

Bank Branch Audit – An Overview

Come the month of March and Chartered Accountants all over the country begin to sharpen their skills for conducting audit of several thousands of bank branches in the country. A well-planned audit will make the entire assignment of bank branch audit totally pleasurable while an ill-planned audit will end in chaos. This article aims to serve as a ready reckoner for the auditors entrusted with the responsibility of carrying out the branch audits.

The rapid advancement in information technology has revolutionised the Indian banking sector—perhaps one of the largest in the world as far as its extensive branch network is concerned. Not a day passes without a new ATM being opened or a new financial product being introduced. The impact of information technology has to be borne in mind while carrying out the branch audits. It is imperative to adopt the right approach and techniques to ensure that the audit is completed with best quality and within the shortest time possible.

Acceptance of the Appointment

Before accepting the appointment as branch auditor, ensure that your firm does not suffer from any of the disqualifications like:

- Change in the constitution of the firm since your application to the ICAI.
- Being indebted to the bank for a sum exceeding Rs 1000/-.
- Holding any security of the bank carrying voting rights.

In case of a change in the constitution of the firm since the date of application to ICAI, you need to inform the bank regarding the change and wait for their confirmation before accepting the appointment.



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Ensure that the acceptance letter is sent in the specified format along with the required declaration of secrecy and fidelity to the concerned authority within the specified time.

Communicate with the previous auditor as a matter of good ethical practice.

Plan for the Audit

Prepare a file for each branch to be audited containing photocopies of the appointment letter, circulars and instructions received, formats of various certificates, audit report, LFAR and tax audit report.

Ensure that each audit team has copies of the latest ICAI guidance note on bank audit, recent RBI master circular and an audit programme.

Prepare a letter of authority for each team setting out the names, qualification and specimen signature of the team members.

Send a questionnaire to the branch calling for specific details well in advance, which will help, in timely completion of audit. (A sample questionnaire is set out below)

LFAR

1. What is the cash retention limit of the branch?
2. What is the insurance cover held by the branch for cash on hand and cash in transit?
3. Does the branch have an account with RBI, SBI and other banks? If yes, confirmation of balance from the respective banks.

4. Does the branch have any investment?
5. List of accounts of large borrowers having limit/ balance outstanding in excess of 5% of the branch advances or Rs. 2 crore whichever is less.
6. List of large advances where stock audit has not been done during the year.
7. List of large advances where documentation is still pending.
8. List of advances where renewal has not been completed.
9. List of advances where stock statements have not been received regularly.
10. List of cases where the valuation report is more than three years old.
11. List of non-corporate entities with advances in excess of Rs. 10 lakhs.
12. List of major suits filed and other accounts classified as doubtful.
13. List of BIFR and other accounts being considered for revival, rehabilitation or settlement.
14. Have all credit card dues been recovered promptly?
15. DICGC / ECGC Claims
 - a) Claims at the beginning of the year
 - b) Claims lodged during the year, if any
 - c) Claims settled
 - d) Claims rejected
16. Details of outstanding amounts of guarantees invoked and funded by the branch at the end of the year.
17. Details of outstanding amounts of letters of credit and co-acceptances funded by the branch at the end of the year.
18. Details of outstanding entries in IBIT, if any.
19. Details of outstanding entries in sundry Assets and suspense account.
20. Details of outstanding entries in sundry deposits.
21. Quantum of overdue/ matured term deposits at the end of the year.
22. List of major items of contingent liabilities (other than constituents' liabilities such as guarantees, letters of credit, acceptances, endorsements, etc) not acknowledged by the branch.
23. A statement showing the variation in the accounts of interest paid, interest received and other major income and expense heads between the current and previous years. (Please request the branch management to give comments / reasons for any abnormal variation).
24. Particulars of fraud, if any, discovered during the year.

PMRY

1. Number of loans granted during the year under PMRY.
2. Amount advanced.
3. Subsidy claim amount.

TAX AUDIT

1. Capital expenditure debited to Profit and Loss account, if any.
2. Payment made to clubs towards fees and for services.
3. Total amount of TDS deducted during the year:
 - a) on salary
 - b) on Interest on Term Deposits
 - c) on Interest on NRO Deposits
 - d) On contract payments
 - e) on Rent
 - f) on professional fees
 - g) on other payments (specify)
4. Has any amount been recovered during the year out of bad debts, written-off in earlier year?

5. Locker rent accrued during the period 1.04.2006 – 31.03.2007.

Audit Programme

Ensure that a comprehensive audit programme is chalked out. The size of the branch, the volume of transactions, the level of computerisation and the classification of the branch must be taken into account while drawing up the audit programme. The size and skill sets of the audit team can be determined based on the above parameters.

The audit programme should ensure that a compliance test of the internal controls to identify areas of weaknesses is carried out. Based on the results of the compliance testing, one may have to prepare a programme for substantive testing.

The following areas require full checking irrespective of the level of internal controls:

- Verification of Balance Sheet and Profit and Loss account with the main and subsidiary ledgers
- Verification of all closing returns with the ledgers and registers
- Verification of all large advances granted during the year with specific reference to terms of sanction and documents
- Verification of all large NPA advances and the provisioning thereof
- Balancing of books
- Inter branch items and clearing differences
- PMRY loans granted during the year

Verification of Advances

As advances constitute a very high percentage of the assets of the branch, verification of the same is probably one of the most important aspects of a bank branch audit. It may be advisable to draw up a programme separately for verification of advances.

Design a format for noting down the particulars of each advance while perusing the borrower credit files and the account statement. The format should be designed to ensure that none of the significant information is missed out. The format will also help at the time of compilation of the audit report and LFAR. (A specimen format is set out in Table A.)

Table - A										
XYZ BANK										
Branch										
CHECK LIST FOR VERIFICATION OF ADVANCES										
Facility										
	A/c No									
Name of the borrower and account No.	1	2	3	4	5	6	7	8	9	10
1. Have you checked whether the branch has complied with the requirements such as obtaining loan applications, preparation of proposals, grant / renewal of advances, enhancement of limits etc.?										
2. Have you checked whether the facility has been granted beyond such delegated powers of the branch?										
3. If so, whether the same has been reported to the higher authorities.										

4. Have you checked whether the terms of sanction has been complied with?									
5. Have you checked whether all the documentation formalities have been complied with before release of facilities by the branch?									
6. Have you checked whether in the cases of corporate borrowers due charges have been registered with the Registrar of Companies?									
7. Have you verified receipt of stock statements. Have you verified that the follow up action of the branch is adequate?									
8. Have you checked whether periodic stock audits has been conducted? Have you perused the latest stock audit report?									
9. Have you checked the procedure adopted by the branch for periodically verifying the assets charged to the bank?									
10. Have you perused the account to ensure that there are no frequent overdrawls, shortfall in the value of security?									
11. Have you checked whether the assets charged to the branch have been adequately insured.									
12. Has the account been classified as per IRAC norms?									
13. If not, have you made out a detailed working for proposing MOC?									
14. Has the branch furnished the relevant information required for the purpose of reporting in LFAR?									
15. Have you checked whether the branch has obtained valuation reports?									
16. Have you verified whether there is any compromise proposals/ write offs in this account?									

Check the files of all large borrowers with specific reference to Credit appraisal, sanction and disbursement, documentation, review and supervision and house keeping.

Ensure that you peruse the delegated powers; Banks advance manual, circulars, guidelines etc before commencing the verification of advances.

A perusal of the latest RBI inspection report, concurrent audit reports and the inspection reports will aid in identifying continuing irregularities and internal control weaknesses. The RBI Inspection report highlights cases of short provisioning and it is the duty of the branch auditor to ensure that provisioning had been made as per the IRAC norms duly

paying heed to the recommendations of the RBI inspection team.

Verification of Compliance with IRAC Norms

Verify all existing NPA accounts and fresh NPAs identified by the branch during the year. Ensure that the date of NPA has been correctly entered since the quantum of provisioning depends on the same.

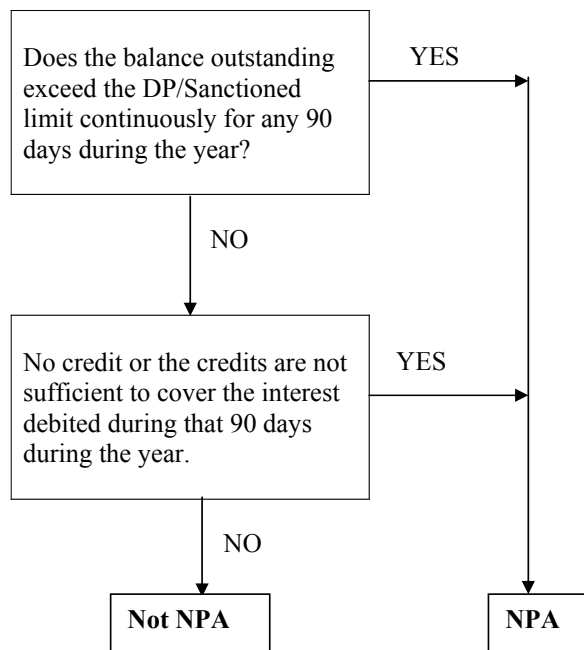
Identifying Fresh NPA

(a) Term Loans

Check if interest debited up to and including
interest debited on 31.12.2006 and principal
up to 31.12.2006 is recovered in full before

31.03.2007. If recovered it is not an NPA else it has to be classified as NPA.

(b) CC/OD accounts



(c) BP/BD accounts

Verify if any bill due on 31.12.2006 is outstanding as on 31.03.2007. If it is outstanding, the account will have to be classified as NPA.

(d) Other Advance Accounts

In respect of other advances if any amount due on or before 31.12.2006 has not been received as on 31.03.2007 then the account will have to be treated as an NPA

(e) Important Points to be considered while ascertaining whether an account is NPA or PA

- (i) If an account has not been renewed within a period of 180 days from due date, the account will become NPA.
- (ii) Drawing Power based on stock statement beyond 90 days will make the account out of order and consequently NPA.

Asset Classification

All performing assets are Standard assets

while NPAs fall under the category of Sub Standard, Doubtful or Loss assets depending on the period for which the account has remained NPA.

With effect from 31st March 2005, a sub-standard asset would be one, which has remained NPA for a period less than or equal to 12 months.

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the sub-standard category for a period of 12 months.

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

Refresher Course for Audit Team

In order to carry out the audit effectively and within the stipulated time ensure that all the team members are familiar with the following:

- i. RBI circulars relating to income recognition, asset classification and provisioning norms. The latest master circular covering all these aspects (DBOD No. BP. BC. 15/21.04.048/2006-2007 dated July 01, 2006) is available on the RBI website (www.rbi.org.in).
- ii. Guidelines issued to the auditors by the banks with reference to certificates to be issued by them.
- iii. Accounts closing instructions issued to the branches by the central office.
- iv. The accounting system of the bank and the related internal controls.
- v. Salient features of the LFAR.
- vi. Audit procedure to be adopted in a computerised environment.

Conduct Audit in Two Stages

The audit needs to be done in two stages

– pre closure and post closure of books.

In the first leg of audit one may take up the following areas for scrutiny:

- i. Review the file of major borrowers.
- ii. Peruse the sanction/renewal letter to ensure compliance with the terms and conditions of sanction.
- iii. Review the status of the accounts already identified as NPA during the year.
- iv. Peruse the stock statements and insurance cover.
- v. Review the quality of credit appraisal of loans granted during the year.
- vi. Ensure that the documentation has been completed in all respects as set out in the terms of sanction.
- vii. Study all accounts which are featured in the 'watch list'.
- viii. Study problem accounts that have since become good.
- ix. Visits of select borrowers if necessary can also be completed prior to March 31.
- x. Test checking of interest received, interest paid and other major heads of income and expenditure can also be carried out.

Computerised Audit Environment

It is imperative that auditing methodology and tools used must be modified to suit the IT environment. For example, if one of the audit objectives is to check whether an account was in excess of the sanctioned limit or drawing power during a particular period, the manual method would be to review all the accounts and list out those accounts which have been in excess for all the specified days. In a computerised environment the audit procedure to be performed should include generation of an exceptional report of all accounts in excess of the DP/sanctioned limits during a specified period.

One needs to obtain an overall understanding of the computer system in operation at the branch. A discussion with the systems manager

or officer in charge will be of immense help.

Compiling the Report

Every branch auditor needs to prepare two audit reports: one the short form wherein he expresses his opinion on the financial statements of the branch and the other a Long Form Audit Report (LFAR).

Before starting to compile your report ensure that all the audit queries and observations have been discussed with the branch management and their replies obtained. It is suggested that the queries be discussed with the officers and branch manager on a daily basis.

Discuss the draft report in detail with the manager preferably in the presence of the officer in charge of advances and ensure that they fully understand your views. Obtain a Management letter of representation.

Several Central Statutory Auditors in various forums have remarked that many branch auditors just state YES, NO or NA for most of the points in LFAR. It should be ensured that all points are answered setting out the full facts clearly. Avoid vague and general comments.

Working Papers

Last but not the least, ensure that all the working papers are organised properly. The need for organising and preserving the working papers assumes greater significance in the light of the Peer Review Process. 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.

Normally, working papers should include -

- Nature of engagement
- The audit plan
- Papers and records which would provide

the basis for relying on the internal controls

- The basis for deciding on the 'sample selection' for scrutiny
- All confirmations and certificates wherever necessary
- In areas where difference of opinion exists, the views of the organisation should be obtained in writing or minuted
- Significant ratio and trend analysis
- Significant audit observations culled out from other audit reports
- Copies of expert opinion where the auditor has placed reliance on the opinion of the expert
- Directive from Government/Regulatory authority, etc which have a bearing on the audit

Working papers are the property of the auditors and should be retained for a reasonable period to satisfy the professional and possible legal requirements. Lack of proper/inadequate working papers has landed many professionals in trouble with the Disciplinary Committee of the ICAI.

Conclusion

Before beginning, plan carefully. A well-planned audit will make the entire assignment of bank branch audit totally pleasurable while an ill planned audit will end in chaos. Spend time and energy on drawing up a detailed audit programme, framing checklists and questionnaires, familiarising the team members about the various aspects of bank audit and you will surely reap the benefits at the end of the assignment. □

STUDY GROUP ON ASSET RECONSTRUCTION COMPANIES INVITATION FOR VIEWS

As you are aware that the permission of foreign direct investment in the equity capital and investment by foreign institutional investors in Security Receipts (SRs) of Asset Reconstruction Companies (ARCs) has opened the possibilities of channeling the funds for NPA resolution. To address the concerns of ARCs, the Ministry of Company Affairs, Government of India has requested the Institute to give its views/suggestions on the issue of conversion of loan into equity by ARCs under Section 81(3) of the Companies Act, 1956.

To formulate the views of the Institute, an announcement has been hosted in the website of the Institute requesting the members to send their views/suggestions in this regard. Committee on Corporate and Allied laws of

the Institute is considering constituting a Study Group to formulate the views on the issues involved. Members are requested to give their views/suggestions immediately to the Committee at corporatelaws@icai.org. The members may also give comments on other issues relating to ARC including report/research on global practices vis a vis Indian Law, practices and impediments, if any.

Considering the merit of the views/suggestions, the Committee at its discretion may invite the members to participate in the meetings of the Study Group. ICAI may also consider publishing some comments/analysis/article in full or in part or extracts in "The Chartered Accountant" at the sole discretion of Editorial Board.