding items of assets / liabilities.

Various other documents / evidence considered in audit process.

Other Bank / RBI balance confirmation.

AUDIT IN A CIS ENVIRONMENT

The principal objective of the auditor in undertaking an audit in a CIS environment is to evaluate the effectiveness of controls. There are mainly four types of controls:

❖ DETERRENT CONTROLS

Deterrent Controls are designed to deter people, internal as well as external, from doing undesirable activities.

❖ PREVENTIVE CONTROLS

Preventive Controls prevent the cause of exposure from occurring or at least to minimize the probability of unlawful event taking place.

❖ DETECTIVE CONTROLS

When a cause of exposure has occurred, detective controls report its existence in an effort to arrest the damage further or minimize the extent of damage.

❖ CORRECTIVE CONTROLS

Corrective Controls are designed to recover from a loss situation for example business continuity planning is a corrective measure.

SECURITY CONTROL ASPECTS THAT AN AUDITOR NEEDS TO ADDRESS

- Ensure that authorized, accurate and complete data is made available for processing.
- Ensure that in case of interruption due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records.
- Verify whether “access controls” assigned to the staff-working match with the responsibilities as per manual. It is important for the auditor to ensure that access and authorization rights given to employees are appropriate.
- Verify that segregation of duties is ensured while granting system access to users and that the user activities are monitored by performing an activities log review.
- Verify that changes made in the parameters or user levels are authenticated.
- Verify that charges calculated manually for accounts when function is not regulated through parameters are properly accounted for and authorized.
- Verify that exceptional transaction reports are being authorized and verified on a daily basis by the concerned officials. It is important for auditor to understand the nature of exception and its impact on financials.

EXECUTION OF AUDIT & REPORTING



AN INTRODUCTION TO THE LONG FORM AUDIT REPORT IN CASE OF BANK BRANCHES.

Long form Audit Report (LFAR) is a detailed questionnaire, prepared by RBI and used since 1985 – later revised in 1992-1993 and latest revision was in 2003, w.e.f. 31/3/2003 (Vide circular no. DBS/CO/PP/BC/11.01.005/2001-02 dated 17/4/2002).

It is a vital tool available to auditors through which they can comment on Balance Sheet, Profit & Loss account, Prudential norms, process lapses in operations and other issues relating to Branch Statutory Audit.

COVERAGE OF LFAR

ASSETS

- ✓ CASH BALANCE
- ✓ BALANCE WITH RBI, SBI & OTHER BANKS
- ✓ MONEY AT CALL AND SHORT NOTICE
- ✓ INVESTMENTS
- ✓ ADVANCES
- ✓ OTHER ASSETS

LIABILITIES & OTHERS

- ✓ BORROWING
- ✓ DEPOSITS
- ✓ OTHER LIABILITIES
- ✓ CONTINGENT LIABILITIES
- ✓ BILLS FOR COLLECTION
- ✓ PROFIT & LOSS ACCOUNT

CASH (VERIFICATION)

The primary check for cash is to carry out verification of the balance of cash on hand.

As far as possible, the auditor should visit the branch at the close of the business on the last working day of the year or before the commencement of business on the next day for carrying out the physical verification of cash.

Physical Verification



Besides the physical verification , if there are specific instructions or certifications specific to the bank, the same needs to be complied with.

Specific questions w.r.t cash also need to be addressed in LFAR.

Additional Points



CASH (LFAR REPORTING)

Q1. Does the bank generally carry cash balances, which vary significantly from the limits fixed by the controlling authorities of the Bank ? Whether Excess Balances have been reported to the controlling authorities of the Bank?

A letter received from controlling office to be perused to ascertain the cash retention limit allotted to the branch.

The limits as above to be verified with the daily closing cash balance (including foreign currency) of the Branch.

Q2. Does the branch hold adequate insurance cover for cash-in-hand and cash-in-transit?

Generally, the Branch cash balance has been covered under the Bankers' Indemnity Policy. Hence no action is required at the branch level.

A copy of the policy to be obtained from Branch. In case the insurance is taken by Head Office / Controlling Office, a copy of policy or any correspondence from Head Office / Controlling Office in this regard to be perused.

Q3. Is cash maintained in effective joint custody of two or more officials, as per the instructions of the controlling authorities of the bank?

Joint custody of cash and its evidencing at the branch is very crucial. Many times, documentary evidence shows that the keys are controlled by minimum two officers. However, during the audit, even for the sake of convenience, if auditor observes the custody is not shared, it should trigger the further audit check on the part of the auditor.

CASH (LFAR REPORTING)

Q4. Have the cash balances at the branch been checked at periodic intervals as per the procedure prescribed by the controlling authorities of the bank?

Obtain the copy of the procedure prescribed by the Controlling Authorities and examine the compliance thereof. Ensure that the branch manager has signed the verification reports along with the stamping of dates.

In addition, ascertain, whether the branch is under Concurrent Audit. Generally, the Concurrent Auditors do the Cash verification every month.

Q5. Does the figure of the balance in the branch books in respect of cash with its ATM(s) tally with the amounts of balances with the respective ATMs, based on the year end scrolls generated by the ATMs? If there is any difference, same should be reported.

In respect of ATM operations, banks are centralizing the process of monitoring ATM balance. This division monitors balance as per the books and balance as per ATM machine (commonly termed as Switch balance) and their reconciliation and ensuring timely adjustment of reconciling entries. The auditor should understand the process of monitoring of balance, reconciliation etc. and based on the risk assessment should understand controls in the process and strategy of testing these controls.

BALANCES WITH RBI, SBI AND OTHER BANKS (VERIFICATION)



Examine that no debit for charges or credit for interest is outstanding and all the items which ought to be taken up in the books of accounts for the year have been considered.



Examine that no cheque sent or received in clearing is outstanding.



Examine that all bills or outstanding cheques sent for collection and outstanding as on the closing date have been credited subsequently.



The auditor should examine the large transactions in inter-bank accounts, particularly towards year end to ensure that no transaction have been put through window dressing.



In respect of balances in deposit accounts, original deposit receipts should be examined in addition to confirmatory certificates obtained from banks in respect of outstanding deposits.

BALANCES WITH RBI, SBI AND OTHER BANKS (LFAR REPORTING)

Q1. Were balance confirmation certificates obtained in respect of outstanding balances as at the year-end and whether the aforesaid balances have been reconciled? The nature and extent of differences should be reported.

Balance confirmation certificates obtained in respect of outstanding balances as at the year end.

Obtain the Bank Reconciliation Statement. If the reconciliation is not carried out or carried out incorrectly the same to be reported.

Auditor's observations on the reconciliation statements may be reported in the following manner:

- Cash transactions remaining un-responded (give details)
- Revenue items requiring adjustments/write-off (give details)
- Old outstanding balances remaining unexplained/ unadjusted. (Give details)
- Other Credit and debit entries originated in the statements provided by RBI/other banks, remaining un-responded for more than 15 days

INVESTMENTS

This is looked after by Treasury Department; hence, such types of transactions do not appear in Branch Books. However, the auditor should confirm that no Investments are appearing in the Branch Trial Balance.

If Investments are appearing in the Branch Trial Balance physical verification and reconciliation with the books should be conducted and reported accordingly. Also verify investment balance confirmation of counter party (Investee) with balance appearing in Branch Books.





ADVANCES

INTRODUCTION TO ADVANCES

Lending constitutes a major activity of a bank besides the investment function. The core business of banks is accepting deposits for onward lending. Advances, generally, constitute the largest item on the assets side of the balance sheet of a bank and are major source of its income.

Audit of advances is one of the most important areas covered by auditors in bank audit. It is necessary that auditors have adequate knowledge of the banking industry and its regulations. Auditors must be aware of various functional areas of the bank/branches, its processes, procedures, systems and prevailing internal controls with regard to advances.

Advances generally comprise of:

- a) Money lent by bank to its customers including interest accrued & due;
- b) Debit balances in depositor accounts;
- c) Inter-Bank Participation Certificates



FUND BASED

Fund Based are those where there is an actual transfer of funds from the bank to the borrower.

Examples: Cash credit, term loans, overdraft, bill discounting, export loans etc.

PRIMARY SECURITY

‘Primary Security’ refers to the security offered by the borrower for bank finance or the one against which credit is extended by the bank



ADVANCES

NON FUND BASED

Non Fund Based are those where there is no immediate involvement of transfer of funds from the bank to the borrower.

Examples: Letter of credit, bank guarantees, co-acceptance of bill

COLLATERAL SECURITY

A collateral security is an additional security.

In carrying out audit of advances, auditor is primarily concerned with obtaining evidence about the following:

- ✓ Amounts included in balance sheet in respect of advances 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 recognized in their valuation.
- ✓ Advances are disclosed, classified and described in accordance with regulatory requirements.

The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by:

- ✓ examining validity of the recorded amounts
- ✓ 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;
- ✓ procedure for loan balance confirmations

ADVANCES AUDIT APPROACH AND PROCEDURES

In nutshell, auditor at branch may keep following in mind to plan comprehensive coverage of advances and for selection of sample.

- ☐ Obtain top 10 exposure accounts
- ☐ Obtain the list of stressed accounts
- ☐ Obtain list of restructured accounts
- ☐ Obtain list of unsecured exposures above Rs. 1 Cr
- ☐ Early mortality cases:
 - ☐ List of accounts upgraded during the year or previous years.
 - ☐ List of accounts rated adversely as per Bank's internal ratings.
 - ☐ List of accounts where adverse issues have been noted in previous audits.



BASIS OF SELECTION OF ADVANCE ACCOUNTS

32



All large accounts(2 crores or 5% of the portfolio.



Cases under consideration of Joint Lenders Forum.



NPA accounts upgraded to Standard.



Advances where restructuring proposals/requests are pending for approval/disposal.



Accounts Restructured in earlier years to determine their year-end status as per RBI Norms.



Accounts Restructured in earlier years to determine their year-end classification.



Restructured advances with moratorium of Interest where interest is accrued contrary to RBI norms.



FITL Cases.



Advances accounts where there is initiation of proceedings involving investigation, vigilance, enquiry fraud.



Staff Advances.



BIFR Cases classified as standard.



SSI/SME cases under rehabilitation.



Standard advances litigation.



Central Govt Guaranteed cases which are standard non-performing.



Standard accounts where there is Interest Suspense / Unapplied Interest.



Advances in the list of willful defaulters.



Cases whose one time settlement has been sought and accepted but default in compliance.



Advances subject to re-financing.



Advances comprises of fraud.



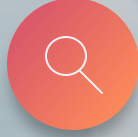
Cases of Flexible Restructuring of Long Term project Loans to Infrastructure & Core Industries - Loan sanctioned after July 15, 2015.



Fresh NPA's identified by the branch.



NPA Cases where assessed realizable value is 50% or more.



NPA Cases where assessed realizable value of security approved by bank . Valuers/ RBI is less than 10 % of Outstanding.



Standard account with deficiencies.



Quick Mortality Cases.



Other Accounts, not covered above.

ADVANCES (LFAR REPORTING)- CREDIT APPRAISAL

In your opinion, has the branch generally complied with the procedures/ instructions of the Controlling Authorities of the bank regarding loan applications, preparation of proposals for grant/ renewal of advances, enhancement of limits, etc., including adequate appraisal documentation in respect thereof.

- ✓ Refer circular issued by Head Office regarding Credit Appraisal.
- ✓ Enquire whether specific facility wise loan application form is prescribed by the Bank.
- ✓ Confirm that the instructions are followed by the Branch while accepting the loan application form.
- ✓ Refer circular issued by Head Office regarding preparation of proposals for grant / renewal of advances, enhancement of limits, etc., including adequate appraisal documentation in respect thereof.
- ✓ While reporting under this clause, auditor should consider the “Early mortality cases” in the branch.

ADVANCES (LFAR REPORTING)-SANCTIONING

In the cases examined by you, have you come across instances of credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch? Are such cases promptly reported to higher authorities?

- ✓ Confirm sanctioning / disbursement discretionary power regarding advances
- ✓ Report the cases where credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch.
- ✓ Whether such type of cases promptly reported to higher authorities.
- ✓ Generally, cases are seen in the branch where the limits of existing borrowers are allowed to be overdrawn for a period beyond permissible time. Such cases should be reported.

ADVANCES (LFAR REPORTING)-DISBURSEMENT

In the cases examined by you, have you come across instances where advances have been disbursed without complying with the terms and conditions of the sanction? If so, give details of such cases.

- Obtain original Title deed, Execution of Documents. Vetting of documents by legal dept./ legal resource.
- Report the cases where advances have been disbursed without complying with the terms and conditions of the sanction letter.

ADVANCES (LFAR REPORTING)-DOCUMENTATION

In the cases examined by you, have you come across instances of credit facilities released by the branch without execution of all the necessary documents? If so, give details of such cases.

- Report the cases where credit facilities released by the branch without execution of all the necessary documents. Physical verification of documents is critical. This is one of the important functions of the branch audit and the reason why branch audit exists.

In respect of advances examined by you, have you come across cases of deficiencies in documentation, non-registration of charges, non-obtaining of guarantees, etc.? If so, give details of such cases.

Report cases of deficiencies in documentation, non-registration of charges, non-obtaining of guarantees, etc.

Make sure that the documents are adequately stamped and also that they are executed within six months of purchasing the stamp paper.

ADVANCES (LFAR REPORTING)-REVIEW

Is the procedure laid down by the Controlling Authorities of the bank, for periodic review of advances including periodic balance confirmation/ acknowledgement of debts, followed by the branch?

- Date / month in which accounts were due for review and the date /month on which the review was done may be obtained.
- It may be noted that there would be cases that are seen performing at the balance sheet date but evidently stressed. Comments on such account with respect to branch efforts on monitoring and information availability on same should be commented upon.
- In view of changes in the reporting requirements in CARO for corporate borrowers, it is necessary for branch auditor to carefully go through the annual reports to ensure that there no adverse comments in the balance sheet of a borrower that affects reporting at the branch level.
- Refer the guidelines issued by Head Office in this regard.

ADVANCES (LFAR REPORTING)-REVIEW

Are the stock / book debt statements and other periodic operational data and financial statements, etc., received regularly from the borrowers and duly scrutinised? Is suitable action taken on the basis of such scrutiny in appropriate cases?

- Borrower wise / month wise record showing receipt of security statement be confirmed.
- Confirm the working of drawing power based thereon.
- Confirm whether these statements are obtained on time.
- Compare movement shown in book debt & creditors with debit/credits in the Bank.

Further, in respect of consortium advance, the drawing power should be determined by the lead bank and circulated to the other member banks as per Circular No. C&I/Circular/2014-15/689 dated 29 September 2014 issued by the Indian Banks Association.

ADVANCES (LFAR REPORTING)-REVIEW

Whether there exists a system of obtaining reports on stock audits periodically? If so, whether the branch has complied with such system?

- Refer the guidelines issued by Head Office in this regard and confirm the compliance thereof.
- Examine the compliances obtained, action taken in cases wherein deficiencies are reported by the stock auditors.
- Obtaining written reverts from the Borrower.
- Whether adverse issues in stock audit reports are duly factored in review / renewal notes.
- Compare with annual accounts for divergences and obtain satisfactory explanations.

ADVANCES (LFAR REPORTING)

Indicate the cases of advances to non-corporate entities with limits beyond Rs.10 lakhs where the branch has not obtained the accounts of borrowers, duly audited under the RBI guidelines with regard to compulsory audit or under any other statute.

- Obtain list of non corporate borrowers enjoying facilities in excess of Rs.10.00 lakhs and report where audited statements are not on record.

Has the inspection or physical verification of securities charged to the Bank been carried out by the branch as per the procedure laid down by the Controlling Authorities of the bank?

- Refer the guidelines issued by Head Office in this regard.
- Reporting deviations if any reasons for the deviations
- A list of such cases is to be given in the following format.

S.N o.	Name of the Borrower	Account Number	Sanction Limit	Last date of inspection or physical verification.

ADVANCES (LFAR REPORTING)

In respect of advances examined by you, have you come across cases of deficiencies in value of securities and inspection thereof or any other adverse features such as frequent/unauthorised overdrawing beyond limits, inadequate insurance coverage, etc.?

- Note down the remarks regarding deficiencies in value of securities and inspection report submitted by the concerned officer.
- Confirm whether Insurance is in favour of Bank.
- Check whether Insurance covers risks the mortgaged securities are subject to – Check adequacy of Insured value and location wise.

In respect of leasing finance activities, has the branch complied with the guidelines issued by the Controlling Authorities of the bank relating to security creation, asset inspection, insurance, etc? Has the branch complied with the accounting norms prescribed by the Controlling Authorities of the bank relating to such leasing activities?

- Refer the guidelines issued by Head Office in this regard.

ADVANCES (LFAR REPORTING)

Are credit card dues recovered promptly?

- Refer the guidelines issued by Head Office in this regard.
- Whether the branch maintains debit balances in the card dues customers.
- Confirm, whether such debit balances are included in advances classification statements.

Has the branch identified and classified advances into standard/substandard/doubtful/ loss assets in line with the norms prescribed by the Reserve Bank of India.

- Refer the guidelines issued by Reserve Bank of India together with Head Office in this regard.
- Wherever, such guidelines are not followed, Memorandum of Changes be given with reasons.
- The branch auditor shall also verify compliance with the guidelines issued by Head Office with regard to identification and classification of loan accounts into special mention accounts and incremental provisioning requirement on account of unhedged foreign current exposures in line with the norms prescribed by the Reserve Bank of India.

ADVANCES (LFAR REPORTING)

Are credit card dues recovered promptly?

- Refer the guidelines issued by Head Office in this regard.
- Whether the branch maintains debit balances in the card dues customers.
- Confirm, whether such debit balances are included in advances classification statements.

Has the branch identified and classified advances into standard/substandard/doubtful/ loss assets in line with the norms prescribed by the Reserve Bank of India.

- Refer the guidelines issued by Reserve Bank of India together with Head Office in this regard.
- Wherever, such guidelines are not followed, Memorandum of Changes be given with reasons.
- The branch auditor shall also verify compliance with the guidelines issued by Head Office with regard to identification and classification of loan accounts into special mention accounts and incremental provisioning requirement on account of unhedged foreign current exposures in line with the norms prescribed by the Reserve Bank of India.

ADVANCES (LFAR REPORTING)

Where the auditor disagrees with the branch classification of advances into standard / sub-standard / doubtful / loss assets, the details of such advances with reasons should be given. Also indicate whether suitable changes have been incorporated / suggested in the Memorandum of Changes.

- Refer the guidelines issued by Reserve Bank of India together with Head Office in this regard.
- Wherever, such guidelines are not followed Memorandum of Changes be given with reason.

Have you come across cases where the relevant Controlling Authority of the bank has authorised legal action for recovery of advances or recalling of advances but no such action was taken by the branch? If so, give details of such cases.

- Wherever, such guidelines are not followed such cases be reported in the following format.

S.No.	Name of the Borrower	Account Number	Sanction Limit	Instructions to take legal action on	Present Status

ADVANCES (LFAR REPORTING)

Have all non-performing advances been promptly reported to the relevant Controlling Authority of the bank? Also state whether any rehabilitation programme in respect of such advances has been undertaken, and if so, the status of such programme.

- Wherever, such guidelines are not followed such cases be reported:

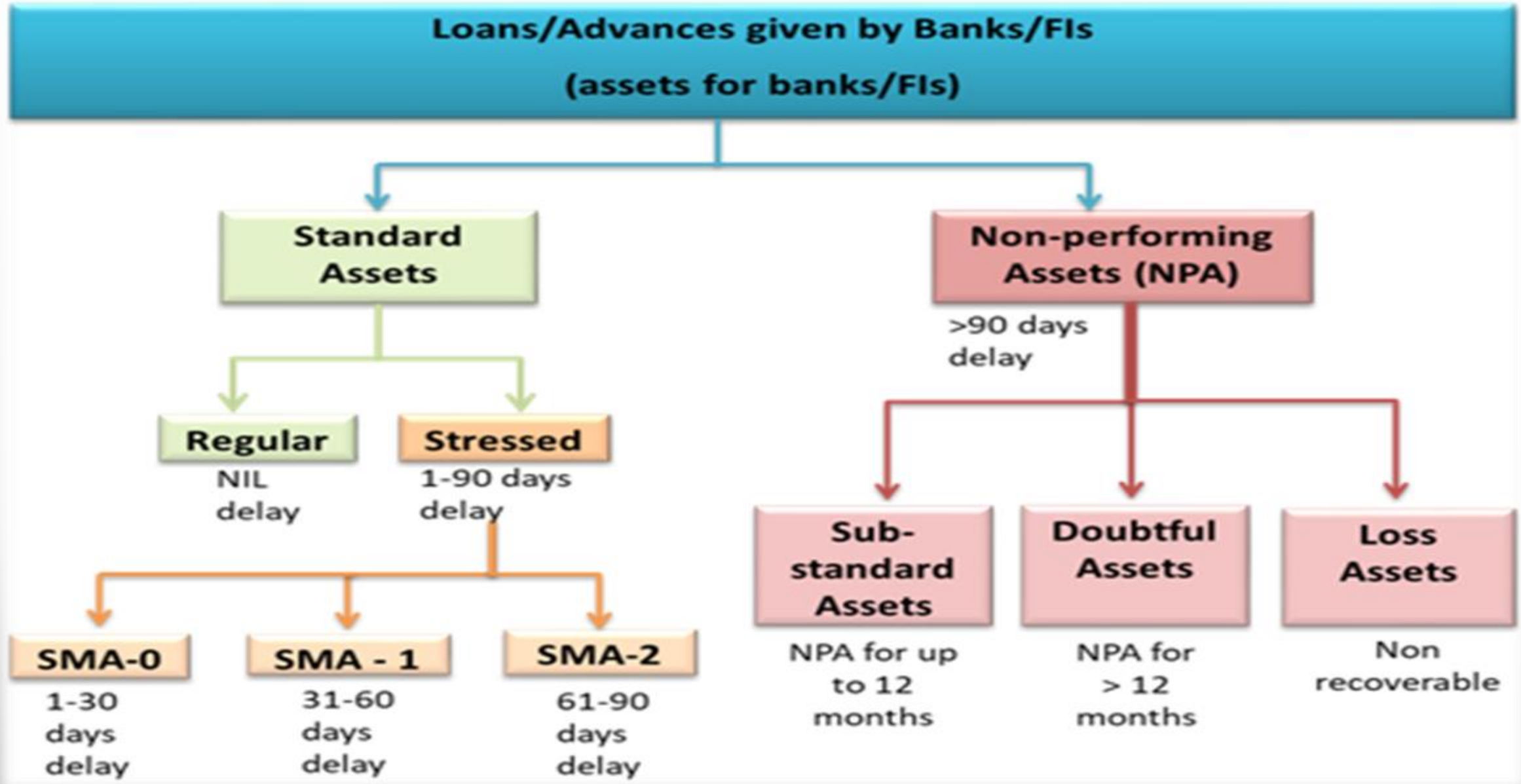
S.No.	Name of the Borrower	Account Number	Sanction Limit	Rehabilitation Programme Sanctioned	Present Status

In respect of non-performing assets, has the branch obtained valuation reports from approved valuers for the fixed assets charged to the bank, once in three years, unless the circumstances warrant a shorter duration?

- Whether valuation is done on a consistent basis – at fair Market value, Realizable value, Distress value –
Whether Fall in Market value has been factored in the valuation

Classification of Bank Advances:

47



Identification of NPA

S.No	Particulars	Time Limit for conversion into NPA
1.	Bill Purchased & Discounted	Exceeding 90 Days
2.	Term Loan	Exceeding 90 Days
3.	Cash Credit/Overdraft	Becomes out of order. No credit in account for cont. 90 days prior to BS date.
4.	Agricultural Advances	Remains Overdue for 2 crop seasons or one crop season**
5.	Securitization Transactions	Exceeding 90 days
6.	Derivative Transactions	Exceeding 90 days
7.	Govt Guaranteed Advances	When Govt repudiates the same/ exceeding 90 days**
8.	Advances to Staff	When default in payment of advances
9.	Take-Out Finance	Prudential Norms to be followed till account remains in bank.
10.	Advances Guaranteed by EXIM Bank	If conditions satisfied for such treatment.
11.	Consortium Advances	When Bank receiving remittances is not parting with share of member bank.
12.	Advances Secured against certain Instruments (NSC, KVP, IVP etc)	Exempt from such provision

Provisioning Norms

TYPE OF ASSET	PROVISIONING PERCENTAGE
Loss Assets	100%
Unsecured Portion of Doubtful Assets	100% of Secured Portion
Doubtful for a period less than 1 Year*	25%
Doubtful for a period more than 1 Year and upto 3 Years*	40%
More than 3 Years*	100%
Sub Standard Asset	15% of Total Outstanding
Unsecured Exposure-Non Infrastructure Advances	An additional Provision of 10%
Unsecured Exposure Infrastructure Advance where safeguards like Escrow Accounts are available	An additional Provision of 5%
Direct Advance to Agricultural and Small and Micro Enterprises (SMES)	0.25%
Advance to Commercial Real Estate (Commercial)	1.00%
Advance to Commercial Real Estate (Residential)	0.75%
Housing Loans during the period of Teaser Rates	2.00%
Housing Loans after period of Teaser Rates	0.40%
Restructured Advances	3.50%
All Other Loans not covered above	0.40%

FIXED ASSETS (VERIFICATION)

In carrying out the audit of fixed assets, the auditor is concerned, primarily, with obtaining evidence about their ownership, existence and valuation. For this purpose, the auditor should review the system of internal controls relating to fixed assets, particularly the following:

- Control over expenditures incurred on fixed assets acquired or self constructed;
- Accountability and utilization controls; and
- Information controls for ensuring availability of reliable information about fixed assets.

The auditor should be careful regarding the date of recording the fixed asset in the books of accounts and commencement of depreciation which should be from the date, the asset is put to use.



FIXED ASSETS

FIXED ASSETS-LFAR REPORTING

Does the branch maintain records of all the fixed assets acquired and held by it irrespective of whether the values thereof and depreciation thereof have been centralised/ where documents of title in relation to branch or other branches are available at the branch, whether the same have been verified. ?

The auditor needs to check the policy of the Bank in this regards. Most of the Banks maintain the records of fixed assets in the CBS. Also the depreciation is mostly taken care at the Head Office. The auditor should carry out the physical verification of the assets and reconcile the same with the details as held in the CBS. For all the assets received from other Branches/ sent from Branch, the supporting documents should be checked and confirmed with the Branch and appropriate changes in the CBS data should be ensured. For purchases made during the year, the relevant invoices should be checked and the amounts and the date of capitalisation along with the classification should be confirmed by the auditor.



FIXED ASSETS

OTHER ASSETS (VERIFICATION)

INTEREST ACCRUED

The main components of this item are interest accrued but not due on investments and advances and interest due but not collected on investments.

The auditor should examine whether the interest has been accrued on the entire loans and advances portfolio of the bank.

TAX PAID IN ADVANCE/TAX DEDUCTED AT SOURCE

The branch auditor needs to examine whether the certificates for such tax deducted at source is collected by the branch and the original copy is sent to the Head Office along with the transfer of such Tax Deducted at Source (TDS) amount to Head Office on periodic basis as defined.

STATIONERY AND STAMPS

Internal controls over stationery of security items (like term deposit receipts, drafts, pay orders, cheque books, traveller's cheques, gift cheques, etc.) assume special significance in the case of banks as their loss or misuse could eventually lead to misappropriation of the most valuable physical asset of a bank, viz., cash.

NON-BANKING ASSETS ACQUIRED IN SATISFACTION OF CLAIMS

The auditor should verify such assets with reference to the relevant documentary evidence, e.g., terms of settlement with the party, order of the Court or the award of arbitration, etc.

OTHERS

Non-Interest Bearing Staff Advances, Security Deposits, Suspense Account, Prepaid Expenses, Miscellaneous Debit Balances on Government Account.

OTHER ASSETS-LFAR REPORTING

Does the system of the Bank ensure adequate internal control over issue and custody of stationery comprising security items (Term Deposit Receipts, Drafts, Pay Orders, Cheque Books, Traveller's Cheques, Gift Cheques, etc.)? Whether the system is being followed by the branch?

- The Head Office instructions to be seen and confirm whether internal control is in existence.
- Carry out the physical verification of security items including stamps.
- Whether lost security items are reported to Controlling Authority.
- Note down the accounting treatment given to Stationery items as every Bank is having different policy in this regard.
- Comment on the usage of security items during the year and the stock of such items vis a vis usage.
- Report lacunas observed in the system at the branch as this is a fraud prone area.



- ❑ The auditor should understand process of new borrowing, repayment of borrowing and test controls around these processes.
- ❑ The auditor should also examine whether a clear distinction has been made between 'rediscount' and 'refinance' for disclosure of the amount under the above head since rediscount does not figure under this head.
- ❑ The auditor should examine whether borrowings of money at call and short notice are properly authorised. The rate of interest paid/payable on, as well as duration of such borrowings should also be examined by the auditor.
- ❑ The auditor should similarly examine the relevant correspondence or other documents to verify whether the branch has been authorised by the head office to borrow/retain other borrowings and that the terms on which borrowings have been made are in accordance with the authorisation.
- ❑ The auditor should examine whether the amount shown in the branch accounts is properly classified based on security or otherwise.

DEPOSITS (VERIFICATION)

Current Accounts

- The auditor should verify the balances in individual accounts on a test check basis and should also examine whether the balances as per subsidiary ledgers tally with the related control accounts in the General Ledger.

Saving Account

- The auditor should also check the calculation of interest on a test check basis. In case of branch under CBS the product sheet for calculation of interest on saving bank account can be obtained in selected sample and can verify the calculation.

Term Deposit

- While evaluating the internal controls over term deposits, the auditor should specifically examine whether the deposit receipts and cash certificates are issued serially and all of them are accounted for in the registers.

Deposits in Foreign Currencies

- Examine whether they have been converted into Indian rupees at the rate notified in this behalf by the head office. The auditor should also examine whether any resultant increase or decrease has been taken to the profit and loss account

DEPOSITS-LFAR REPORTING

Have the Controlling Authorities of the bank laid down any guidelines with respect to conduct and operations of Inoperative Accounts? In the cases examined by you, have you come across instances where the guidelines laid down in this regard have not been followed? If yes, give details thereof. It is necessary that auditor examines whether the bank have a system of identification of dormant/ inoperative accounts and internal controls regarding operations in such accounts?

- Refer the guidelines issued by Head Office in this regard.
- Whether system identifies the inoperative accounts and converts the status of such accounts to inactive.
- Whether branches are transferring inoperative accounts and shown under a separate DEAF Deposits accounts in the branch General Ledger.
- Whether unclaimed liabilities (whether amount due has been transferred to DEAF) is reflected as Contingent Liability.

DEPOSITS-LFAR REPORTING

After the balance sheet date and till the date of audit, whether there have been any unusual large movements (whether increase or decrease) in the aggregate deposits held at the year-end? If so, obtain the clarifications from the Management and give your comments thereon.

- Compare the aggregate deposits as on 15th March, 20XX, 31st March, 20XX and last day of audit.
- Ascertain the reason for large variation other than due to application of interest / provision as on 31st March, 20XX.
- Ensure there is no ever greening.

Are there any overdue/ matured term deposits at the end of the year? If so, amounts thereof should be indicated.

- Refer the guidelines issued by Head Office in this regard.
- Whether interest is provided on matured deposit as per RBI guidelines.

OTHER LIABILITIES - VERIFICATION

Bills Payable

- The important aspect to look for in Bills Payable is ; whether there are material movements in the older balances. The reasonableness of such transactions must be verified.

Inter-Office Adjustments

- The auditor needs to scrutinize the old credit entries and check the nature of such entries and confirm whether the same should remain in the books or should be transferred to head office.

Interest Accrued

- Interest due and payable and interest accrued but not due on deposits and borrowings are to be shown under this head.

Others (including Provisions)

- At Branch level this would include only the expense provisions at the branch.

OTHER LIABILITIES – LFAR REPORTING

The number of items and the aggregate amount of old outstanding items pending for three years or more may be obtained from the Branch and reported under appropriate heads. Does the scrutiny of the accounts under various sub-heads reveal old balances? If so, give details in the following format:

As mentioned above, the balances under this head are susceptible to higher risks if movement in the old balances is seen. The auditor will ensure the transactions are genuine

The number of items and the aggregate amount of old outstanding items pending for one year or more be obtained from the Branch and reported under appropriate heads. Auditor shall maintain the details thereof in following format.

Year	No. of Items	Amount (Rs.)	Remarks

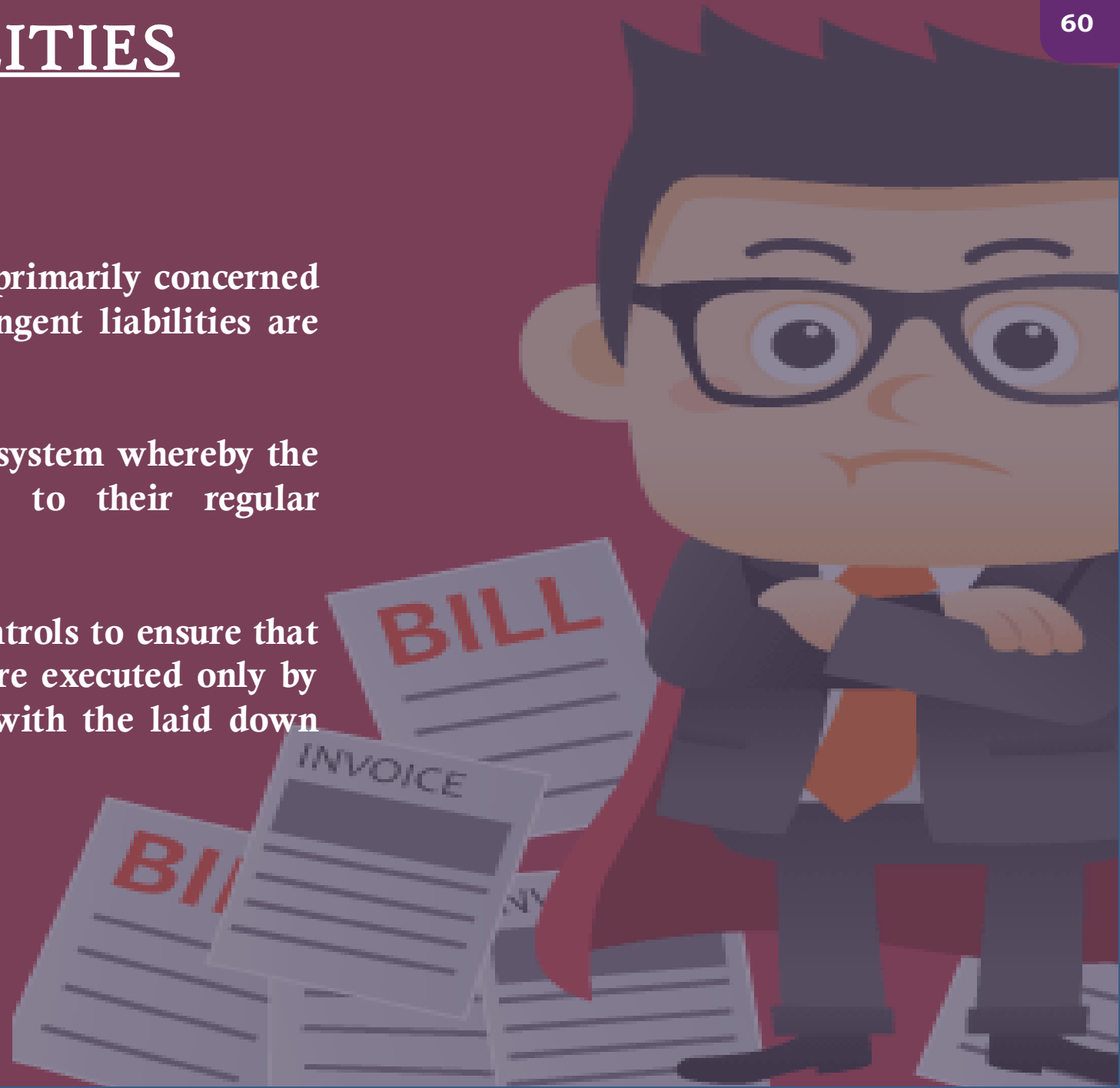
CONTINGENT LIABILITIES

60

In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified, accounted and properly valued.

The auditor should verify whether there exists a system whereby the non fund based facilities are extended only to their regular constituents, etc.

Ascertain whether there are adequate internal controls to ensure that transactions giving rise to contingent liabilities are executed only by persons authorized to do so and in accordance with the laid down procedures.



BILLS FOR COLLECTION

- ✓ Examine whether the bills drawn on other branches of the bank are not included in bills for collection.
- ✓ Examine collections made subsequent to the date of the balance sheet to obtain further evidence about the existence and completeness of bills for collection.
- ✓ Examine the procedure for crediting the party on whose behalf the bill has been collected.
- ✓ The commission of the branch becomes due only when the bill has been collected. accordingly, examine that there exists adequate internal control system that debits the customer's account with the amount of bank's commission as soon as a bill collected is credited to the customer's account.



I N T E R E S T

Interest/Discount on Advances/Bills

- This includes interest and discount on all types of loans and advances purchased and discounted, overdue and penal interest and interest subsidy if any relating to such advances/bills.

Interest Income on Investments

- This will be generally dealt by treasury so branch will not have any income under this head.

Interest on Balances with RBI and Other Inter-Bank Funds

- This will be generally dealt by treasury so branch will not have any income under this head.

Others

- This includes any other interest/discount not included in the above heads. Interest on advances given by the bank to staff members in its capacity as employer rather than as banker.

E A R N E D

FRAUD DETECTION

TYPES OF FRAUD IN BANKING SYSTEM

- ✓ Account Opening Fraud
- ✓ Cheque Kitting
- ✓ Cheque Fraud
- ✓ Counterfeit Securities
- ✓ Digital Fraud
- ✓ Loan Fraud
- ✓ Money Laundering Fraud

ROLES & RESPONSIBILITIES OF THE AUDITOR

Branch Auditor's primary objective is to opine on true and fair view of branch financial statements. The audit process needs to confirm compliance with standards on auditing issued by the Institute of Chartered Accountants of India (ICAI). Specific to the area concerning fraud, as laid down in SA-240, the auditor has responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements taken as a whole are free of material misstatement, whether caused by error or fraud. SA 240 requires auditor to perform procedures with objectives of:-

- ✓ To identify and assess the risks of material misstatement in the financial statements due to fraud;
- ✓ To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- ✓ To respond appropriately to identified or suspected fraud.

While reporting on fraud in LFAR, the Statutory Branch Auditor has to provide appropriate responses to identified or suspected fraud

Suggested audit approach and procedures to be performed are as follows:

- Based on review of advances consider whether the branch is having an effective credit monitoring for its Advances portfolio.
- Obtain internal circulars of the bank pertaining to fraud identification and reporting.
- Examine whether the branch has an adequate system in place to identify Early Warning Signals (EWS) of incipient sickness / fraudulent activities in respect of loans within shortest possible time.
- Obtain and review reports of internal auditor, concurrent auditor, internal inspector, revenue audit, system audit and vigilance functions and assess existence of any of the early warning signals (EWS).
- If any of the aforesaid reports are pointing out existence of early warning signals in any of the accounts, conduct further enquiries with the branch to assess the branch has taken appropriate action and current status thereof.
- Enquire about any fraud reported to Controlling Authority/vigilance department, Head Office during the financial year and current status thereof.
- Whether frauds are examined from staff angle and, wherever necessary, the cases are reported to the Vigilance Cell for further action.
- Whether Preventive/punitive steps have been taken by the bank during the year to reduce/minimise the incidence of frauds.
- Whether frauds have taken place because of laxity in following the systems and procedures and, if so, whether effective action has been taken to ensure that the systems and procedures are scrupulously followed by the staff concerned.
- Whether frauds are reported to local Police or CBI, as the case may be, for investigation, as per the guidelines issued in this regard to public sector banks by Government of India.
- Whether adequate provision for fraud has been done.

CERTAIN CASES WHERE FRAUDS HAD SHOWN OCCURRENCE OR INCREASING TREND IN BANKS

The Reserve Bank of India, based on the findings from certain forensic scrutinizes conducted by it, vide its Circular No. DBS. CO.FrMC.BC.No.10/23.04.001/2010-11 date 31st May 2011, had identified certain areas wherein frauds had shown occurrence or increasing trend in banks. These areas include:-

- Loans and advances against hypothecation of stock
- Housing loan cases
- Submission of forged documents including letters of credit
- Escalation of overall cost of the property to obtain higher loan amount
- Over valuation of mortgaged properties at the time of sanction
- Grant of loans against forged FDRs
- Over-invoicing of export bills resulting in concessional bank finance, exemptions from various duties, etc.
- Frauds stemming from housekeeping deficiencies.

CORE BANKING SOLUTIONS



WHAT IS A CORE BANKING SOLUTION?

Core Banking Solution (CBS) is networking of bank branches, which allows customers to manage their accounts, and use various banking facilities from any part of the world.

In simple term, there is no need to visit your own branch to do banking transactions. You can do it from any location, any time. You can enjoy banking services from any branch of the bank which is on CBS network regardless of branch you have opened your account.

For the bank which implements CBS, the customer becomes the bank's customer instead of customer of particular branch.

Execution of Core banking system across all branches helps to speed up most of the common transactions of bank and customer. In Core banking, the all branches access banking applications from centralized server which is hosted in secured datacenter.

Banking software/application performs basic operations like maintaining transactions, balance of withdrawal & payment, interest calculations on deposits & loans etc. This banking applications are deployed on centralized server & can be accessed using internet from any location.

AN OVERVIEW OF FINACLE FOR AUDITING AND RISK MANAGEMENT

WHAT IS FINNACLE?

- Finacle is a banking solution built by the Indian Corporation, Infosys to provide core banking solutions and promote a growth of the e-banking facilities. It was first launched in the year 1999. It was used for the very first time by the State Bank of India to bring an overall change in its structure of E-Banking. It was built under the leadership of Sharad Hedge.
- Finacle services allow bank to reduce the cost of maintaining the database by downsizing the data centres into one.
- The products of Finacle make global banking easier by bringing them to a single platform instead of maintaining scattered database.
- The banks can adopt the Finacle services to meet the increasing needs of digital and cloud banking facilities
- The platform ensures that the banks are able enough to keep up with the rapid changing demand regarding the banking systems of the customers.
- With the reduction of the burden of application and infrastructure the banks will now be able to focus on the development and innovations.

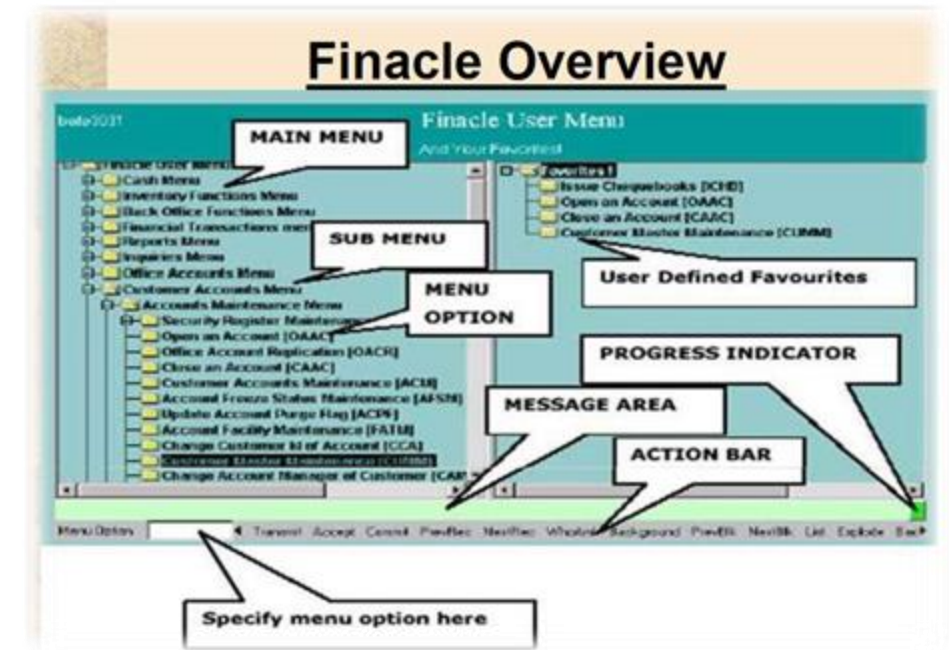
FINNACLE COMMANDS FOR AUDITORS

Transaction – Menu Options

HTI	Transaction Enquiry
HFTI	Financial Transaction Enquiry
HFTR	Financial Transaction Report
HABI	Balance Enquiry
CNSTRP	Transactions Report
HCCI	Outward Cheque Inquiry

Interest Enquiries – Menu Options

HAITINQ	Account Interest Enquiry
HFTI	Financial Transaction Enquiry
HFTR	Financial Transaction Report
HABI	Balance Enquiry



FINNACLE COMMANDS FOR AUDITORS



Savings Accounts – Menu Options

CATREP	Accounts Transfer Report
CCHQREP	Cheque Report Generation
CMITMA	Minor to Major Report
CRVACC	Dormant Accounts Revived Report
CSIREP	Silent Account Report
HAFSM	Account Freeze/ Unfreeze

Loan Accounts – Menu Options

HLAOPI	Loans Overdue Position Enquiry
HLAPOSR	Loan Collection & Position Report
HCULA	Loan Accounts of Customer Reports
HCLL	Collateral Look Report
HLNGI	Loan General Report
HLACLI	Ledger Enquiry

Effect of RBI Relaxation due to COVID-19 on Advances

To cope up with the COVID-19 outbreak, RBI vide its press release dated March 27, 2020, introduced certain developments and regulatory policies to address the stress in financial conditions caused by COVID-19.

All commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, all-India Financial Institutions, and NBFCs (including housing finance companies and micro-finance institutions) (“lending institutions”) are being permitted to allow a moratorium of three months on payment of installments in respect of all term loans outstanding as on March 1, 2020. Accordingly, the repayment schedule and all subsequent due dates, as also the tenor for such loans, may be shifted across the board by three months

In respect of working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions are being permitted to allow a deferment of three months on payment of interest in respect of all such facilities outstanding as on March 1, 2020. The accumulated interest for the period will be paid after the expiry of the deferment period

Due to this relaxation, at the time of confirming the Loans and Advances as Non-Performing Assets the position of accounts shall be taken as on 01st March, 2020. In case, as on 1st March, 2020, the Account is standard, the same will be considered as Standard and not NPA.

Thank You

CA ATUL AGRAWAL (M. No. 077293)
B.Sc, LL.B., FCA,
Certificate Course on Concurrent Audit of Banks
Founder Partner
AAAM & Co., Chartered Accountants
+91-9990057390 | atul@aaaca.in

