

BANK BRANCH AUDIT

Critical Aspects

Kottayam Branch of SIRC of ICAI
25th March 2023

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Introduction

- ▶ An annual Audit Process
- ▶ Empanelment by RBI through ICAI
- ▶ Appointment by Respective Banks from the list sent by RBI
- ▶ Governed by RBI Circulars - **RBI/2022-23/15**
DOR.STR.REC.4/21.04.048/2022-23 dated April 01, 2022- **Master circular for Prudential norms**
- ▶ Guided by ICAI through Guidance Note

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Reports & Certificates

- Regular Audit Report
- Long Form Audit Report
- Tax Audit Report – If applicable
- Various Certificates such as IRAC Norms, Capital Adequacy, Ghosh & Jilani Committee

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Criticality

- Onerous task
- Huge responsibility
- Limited time available
- Shortage of trained manpower



Resultant Need
Proper **Planning** & approach

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Critical areas of audit

- Advances - Process
- Advances – Classification
- Non funded Limits
- Other Assets & Liabilities
- Financial Statements
- Certifications
- Information Technology
- Controls

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PLAN FOR THE AUDIT

- ▶ Branch profiling
 - Obtain a facility wise break up of advance portfolio of the branch along with No. of accounts [Portfolio of advances.pdf](#)
 - Send a questionnaire calling for important details from the branch
- Carry out certain analytical review with data obtained
- Prepare a detailed audit checklist
- Timing – Start Date / End Date
- Manpower – Formation of team and training
- Working paper management

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Program

- Audit program should cover all the areas under liabilities, assets, income, expenditure and off Balance sheet items – specially in view of PNB Fraud
- Special emphasis on verification of advances, income recognition and provisions to be made
- Carry out a compliance test of internal controls
- Identify areas of weakness
- Prepare plans for substantive testing

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Areas that require full check

- Verification of Balance Sheet and Profit & Loss account
- Verification of all closing returns with the ledgers and registers
- Verification of all large advances granted during the year
- Verification of all large NPA advances

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ADVANCES - Critical segments

- IRAC Norms – classification and verification
- LFAR – Reporting of deficiencies
- Asset Classification – MOC where discrepancies are there
- NPAs – Intensive monitoring
- Non Fund Based Limits – Expired and defaulted items
- Certifications – As required by banks

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Advances - Critical areas

- Agri Loans – KCC/STL/LTL
 - Crop Seasons & Natural disasters - rephasements
- Jewel Loans – Agri & Non Agri
- Personal segment loans
 - Housing
 - Education
 - Consumer Loans
- SME Segment Loans
- Mortgage Loans
- Unorganised sector advances

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IRAC NORMS - Critical areas

- Generally 90 days norms applicable for all advances including Government Guaranteed Accounts
- Agricultural Advances – Based on Crop Seasons
 - Guidance Note issued by ICAI very useful for classification and recognition
- Other Significant factors :
 - Stock Statements more than 3 months old
 - Limits not renewed for more than 180 days
 - Solitary or few credits in the account
- Restructuring / Rescheduling – Any alteration of sanction terms
- Covid Relief circulars – Irrelevant for current year
- RBI circular dated 12.11.2021 – very critical

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Prudential norms on IRAC and Provisioning pertaining to Advances - Clarifications

RBI/2021-2022/125 DOR.STR.REC.68/21.04.048/2021-22 Nov12, 2021

- ▶ A. Specification of due date/repayment date
- ▶ B. Flagging of SMA & NPA
- ▶ C. Clarification regarding definition of 'out of order'
- ▶ D. NPA classification in case of interest payments
- ▶ E. Upgradation of accounts classified as NPAs
- ▶ F. Income recognition policy for loans with moratorium on payment of interest

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A. Specification of due date/ repayment date

- The **exact due dates** for repayment of a loan, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. shall be clearly specified in the loan agreement.
- ☞ In cases of loan facilities with moratorium on payment of principal and/or interest, the exact date of commencement of repayment shall also be specified in the loan agreements.
- ☞ Compliance at the earliest, but not later than December 31, 2021, in respect of fresh loans.
- ☞ In case of existing loans, however, compliance to these instructions shall necessarily be ensured as and when such loans become due for renewal/review.

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B. Flagging of SMA & NPA

- ☞ Borrower accounts shall be flagged as overdue by the lending institutions as part of their day-end processes for the due date, irrespective of the time of running such processes.
- ☞ The **exact due dates** for repayment of a loan, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc. shall be clearly specified in the loan agreement.
- ☞ Classification of borrower accounts as SMA as well as NPA shall be done as part of day-end process for the relevant date and the SMA or NPA classification date shall be the calendar date for which the day end process is run. In other words, the date of SMA/NPA shall reflect the asset classification status of an account at the day-end of that calendar date. (Para 8.4)

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C. Clarification regarding definition of 'out of order'

- *Covering cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power*
- *The balance o/s is within the limit/DP, but there are no credits continuously for 90 days ~~as on the date of the Balance sheet~~*
- *or the credits are inadequate to cover the interest debited during the ~~same period~~ previous 90 days period.*

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D. NPA classification in case of interest payments

- ✿ *In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days **from the end of the quarter.** (Para 2.1.3 of Master circular dated Oct 01, 2021)*

CHANGED TO

- ✿ *In case of interest payments in respect of term loans, an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days.*

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E. Upgradation of accounts classified as NPAs

- ☼ it is clarified that loan accounts classified as NPAs may be upgraded as 'standard' asset only if **entire arrears of interest and principal** are paid by the borrower.
(Ref GN page 429 para 11.136 - Para 4.2.5 of RBI master circular)
- ☼ With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of date of commencement of commercial operations (DCCO), etc., the instructions as specified for such cases shall continue to be applicable.

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F. Income recognition policy for loans with moratorium on payment of interest

- ☼ Loans where moratorium has been granted for repayment of interest, lending institutions may recognize interest income on accrual basis for accounts which continue to be classified as 'standard'.
- ☼ However loans with moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest corresponding to the interest accrued during such moratorium period need not be reversed.

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Extent of verification - LFAR

Selection of samples – depends on existence and efficacy of internal control procedures and report from various auditors

Concurrent auditors report is important

Large advances are those in respect of which the outstanding amount is in excess of:
10% of the aggregate advances (**both FB & NFB**) of the branch (**or**)
Rs. **10 crores**, whichever is less

If monitoring not good or high irregularities or an extensive problem is identified, percentage of check should be increased.

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Advances verification - Critical areas

- Credit appraisal
- Sanction & Documentation
- Disbursement
- Review & supervision
- Monitoring

Have a Checklist for large and other advances ***

[Large Advances.pdf](#)

[Other Advances checklist.pdf](#)

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Pre-disbursement Appraisal

- ▶ Application from borrower
- ▶ KYC compliance
- ▶ Timely preparation of proposal for grant, renewal, enhancement or rephasing of loans
- ▶ Appraisal carried out in the prescribed manner e.g. CMA data. Turnover, MPBF
- ▶ Past dealings with / of the borrower
- ▶ Board Resolution
- ▶ Financial statements, tax assessments, visit report by branch etc.
- ▶ Credit reports especially in take over cases

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Pre-disbursement Appraisal

- ▶ Verify appraisal note of the bank – competent authority
- ▶ Whether projections are realistic
- ▶ Net worth Statement of borrower
- ▶ NOC from existing banker
- ▶ Adequacy of the security
- ▶ Ratios are satisfactory

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LFAR Questions on Credit Appraisal

- ▶ Has the branch generally complied with the procedures / instructions of the controlling authorities of the bank. What, in your opinion, are the major shortcomings in credit appraisal, etc
- ▶ Have you come across cases of quick mortality in accounts?
- ▶ Whether in borrowal accounts the applicable interest rate is **correctly fed** into the system?
- ▶ Whether the interest rate is reviewed periodically?
- ▶ Have you come across cases of frequent renewal / rollover of short-term loans?
- ▶ Whether **correct and valid** credit rating has been fed into the system?

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Sanctioning & documentation

- ▶ Within delegated powers
- ▶ Disbursement shall be in line with the terms of sanction
- ▶ All charges are collected
- ▶ Execute all documents as envisaged in the Sanction letter / legal report
- ▶ ICAI guidance note gives a detailed check list
- ▶ List out the deficiencies in documentation account wise in LFAR
- ▶ Additional Documentation in respect of Consortium Advances as per agreement
- ▶ Ensure lien is marked on deposits
- ▶ Verify margin money to be brought by borrower
- ▶ Charges created and filed with RoC

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Documentation & disbursement

Ensure all documents as per sanction letter are executed:

- DPN
- Docs for hypothecation/ pledge/ mortgage
- Letter of guarantee
- Titles of immovable property
- Stamping of documents
- Insurance of movable and immovable property
- Endorsing insurance in bank's favour

Disbursement to be done as per agreed terms. Eg: Housing Loan

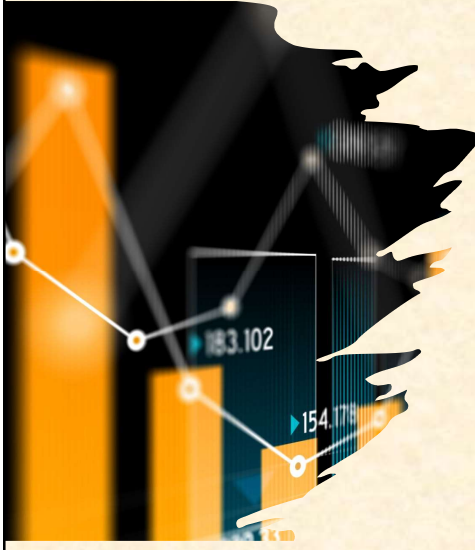
Disbursement to the third party (eg: Housing Loan/ Vehicle Loan)

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Review and Monitoring

- ▶ Most important stage
- ▶ *Any transaction susceptible to fraudulent transaction to be reported to RBI directly*
- ▶ Periodic review of operations
- ▶ Justify the end use
- ▶ Prompt reporting
- ▶ Exchange of information on consortium advances
- ▶ Renewal of WC limits every year
- ▶ Periodically obtaining financial statements, stock statements, etc and compare with the projections trend

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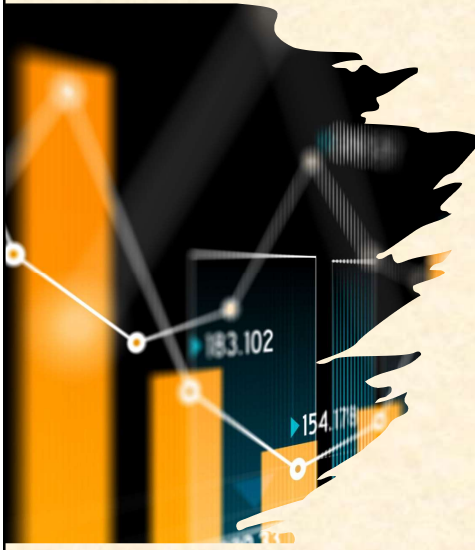


Review and Monitoring

- ▶ Intelligent scrutiny of bank statement/ debit-credit entries, withdrawals & deposits/ transfers to other accounts/ transfers to personal accounts
- ▶ Comparison of movement of stock/ book debts monthly with stock statements
- ▶ Many banks insist that book debts statement be certified by CA on a quarterly basis
- ▶ Verify if stock includes unpaid stock (represented by S.Crs), stock under L/C or stock under PC – to deducted while computing DP Limit

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Review and Monitoring

- ▶ Maintenance of sufficient margin
- ▶ Ensure stock is not obsolete/ unrealizable
- ▶ Physical verification of the security provided
- ▶ NCE with sanctioned limits above Rs 25 lakhs, compulsory audit
- ▶ Interest and other charges collected on time
- ▶ Any irregularity
- ▶ Accounts overdue for renewal between 3 and 6 months and over 6 months
- ▶ **Financial statements and Audit Report to be verified in detail for revised Schedule III and CARO 2020**

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Review and Monitoring of NPA

- ▶ Timely recovery of all dues including credit card dues
- ▶ Whether legal action taken for recovery, wherever authorised/necessary. Eg. Sarfaesi, DRT, NCLT, IBC
- ▶ Whether NPAs are promptly reported to the controlling office
- ▶ Whether any re-habilitation done with respect to NPAs
- ▶ Whether OTS schemes are executed as per control office guidelines. Auditor to report cases above Rs. 50 lakhs in LFAR

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LFAR Questions on Review and Monitoring

-  Procedure laid down for periodic review/ balance confirmation followed by the branch?
-  Are stock and book debts statement received regularly from the borrowers?
-  Is there a system of obtaining stock audit reports periodically?
-  Advances given to NCE beyond limits without obtaining audited accounts of borrowers?
-  Due diligence report for consortium advances?
-  Physical verification of securities charged to bank carried out? Any substantial deterioration in value?
-  Comment on adverse features considered significant in top 5 standard large advances and which need management's attention
-  Red Flagged Accounts - reporting

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Indicators of frauds/ irregular accounts



- Major borrowers constitute 50% to 75% of the borrowings Bank does not pursue recovery of overdue bills
- Stock statements not received in time and yet drawing power limit is continued/ renewed
- On verification of CC a/cs/ OD a/c and bills a/c:
 - ✓ Account is continuously overdrawn
 - ✓ Cheques bounced due to insufficient funds
 - ✓ Cheques deposited not honored and returned unpaid
 - ✓ 12 month's turnover not commensurate with the sale and purchase shown in 12 monthly statements
 - ✓ Realization of bills purchased/ bills discounted not received on due date & cleared by debit to the borrower's CC/OD a/c
 - ✓ All overdue CC limits, OD limits, unrealized bills, unrealized interest bundled together and granted WCTL to avoid NPA.

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Indicators of frauds/ irregular accounts



- Stock statements not submitted on time
- Item wise details not given, lumpsum figure given without quantitative details
- Compare statements over a period of time – same sheet with just period changed
- Unpaid stock not deducted for computing DP limit
- Stock includes items financed by the Bank under PC or LC or others
- Huge difference in annual stock statement and monthly statements
- Unusually high value stock in transit not commensurate with purchase statement
- Branch not obtained stock audit report
- Stock Audit report with adverse comments not considered by Bank
- Book debts ageing shows recoverable beyond 6 months
- Search Report from Registrar's office not obtained
- Branch not obtained NOC from builder

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Renewal or Enhancement

- ▶ Generally renewed end of one year
- ▶ Nonrenewal can make account NPA
- ▶ Necessary documents required for realignment or enhancement
- ▶ Auditors to ensure Realignment or restructuring done as per RBI Norms
- ▶ To avoid docs from becoming time-barred, banks obtain LAD or ADS (Letter of Acknowledgment of Debt and Securities) or Balance Confirmation Certificate

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Asset Classification

- ▶ Classification through computer system, without manual intervention – to be commented
- ▶ Classification according to IRAC Norms - SMA-0, 1, 2
- ▶ Downgraded or upgraded Accounts with outstanding more than Rs.10 crores to be listed with reason
- ▶ Restructured/Rephased accounts – reporting to authorities/RBI guidelines/regulatory stance to be verified and reported

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Asset Classification

- ▶ Upgradations according to norms ?!
- ▶ Disagreement to be reported
- ▶ Accounts where IBC process mandated not initiated to be reported
- ▶ Accounts where IBC process by other creditors include the bank ? – To be listed and comment of provisioning – Highly difficult to assert
- ▶ **SUIT FILED ACCOUNTS – ASSERTIONS**
 - ▶ Branch promptness in ensuring decree execution – Age wise analysis to give
 - ▶ Concluded cases – recoveries appropriation
- ▶ Documents held at Centralized processing Centres – Auditors to assert receiving of documents to their satisfaction

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LFAR Questions on Asset Classification

- ▶ Branch has identified advances into categories?
- ▶ Classification in line with RBI norms?
- ▶ SMA-0, 1 and 2 classified? Any disagreement with branch by auditor
- ▶ Changes incorporated in MOC?
- ▶ A/c > 10 crores downgraded or upgraded
- ▶ IRAC followed?
- ▶ A/cs restructured or rephased reported?
- ▶ **IBC initiation**
- ▶ Valuation reports for immovable properties?
- ▶ **CPC- documents received?**

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Advances verification

- Delegated powers
- Banks advance manual, circulars, guidelines, etc.
- RBI Guidelines on lending
- Borrowers proposal and respective credit file
- RBI inspection report, concurrent audit report, inspection report & watch list (SMA) – LFAR needs specific reporting including Listing of reports verified

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Audit Techniques

- Review all exception reports
- Obtain an overall understanding of the CBS system in operation at the branch.
- Check whether the key controls are under dual operation

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Audit Techniques

- Obtain the data files required for review in .txt or .sdf format or excel
- Account review can be done offsite by opening the data files with MS Excel
- Use SQL (Structured Query Language) to query the database and obtain the required reports
- Audit Module of CBS environment gives lot of audit features – explore and utilise

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Compiling the Report

- Short form – expressing an opinion on the financial statements of the branch
- Long Form Audit Report (LFAR)
- Tax Audit Report – If applicable
- Certificates
- Discuss the report with the branch management
- Avoid vague & general comments
- A “YES/NO/NA” answer in LFAR will not suffice.
Give full details.

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UDIN MANDATORY - ICAI

- ▶ In addition to the membership number and FRN No, the signatory must generate UDIN and display in the audit report/certificates.
- ▶ UDIN has to be generated per Assignment per Signatory.
- ▶ In Bank Branch Audit, One Branch is one assignment, hence, one UDIN for all certificates will suffice.
- ▶ Care should be taken that a list of all certificates bearing same UDIN should be compiled and handed over to management under a covering letter so that the UDIN generated cannot be misused by affixing on any other certificate which has not been signed by you.

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UDIN MANDATORY - ICAI

- ▶ In Bank Branch Audit, separate UDIN has to be taken for Tax Audit.
- ▶ While generating one UDIN for all the Certificates, some common figures /parameters should be given in 3 mandatory fields and if no common figure is there then name of the Bank and Branch, Advances, Deposits etc must be the one common field which can be correlated with all the certificates.

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Examples of Bank Branch Audit Documentation

- ❖ Audit Plan
- ❖ Audit programmes
- ❖ Checklists for LFAR, Advances, NPA verification, Tax audit, Certifications, etc. (www.casconline.org)
- ❖ Analysis done – ratio analysis, Interest variations, LFAR excess cash carrying, suspense items, etc.
- ❖ SA 580- Letter of Representation – TDS, Frauds, cont. Liab.
- ❖ Correspondence (including e-mails) regarding significant matters

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Housekeeping - Working Papers

It is necessary to prepare and keep adequate working papers to show precisely

- **What work was done and by whom**
- **What explanations and information was given and by whom**
- **What decision on the various points was taken and by whom**

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Housekeeping - Working Papers

- Aid in the planning and performance of the audit
- Aid in the supervision and review of the audit work
- Provide evidence of the audit work performed to support the auditors' opinion
- Become the basis for drafting the auditors report
- Retention for a period of 7 years
- Useful for reference and defense in case of issues

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SUMMARY

- ▶ Plan your Audit
- ▶ Structure the activities
- ▶ Train manpower and guide them on site
- ▶ Exercise Due diligence
- ▶ Complete on a timely manner
- ▶ Interact with the branch management
- ▶ Compile and submit the report
- ▶ Collect the working papers
- ▶ HAPPY AUDITING !!!!!

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THANK YOU

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