EXECUTIVE SUMMERY

A banking companies are requires maintaining the books of account in accordance with section 209 of the companies act, 1956. Banking generally a sound internal control system their day to day transaction. The auditor has to evaluate such system carefully. The fundamental requirement of an audit, as regards reporting on statement of account can be discharged from the examination of the internal checked and verification of assets and liabilities by making a comparison and reconciliation of balance with those in the year and that of amount of income and expenses by application of test checks. The banking regulation act casts greater responsibilities on the directors of banks as compared to those of other companies in the matter of supervision over their working. Therefore, they exercise, or are expected to exercise greater supervision over the affairs of bank. The auditor is entities to rely on such supervision and to limit his checking to test checks. The financial position of a bank is depended on the condition of assets, loan, investment, cash balanced and those of its liabilities and fund. Their verification form an important part of the balance sheet. Most of the bank have their own internal audit or inspection department entrusted with the responsibilities of checking the account of various branches. The statutory auditor may not, therefore, duplicate work.

INTRODUCTION

The audit of banking companies plays a very important role in India as it help to regulate the banking companies in right manner. In audit of banks includes various types of audit which are normally carried out in banking companies such as statutory audit, revenue/income expenditure audit, concurrent audit, computer and system audit etc. the above audit is mainly conducted by the banks own staff or external auditor. However, the rules and the regulation relating to the conduct of various types of audit or inspections differ from a bank to bank expect the statutory audit for which the RBI guidelines is applicable. In this, I have given more importance on the overall bank audit system. In today's competitive world audit is very much necessary as well as compulsory , because investor investing decision is depend on that particular concept if auditor has expressing his view about particular organization is true and fair then investor can get his ideas about how much he should invest in particular companies.

ORIGIN AND EVOLUATION OF AUDITING

1) Origin of term :

The term audit is derived from the Latin term “audire” mean to hear. In early days, an auditor used to listing to the account read out by the accountant in order to check them.

2) Ancient origin :

Auditing is as old as accounting. It was in use in all ancient countries such as Mesopotamia, Egypt, Greece, Rome, U.K., and India. The Vedas,Ramayana, Mahabharata contain references to accounting and auditing. Arthashasastra by Kautilya gives detailed rules for accounting and auditing of public finances. The Mauryas, the Guptas and the Mughals had developed and accounting and auditing system to control state finances. Thus, basically, accounting and auditing had their origin in the need for the government to control the income and expenditure of the state and the army. The original object of auditing was to detect and prevent errors and frauds.

3) Compulsory audits of companies:

With increasing number of companies, the companies' acts in different countries began providing for compulsory audit of accounts of companies. Thus U.K. audit of accounts of limited companies became compulsory in 1900. In India, the companies act, 1913 made audit of company accounts compulsory. With increase in size of companies, the object of audit also shifted to ascertaining whether the accounts were "true and fair" rather than "true and correct". Thus, the emphasis was not arithmetical accuracy but on fair representation of financial affairs.

4) Development of accounting and auditing standard:

The international accounting standards committee and the accounting standards board of institute of chartered accountant of India have developed standard accounting and auditing practices to guide the accountants and auditor in their day-to-day work.

5) Computer technology:

The latest development in auditing pertains to the use of computers in accounting as well as auditing.

Really, auditing has come a long way from "hearing" the accounts in the ancient day to using computers to examine computerized accounts of today.

DEFINITION OF AUDITING

Various persons such as the owners, shareholders, investors, creditors, lenders, government etc. use the final account of business concern for different purposes. All these users need to be sure that the final accounts prepared by the management are reliable. An auditor is an independent expert who examines the accounts of a business concern and reports whether the final accounts are reliable or not. Different authorities have defined auditing as follows.

- **Mautz** define the auditing as "auditing is concerned with the verification of accounting data, with determining the accuracy and reliability of accounting statement and reports".

- **International auditing guidelines** defines the auditing as "auditing is an independent examination of financial information of any entity with a view to expressing an opinion thereon".

BASIC PRINCIPAL OF AUDITING:

1) **Integrity, objectivity and independence:**

The auditor should be honest and sincere in his audit work. He must be fair and objective. He should also be independent.

2) **Confidentiality:**

The auditor should keep the information obtained during audit, confidential. He should not disclose such information to any third party. He should, keep his eyes and ears open but his mouth shut.

3) **Skill and competence:**

The auditor should have adequate training, experience and competence in Auditing. He should have a professional qualification (i.e. be a Chartered Accountant) and practical experience. He should be aware of recent developments in the field of auditing such as statement of ICAI, changes in company law, decisions of courts etc.

4) Working papers:

The auditor should maintain working papers of important matters to prove that audit was conducted with due care according to the basic principles.

5) Planning:

The auditor should plan his audit work. He should prepare an audit programmed to complete the audit efficiently and in time.

6) Audit evidence:

The report of the auditor should be base on evidence obtained in the course of audit. The evidence may be obtained through vouching of transactions, verification of assets and liabilities, ratio analysis etc.

7) Evaluation of accounting system and internal control:

The auditor should ensure that the accounting system is adequate. He should see that all the transaction have been properly recorded. He should study and evaluate the internal controls.

8) Opinion and report:

The auditor should arrive at his opinion on the account based on the audit evidence and submit his report. The opinion may be unqualified, qualified or adverse. The audit report should clearly express his opinion. Law should require the content and form of audit report.

AUDIT COMMITTEE

In pursuance of RBI circular September 26, 1995, a bank is required to constitute an Audit Committee of its Board. The membership of the audit committee is restricted to the Executive Director, nominees of Central Government and the RBI, Chartered Accountant director and one of the non-official directors.

One of the functions of this committee is to provide direction and oversees the operations of the total audit function in the bank. The committee also has to review the internal inspection function in the bank, with special emphasis on the system, its quality and effectiveness in terms of follow up. The committee has to review the system of appointment and remuneration of concurrent auditors.

The audit committee is, therefore, connected with the functioning of the system of concurrent audit. The method of appointment of auditors, their remuneration and the quality of their work is to be reviewed by the Audit Committee. It is in this context that periodical meeting by the members of the audit committee with the concurrent auditors help the audit committee to oversee the operations of the total audit function in the bank.

Considering the coverage of this audit assignment and the specialized nature of work there is also a need for training to be imported to the staff of the auditors. This training has to be given in specialized field such as foreign exchange, computerization, and areas of income leakage, fraud prone areas, determination of credit rating and other similar specialized areas. The bank can organize such training programmed at various places so that it can ensure the quality of audit.

ADVANTAGES OF AUDITING

1) Assurance of true and fair accounts:

Audit provides an assurance to the various users of final accounts such as owners, management, creditors, lenders, investors, government's etc. that the accounts are true and fair.

2) True and Fair balance sheet:

The user accounts can be sure that the assets and liabilities shown in the audited balance sheet show the concern, as it is i.e. neither more nor less.

3) True and fair profit and loss account:

The user can be confident that the audited profit and loss account shows the true amount of profit or loss as it is i.e. neither more nor less.

4) Tally with books:

The audited final account can be taken to tally with the books of accounts. Thus, the income-tax officer can start with the figure of audited books profit, make adjustments and compute the taxable income. An outside user need not go through the entire books.

5) As per standard accounting and auditing practices:

The audited final accounts follow the standard accounting and auditing principles laid down by professional bodies. Thus, audited accounts are based on objectives standard and not on personal whims and fancies of a particular accountant or auditor.

6) Detection and prevention of errors and frauds:

Audited accounts can be assumed reasonably free from errors and frauds. The auditor with his expert knowledge would take due care to see that Errors and frauds are detected so that the accounts shoe a true and fair view.

7) Advice on system, taxation, finance:

The auditor can also advise the client about the accounting system, internal control, internal check, internal audit, taxation, finances etc.

LIMITATIONS OF AUDITING

1. An auditor cannot check each and every transaction he has to check only the selected areas and transaction on a sample basis.

2. Audit evidence is not conclusive in nature thus confirmation by a debtor is not conclusive evidence that the amount will be collected. It is said evidence is rather than conclusive in nature.

3. An auditor cannot be expected to discover deeply laid frauds usually involves acts designed to conceal them such as forgery , celibate failure to record transactions, false explanation and hence are difficult to detect.

4. Audit cannot assure the users of account about the future profitability, prospects or the efficiency of the management.

5. An auditor has to rely upon expert auditor may have to rely on expert in related field such as lawyers, engineers, value's etc. for estimating contingent liabilities, valuation of fixed assets etc.

INTERNAL CONTROL IN CERTAIN SELECTED AREAS

General

- The staff and officer of a bank should lift form one position to another frequently and without prior notice.
- The work of one person should always be checked by another person in the normal course of business.
- All arithmetical accuracy of the book should be proved independently every day.
- All bank form (e.g. books, demand draft book, ‘travellers’ cheque, etc.) should be kept in the possession of an officer, and another responsible officer should occasionally verify the stock of such stationary.
- The mail should be opened by responsible officers. Signature on all the letters and advice received from other branches of the bank or its correspondence should be checked by an officer with signature book.
- The signature book of the telegraphic codebook should be kept with responsible officers, used, and seen by authorized officers only.
- The bank should take out insurance policies against loss and employees infidelity.
- The power of officers of different grade should be clearly defined.
- There should be surprise inspection of office and branches at periodic interval by the internal audit department. The irregularities pointed out in the inspection reports should be promptly rectified.

Cash:

- Cash should be kept in the joint custody of two responsible people.
- In addition to normal checking by the chief cashier, cash should be test checked daily and counted in full occasionally by responsible officers unconnected with the balanced shown the balanced shown by the daybook every day.
- The cashier should have no access to the ledger account and the daybook. This is an important safeguard. Bank management are often tempted to used cashier because of their shorter working hours as a ledger clerks in the absence of regular staff on leave, etc. This cash can be a very expensive price of economy.

Clearings:

- Cheques received by the bank in clearing should with the list accompanying them independent list should be prepared for cheques debited to different customers account and those return unpaid and these should be checked by officers.

- The total numbered and amount of cheques sent out the bank for clearing should be agreed with the total of the clearing pay-in-slip, by an independent person.
- The unpaid cheques received back return clearing should be checked in the same manner as the cheques received.

Constituent ledger:

- Before making payment, cheques should properly checked in respect of signature, date, balanced in hand etc. and should be passed by an officers and entered into constituent's account.
- No withdrawal should normally be allowed against cheques deposited on the same day.
- An officer should check all the entries made in the ledger with the original document particularly nothing that the correct account have been debited or credited.
- Ledger keeper should not have access to voucher summary sheet after they have been checked by an officer and to the daybook.
- Interest debited or credited to constituent account should be independently checked.

Bill of collection:

- All documents accompanying the bill should be received and entered in the register by a responsible officer. All the time of dispatch, the officer should also see that all document sent along with the bills.
- The account of customers or principals should be credited only after bills have been collected or an advice to that effect received form the branch or agent to which they were sent for collection.
- It should be ensured that bills sent by one, branch for collection to another branch of the bank, are not in the collection twice in the amalgamated balance sheet of the bank. For this purpose, the receiving branch should reverse the entries such as bills at the end of the receiving branch at the end of the year fir closing purposes.

Bill purchased:

- At the time of purchased of bill, an officer should verify that all the document of titles are properly assigned to the bank.
- Sufficient margin should be kept while purchased or discounting a bill to cover any decline in the value of the security etc.
- If the bank is unable to collect a bill on the due date, immediately step should be taken to recoveries the amount form the drawer against the security provided.

- All irregular outstanding account should be reported to the head office.
- In the case of purchased outstanding at the close of the year discount received thereon should thereon should be properly apportioned between years.

Loan and advances:

- The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from the proper authorities of bank.
- The entire necessary document (e.g. agreement, demand promissory note, letter of hypothecation etc.)
- Sufficient margin should be kept against securities taken to cover any decline in the value thereof and also to comply with proper authorities of directives. Such margin should be determined by the proper authorities of the bank as a general policy or for particular account.
- All the securities should be received and returned by responsible officer. They should be kept in the joint custody of two such officer
- In the case of good in possession of the bank, content of the package should be test checked at the time of receipt.
- Surprise check should be made in respect of hypothecated goods not in the possession of the bank.

- Market value of good should be checked by officer of the bank by personal enquiry in addition to the invoice to the invoice value given by the borrowers.
- As soon as any increased or decreased takes take place in the value of securities proper entries should be made in the drawing power book and daily balance book. These entries should be checked by an officer.
- All account should be kept within both the drawing power and the sanctioned limit at all times.
- At the account, which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular, should be brought to the notice of the management/head office regularly.

Demand draft:

- The signature on demand draft should be checked by an officer with signature book.
- All the best demand draft sold by should be immediately confirmed by the advice to the branches concerned.
- If the branches does not receive does not received proper confirmation of ant demand draft form the issuing branch or does not received credit in its account with that branches, it should take immediate step to ascertain the reason.

Inter branch account:

- The account should be adjusted only on the basis of application with reasonably good credit assessment.
- Prompt action should be taken preferably by central authorities, if any entries are not reasonably time.

Credit card operation:

- There should be effective screening of application with reasonably good credit assessment.
- There should be strict control over storage and issues of card.
- There should be at system whereby a merchant confirm the statues of utilized limit of a credit card holder form the bank before accepting the settlement in case the amount to be settled exceed a specified percentage of the total limit of the credit holder.
- There should be system of prompt reporting by the merchant of all settlement accepted by them through credit cards.
- Reimbursement to merchants should be made only after verification of the validity of merchant acceptance of card.
- All the reimbursement should be made immediately charged to the customers account.
- There should be a system to ensure that statements are sent regularly and promptly to the customers.

- There should be a system to monitor and follow up customer payment.
- Items overdue beyond a reasonable period should identification and attended to carefully. Credit should be stopped by informing the merchant through periodic bulletin, as early as possibly to avoid increased losses.
- There should be a system of periodic review of credit card holder account. On the basis, the limit of customer may be revised; it necessary, the review should also includes determination of doubtful amount and the provisioning in respect thereof.

STAGES IN AUDITING

1) Preliminary work:

a) The auditor should acquire knowledge of the regulatory environment in which the bank operates. Thus, the auditor should familiarize himself with the relevant provisions of applicable laws and ascertain the scope of his duties and responsibilities in accordance with such laws. He should be well acquainted with the provisions of the Banking Regulation act, 1956 in the case of audit of a banking company as far as they relate of preparation and presentation of financial statements and their audit.

b) The auditor should also acquire knowledge of the economic environment in which the bank operates. Similarly, the auditor needs to acquire good working knowledge of the services offered by the bank. In acquiring such knowledge, the auditor needs to be aware of the many variation in the basic deposit, loan and treasury services that are offered and continue to be developed by banks in response to market conditions. To do so, the auditor needs to understand the nature of services rendered through instruments such as letters of credit, acceptances, forward contracts and other similar instruments.

c) The auditor should also obtain and understanding of the nature of books and records maintained and the terminology used by the bank to describe various types of transaction and operations. In case of joint auditors, it would be preferable that the auditor also obtains a general understanding of the books and records, etc, relating to the work of the other auditors, In addition to the above, the auditor should undertake the following:

I. Obtaining internal audit reports, inspection reports, inspection reports and concurrent audit reports pertaining to the bank/branch.

II. Obtaining the latest report of revenue or income and expenditure audits, where available.

III. In the case of branch auditors, obtaining the report given by the outgoing branch manager to the incoming branch in the case of change in incumbent at the branch during the year under audit, to the extent the same is relevant for the audit.

d) RBI has introduced and offsite surveillance system for commercial banks on various aspects of operations including solvency, liquidity, asset quality, earnings, performance, insider trading etc., and has indicated that such reports shall be submitted at periodic intervals from the year commencing 1-04-1995. It will be appropriate to be familiar with the reports submitted and to review them to the event that they are relevant for the purpose of audit.

e) In a computerized environment the audit procedure may have to appropriately tuned to the circumstances, particularly as the books are not authenticated as in manually maintained accounts and the auditor may not have his in-house computer facility to taste the software programmes. The emphasis would have to be laid on internal control procedure related to inputs, security in the matter of access to EDP system, use of codes, passwords, data inputs being prepared by person independent of key operators and other build-in procedure for data validation and system controls as to ensure completeness and correctness of the transaction keyed in. system documentation of the software may be obtained and examined.

f) One set of tests that the auditor at both the branch level and head office level may apply for audit of banks in analytical procedure.

2) **Evaluation of internal control system:**

It may be noted that transaction in banks are voluminous and repetitive, and fall into limited categories/heads of account. It may, therefore, be more appropriate that the evaluation of the internal control is made for each class/category of transaction. If the exercise of internal control evaluation is properly carried out, it assist the auditor to determine the effectiveness or otherwise of the control systems and accordingly enable him to strengthen his audit procedures, and lay appropriate emphasis on the risk prone areas. Internal control would include accounting control administrative controls.

a) Accounting controls:

Accounting controls cover areas directly concerned with recording of financial transactions and maintenance of such registers/records as to ensure their reliability.

Internal accounting controls are also envisaging such procedures as would determine responsibility and fix accountability with regard to safeguarding of the assets of the bank. It would not be out of place of mention that there is a distinction between accounting system and internal accounting controls. Accounting system envisages the processing of the transaction and events, their recognition, and appropriate recording. Internal controls are techniques, method and procedures so designed and usually built into systems, as would enable prevention as well as detection of errors, omissions or irregularities in the process of execution and recording of transaction/events.

The internal accounting controls as would ensure prevention of errors, omissions and irregularities would include following:

I. No transaction can be registered/recorded unless it is sanctioned/approved by the designated authority.

II. Built- in dual control/supervisory procedures ensure that there is an independent automatic check on input/vouchers.

III. No single person has authority to initiate transaction and record through all stages to the general ledger. Each day transactions are accurately and promptly recorded, and the control and subsidiary records are kept balanced through personnel independent of each other.

The auditor would be well advised to look into other areas may lead to detection of errors, omissions and irregularities, inter alias in the following:

I. Missing/loss of security paper, stationery forms.

II. Accumulation of transactions/balances in nominal heads of accounts like suspense, sundries, inter-branch accounts, or other nominal head of accounts particularly if there accounts particularly if these accounts are extensively used to balance books, despite availability of information.

III. Accumulation of old/large unexplained/unsubstantiated entries in accounts with Reserve Bank of India and other banks and institutions.

IV. Transaction represented by mere book adjustments not evidenced/substantiated or upon non-honoring of contracts/commitments.

V. Origination debits I head office accounts/inter-branch accounts.

VI. Analytical review procedure.

VII. Serious irregularities pointer out in internal audit/inspection/special audit

VIII. Complaints/matters pending in the vigilance/grievances cell, as regards discrepancies in accounts of constituents, etc.

IX. Results of periodic analytical review, if observed as adverse.

a) <u>Administrative control:</u>

These are broadly concerned with the decision making process and laying down of authority/delegation of powers by the management. It may be noted that in the normal course, the head office use the zonal/regional offices do not conduct any banking business. They are generally responsible for administrative and policy decisions which are executed at the branch level.

3) **<u>Preparation of audit programme for substantive testing and its execution</u>**

Having familiarized him the requirements of audit, the auditor should prepare an audit programme for substantive testing which should adequately cover the scope of his work. In framing the audit programme, due weightage should be given by the auditor to areas where, in his view, there are weaknesses in the internal controls. The audit programme for the statutory auditors would be different from that of the branch auditor. At the branch level, basic banking operation are to be covered by the audit. On the other hand, the statutory auditors at the head office (provisions for gratuity, inter-office accounts, etc.). The scope of the work of the statutory auditors would also involve dealing with various accounting aspects and disclosure requirements arising out of the branch returns.

4) **<u>Preparation and submission of audit report</u>**

The branch auditor forwards his report to the statutory auditors who have to deal with the same in such manner, as they considered necessary. It is desirable that the branch auditors' reports are adequately in unambiguous terms. As far as possible, the financial impact of all qualification or adverse comments on the branch accounts should be clearly brought out in the branch audit report. It would assist the statutory auditors if a standard pattern of reporting, say, head wise, commencing with assets, then liabilities and thereafter items related to income and expenditure, is followed.

In preparing the audit report, the auditor should keep in mind the concept of materiality. Thus, items which do not materially affect the view presented by the financial statements may be ignored. However, in the judgement of the auditor, an item though not material, is contrary to accounting principles or any pronouncements of the Institute of Chartered Accountants of India or in such as would require a review of the relevant procedure, it would be appropriate for him to draw the attention of the management to this aspect in his long form audit report. In all cases, matters covering the statutory responsibilities of the auditor should be dealt with in the main report. The LFAR should be used to further elaborate matters contained in the main report and as substitute thereof. Similarly while framing his main report, the auditor should consider, wherever practicable, the significance of various comments in his LFAR, where any of the comments made by the auditor threrin is adverse, he should consider whether qualification in his main report is necessary by using his discretion on the facts and circumstances of each case. In may be emphasized that the main report should be self-contained document.

BOOKS OF ACCOUNTS OF BANKS

A banking company is required to maintain the books of accounts in accordance with sec.209 of the companies act. There are, however, certain imperatives in banking business they are the requirements to maintain accurate and always up to date account. Banks, therefore, device their accounting system to suit these requirements. The main characteristics of a banks system of book keeping are as follows:
entries in the personal ledgers are made directly from vouchers instead of being posted from the books of prime entry.

A. The vouchers entered into different personal ledgers each day are summarized on summery sheet; the totals of each are posted to the control accounts in the general ledger.

B. The general ledger trail balance is extracted and agreed every day.

C. All entries in the detail personal ledgers and the summary sheet are check by person other than those who have made the entries, with the general results that most clerical mistakes are detected before another day begins.

D. A trial balance of the detailed personal ledgers is prepared periodically, usually every two weeks, and agreed with the general ledger control accounts.

E. Expecting for cash transactions, always two vouchers are prepared for each transaction, one for debit and the other for credit. This system ensures double entry at the basic level and obviates the possibility of errors in posting.

PRINCIPAL BOOKS OF ACCOUNT

- **General ledger:**

It contains control accounts of all personal ledgers, the profit and loss account and different assets and liabilities accounts. There are certain additional accounts known as contra accounts, which is unique feature of bank accounting. These contra accounts are maintained with a view to keeping control over transactions, which have no direct effect on the banks positions.

For e.g. letter of credit opened, bills received for collection, guarantee is given etc.

- **Profit and Loss ledgers;**

Some banks keep one account for profit and loss in this general ledger and maintained separate books for the detailed accounts. These are columnar books having separate columns for each revenue receipt and expense head. Other banks keep separate books for debits and credits posted are entered in to the profit and loss account in the general ledger.

SUBSIDIARY BOOKS OF ACCOUNTS

- **Personal ledgers:**

Separate ledgers are maintained by banks for different types of accounts, i.e. current account, saving account, etc. As has been maintained earlier, these ledgers are posted directly from vouchers and the entire voucher entered in each ledger in a day are summarized in to Voucher Summary Sheets.

- **Bill Registers:**

  Details of different types of bills are kept in separate registers, which have suitable columns. For e.g. bill purchased, inward bill for collection, outward bills for collection etc are entered serially day to day in separate registers. Entries in these registers are made by reference to the original documents.

- **Other subsidiary registers:**

There are different registers for various types of transaction. Their number, volume and details, which differ according to the individual needs of each bank. For example, there will be registers for:

A. Demand drafts, telegraphic and mail transfers issued on branches or agencies.

B. Demand drafts, telegraphic and mail transfers received from branches and agencies.

C. Letters of credit.

D. Letter of guarantee.

- Departmental journals:

  Each department of bank maintains a journal to note the transfer entries passed by it. These journals are memoranda book only, as all the entries made there are also made in the daybook, through voucher summary sheets. The purpose is to maintain a record of all transfer entries originated by each department.

  - Other memoranda books:

  - Besides the book mentioned above, various departments of a bank have to mention a number of memoranda books to facilitate their work. Some of the important books are described below:

    - Receiving cashiers cash book

- Paying cashiers cash book
- Main cash book
- Cash balance book

The main cashbook is maintained by a person other than cashier. Each cashier keeps a separate cashbook. When cash is received, it is accompanied by pay-in-slips or other similar documents. The cashier makes entry in his book, which is check by the chief cashier.

- **Outward clearings**:

A person checks the vouchers and list with the clearing cheques received books. The voucher are then sent to appropriate departments, where customers account are immediately credited. Normally no drawings are allowed against clearing cheques deposited the same day but exceptions are often made by the manager in the case of established customer.

- **Inward clearing:**

Cheques received are check with the accompanying list. These are then distributed to differed department and number of cheques given to each department is noted in a memo book. When the cheques are passed and posted in to ledger, there number is independently agreed with the memo book. If the cheques are found unpayable, they are return to clearing house.

- Loans and overdrafts departments:

a) Registers for shares and other securities held on behalf of its customer

b) Summary books of securities give in details of government securities.

c) Godown registers maintained by the Godown keepers of bank.

d) Overdraft sanction register

e) Drawing power book.

f) Delivery order books.

g) Storage books.

- Deposit department:

a) Account opening and closing registers.

b) Fixed deposits rate register.

c) Due date dairy.

d) Specimen signature book.

- Establishment department:

a) Salary and allied registers.

b) Register of fixed assets.

c) Stationary registers

d) Old record registers

- General:

a) Signature books of bank officers

b) Private telegraphic code and ciphers

- Statically books:

Statically records kept by different books are in accordance with their individual needs. For example, there may be books for recording:

a) Average balances in loans etc.

b) Deposits received and amounts paid out each month in the various departments.

c) Number of cheques paid.

d) Number of cheques, bills and other items collected.

- **Incomplete records:**

In some situations, the auditor may find that certain accounting and other records are not up to date. In such a situations, the auditor should first ascertain the extent of arrears in housekeeping and the areas in which accounting and other records are not up to date. It may also be noted that in Long Form Audit Report (LFAR0), the auditor has to make detailed observation on such arrears.

VERIFICATION OF ASSETS AND LIABILITES

Capital and Liabilities:

1) Capital

The following particulars have to be given in respect of share capital in the balance sheet

- For nationalized banks

The capital owned by central government as on the date of balance sheet including contribution from government, if any, for participation in world bank project should be shown.

- For banks incorporated outside India

Capital (the amount brought in by banks by way of start up capital as prescribed by RBI shown under this head)

Amount of deposit kept with RBI under section 11(2) of the banking regulation act, 1949.

- For other banks

Authorized capital (shares of Rs…….each)

Issued capital (-do-)

Subscribed capital (-do-)

Called-up capital (-do-)

Less: calls unpaid

Add: forfeited shares

The auditor should verify the opening balance of capital with reference to the audited balance sheet of the previous year. In case there has been increase in capital during the year, the auditor should examine the relevant documents supporting the increase. For example, in case of an increase an authorized capital of a banking company, the auditor should examine the special resolution of shareholders and the memorandum of association. An increase in subscribed and paid-up capital of a banking company, on the other hand, should be verified with reference to prospectus/ other offer document, reports received from registers to the issue, bank statement, etc.

2) **Reserves and surplus:**

The following are required to be disclosed in the balance sheet under the head 'Reserves and Surplus'.

a) Statutory reserves.

b) Capital reserves.

c) Share premium.

d) Revenue and other reserves.

e) Balance in profit and loss account.

The auditor should verify the opening balances of various reserves with reference to the audited balance sheet of the previous year. Addition to or deductions from reserves should also be verified in the usual manner, e.g. with reference to board resolution. In the case of statutory reserves and share premium, compliance with legal requirements should also be examined. Thus, the auditor should specifically examine whether the requirements of governing legislation regarding transfer of the prescribed percentage of profits to reserve fund have been complied with. In case the bank has been granted exemption form such transfer, the auditor should examine the relevant documents granting such exemption. Similarly, it should be examined whether the appropriations from share premium account conform to the legal requirements.

3) **Deposits:**

Deposits are required to be classified in the balance sheet under the following heads.

A. I. Demand Deposits

(i) from banks

(ii) from others

II. Saving Bank Deposits

IV. Term Deposits

(i) From banks.

(ii) From Others.

B. I. Deposits of Branches in India.

II. Deposits of Branches outside India.

The auditor may verify types of deposits in the following manner.

I. Current account:

The auditor should verify the balances in individual accounts on a sampling basis. He should also examine whether the balances as per subsidiary ledgers tally with the related control accounts in the general ledger.

The auditor should consider the debit balances in current account are not netted out on the liabilities side but appropriately included under the 'advances'.

Inoperative accounts are a common area of frauds in banks. While examining current account, the auditor should specifically cover in his sample some of the inoperative account revived during the year. The auditor should ascertain whether inoperative are 'revived' only with proper authority. For this purpose, the auditor should identify cases where there has been a significant reduction in balances compared to the previous year and examine the authorization for withdrawals.

II. Saving bank deposits:

The auditor should verify the balances is individual account on a sampling basis. He should also examine whether the balances as per subsidiary ledgers tally wit the related control accounts in the general ledger.

The auditor should also check the calculations of interest on a sampling basis. It is not usual for branches to interest saving bank up to a date close to the end of the accounting period for e.g.25th March based on the actual balances with interest of the remaining period on an estimated basis at the head office level.

III. **Term deposits:**

Term deposits are deposits repayable after a specified period. They are considered time liabilities of the bank.

The auditor should verify the deposits with reference to the relevant registers. The auditor should also examine, on a sampling basis, the registers with the counter-foils of the receipts issued and with the discharged receipts returned to the bank.

IV**. Deposits designated in foreign currencies:**

In the case of deposits designated in a foreign currency, for e.g. foreign currency non-resident deposits, the auditor should examine whether they have been converted into Indian rupees at the rate notified in his behalf by the head office.

V. **Interest accrued but not due:**

The auditor should examine that interest accrued but not due on deposits is not included under the deposited but is shown under the head 'other liabilities ad provision'

2) Borrowing:

Borrowings of a bank are required to be shown in balance sheet as follows:

I. Borrowing in India.

a. Reserves Bank of India.
b. Other banks.
c. Other institution and agencies.

II. Borrowing from RBI, other banks/financial institution etc. should be verified by the auditors with reference to confirmation certificated and other supporting document such as agreements, correspondence etc.

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 borrowing of money at call and short notice is properly authorized. The rate of interest paid/payable on as well as duration of , such borrowing should also be examined by the auditor.

Other current liabilities:

The third schedule to the banking Regulation act, 1949, requires disclosure of the following items under the head 'other liabilities and provision'

- Bills payable
- Inter office adjustments.
- Interest accrued
- Other (including provisions)

The auditor may verify the various items under the head other liabilities and provision in the following manner.

- **Bills payable**

Bills payable represent instrument issued by the ranch against money received from customers, which are to be paid to the customers or as per his order. These include Demand Draft, Telegraphic Transfer, and Mail transfer and Mail Transfer, Traveller cheques, Pay order, Banker cheques, and similar instrument issued by the bank but not presented for payment until the balance sheet date.

Inter office adjustment:

The balanced in inter office adjustment account, if in credit, is to be shown under this head.

Interest accrued:

Interest accrued but not due on deposit is to be shown and borrowing is to shown under this head. The auditor should examine this with reference to terms of various type of deposits and borrowings. It should be specially examined that such interest has not been clubbed with the deposits and borrowing shown under the deposits and borrowing.

Other

According to the notes and instructions for compilation of balance sheet and profit and loss account, issued by the Reserve Bank of India, the following items are to be included under this head.

- Net provision for income tax and other taxes like interest tax, less advances payment and tax deducted at source.
- Surplus in aggregate in provision for bad and doubtful debts provision account.
- Contingency funds, which are actually in the nature of reserved but are not disclosed as such.
- Provision towards standard assets. These are to shown separately as contingent standard assets.
- Proposed dividend/transfer to government.

ASSETS:

Cash, bank balanced and money at call and short notice:

The third schedule to the Banking Regulation act, 1949, requires following disclosure to the be made in the made in the balance sheet regarding cash, balances with Reserve Bank of India., balance with other bank, and money at call and short notice.

Cash and balance with Reserve Bank of India.

I. Cash in hand (including foreign currency notes)
II. Balance with Reserve Bank of India

a) In current account
b) In other account

Balanced with banks money at call and short notice

I. In India

A) Balanced with banks

1. In current account
2. In other deposits account.

B) Money at call and short notice

1. With banks
2. With other institutions

II Outside in India

1. In current accounts.
2. In other deposits account.
3. Money at call and short notice.

Cash Reserved:

One of the determinants of cash balance to be maintained by banking companies and other schedule is the requirement for maintenance of certain minimum cash reserve. While the requirement for maintenance of cash reserve by banking companies is contained in the banking regulation act,1949 corresponding requirements for schedule bank is contain in the Reserve Bank of India.

Statutory liquidity ratio:

Section of 24 the act requires that every banking company shall maintain in India in cash, gold or unencumbered approved securities an amount which shall not, at the close of business on any day, be less than twenty five percent, or such other percentage not exceeding forty, as the RBI bank form time to time, of total demand and time liabilities in India as on last Friday of the second preceding fortnight.

Deposits by foreign banking company:

Section 11(2) of the act requires the banking companies incorporated outside India to deposit with RBI certain amount either in cash or in unencumbered securities or partly in cash and partly in such securities.

2) Investment:

The auditor should verify the investment scripts physically at the close of business on the date of balance sheet. In exceptional cases where physical verification of investment scripts on the balance sheet date is not possible the auditor should carry out the physical verification on a should take in to consideration any adjustment for subsequent transaction of purchase, sale etc. he should take particular care to see that only genuine investment are produced before him.

3) Advances:

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

- **a)** Amount included in balance sheet in respect of advances are outstanding at the date of balance sheet.
- **b)** Advances represent amount due to the bank.
- **c)** There are no unrecorded advances.
- **d)** The stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognized in their valuation.
- **e)** The advances are disclosed, classified and describe accordance with recognized accounting policies and relevant statutory and regulatory requirements.
- **f)** The auditor should ascertain the statues of balancing of subsidiary ledger relating to advances.
- **g)** The auditor should review the operation other advances accounts.

4) Fixed assets:

In carrying out an audit of fixed assets, the auditor is concerned primarily with obtaining evidence about their existence and valuation.

The branch auditor should ascertain whether the accounts in respect of premises and/or other fixed assets are maintained at the branch or centrally. Similarly, he should ascertain the location of documents of title or other documents evidencing ownership of various items of fixed assets. The auditor should verify the opening balance of premises with reference to schedule of fixed assets, ledger or fixed asset register.

In respect of fixed assets sold during the year, a copy of the sale deed and receipt of the salve value should examined by the auditor.

5) **Other assets:**

The auditor should see that whether there are any reversals entries indicating the possibility of irregular payments or frauds in case of inter- office adjustments. The auditor should also pay attention towards interest-accrued part from the banks point of view. The auditor should see that internal control over stationery items. The auditor should verify the stationery and stamps.

The auditor should examine the non-interest bearing advances to the staff with reference to the relevant documentation. The auditor should also see that the entries under the head ‘suspense account’. The auditor should also verify prepaid expenses in the same manner as in the case of entities.

N.P.A.GUIDELINES

The guideline requires the banks to classify their advances in four broad categories as follows:-

1. **Standard asset:-**

A standard asset is one, which does not disclose any problems, and which does not carry more than normal risk attached to the business such asset is not a non-performing asset.

2. **Sub-standard asset:**

It is one, which has been classified as N.P.A. for period not exceeding not more than 18 months.

3. **Doubtful asset:**

It is one, which remained has N.P.A for period exceeding 18 months.

4. **Loss asset:**

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

With the view to moving towards international based practices and to ensure greater transference it has been decided to adopt the 90 days overdue norms for identification. Of N.P.A. from the year ending 31st March 2004, according with effect from 31st march 2004, a non-performing asset shall be a loan or advances where,

i. Interest and installment of principle remains overdue for the period of more than 90 days in respect of term loan.

ii. The account remains out of order for period of more than 90 days. In respect of overdraft or cash credit limit.

iii. The bill remains overdue for period of more than 90 days in the case of bills purchased and discounted.

iv. Interest and installment of principle remains overdue for two harvest season but not exceeding 2.5 years in the case of advanced granted for agriculture purpose.

v. Any amount to be received remains overdue for a period of more than 90 days in of other account.

The identification of N.P.A. is to be on the basis of the position as on balance sheet day if an account has been regularized before the balance sheet day by payment of overdue amount through genuine sources and not by sanction of additional facilities or transfer of funds between accounts, the accounts need not be treated as N.P.A. the bank should however ensured that the accounts remains in order subsequently. If the account is out of order or deficient for a temporary period due to non-availability of adequate drawing power. Non-submission of stock statement, non-renewal of due date, will not classify as N.P.A.

N.P.A. classification will be as per borrower wise and not facility wise. It means that if any of the credit facilities granted to a borrower becomes non-performing all the facilities granted to a borrower will have to be treated as N.P.A. without having any regard to performing status of other facilities.

Some of the Exemptions are their as follows,

i. Project finance:

In the case of bank, finance given for industrial project or for agricultural status where moratorium period is available for payment of interest, payment of interest becomes due after the moratorium period is over and not on the date of debit of interest.

ii. Advance to Staff:

As in the case of project finance in respect of housing loan all similar advances granted to staff members where interest is payable after recovery of principle. The overdue status should be recognized from the date when there is default in payment of interest on due date of payment.

iii. Agricultural Advances Affected by Natural Calamities:

In terms of RBI instruction where Natural calamities in fairs the repayment capacity of agricultural borrower the bank can convert short term production loan, in to term loan or reschedule the repayment and sanction them short term loan loans in such cases the term loan as well as fresh short term may be treated as current dues and need not be classified as N.P.A.

iv. Loans and Advances backed or supported by government:

Any loans and advances provided by the bank under any scheme introduced by GOVT. like PMRY. Scheme will not be treated as N.P.A. though the account in overdue or outstanding for more than 90 days.

v. Advances secured against certain instruments:

Advances secured against Term Deposits, National Saving Certificate eligible for surrender, Indira Vikas Pattra and Life Insurance Policies have been exempted from the above guidelines thus interest on such advances may be taken to income account on due provided adequate margins available in respect of such accounts.

In respect of consortium advances each bank may classify the borrower accounts according to the own record of recovery and other aspect. Having a bearing on the recoverability of the advances.

Provisioning for Loans and Advances:

The guidelines require provisions for different classes of advances to be made as follows:-

- **Standard Asset:**

A general provision of minimum of 0.25% on total standard asset should be made.

- **Sub-standard Asset:**

A general provision of minimum of 10% on total Standard Asset should be made.

- **Doubtful Asset:**

Full provision to the extend of unsecured portion should be made in doing so the realizable value of the security available to the bank should be determined on a realistic basis additionally 20% to 50% of the secured portion should also be provided for depending upon the period for which the advances has been considered as a doubtful are as follows

- **Loss Asset:**

The entire amount should be written off or full provision should be made for the mount outstanding

Treatment of Restructured Sub-Standard Accounts:

A rescheduling of installment of principle amount would render sub-standard asset eligible to be continuing in sub-standard category for specified period provided loan or credit facility is fully secured. A rescheduling of interest elements would rendered a sub-standard asset eligible to continue to classified in sub-standard category for the specified period subject to the condition that amount of sacrifice if any in present value terms is either written off or provision is made to the extend of sacrifice involved in the amount of interest should either be written off or provision made to the extend of sacrifice involves.

Reversal of Interest or Income Recognition:

In respect of account classified as N.P.A. for the 1st time the unrealized portion of interest debited to the borrower account and credited to the income account in the previous year as well as interest debited during the current year has to be reversed, in respect of accounts that were classified as N.P.A. in the previous year banks generally do not debit any interest to the account there is therefore no question of reversal of interest. However in the case of operative cash credit or overdraft account some bank follows a practice where by unrealized interest is reversed in the year in which the account is classified is N.P.A. for the 1st time but redebited at the beginning of the next financial year during next financial year interest is debited to the account in the usual manner unrealized interest is reversed and again redebited at the subsequent financial year.

TYPE OF AUDIT IN BANK

- **Statutory audit:**

The statutory audit, which is compulsory as per the law. The statutory audit of banks includes examination and inspection of internal audit, concurrent audit, etc. The statutory audit of banks is like a post mortem activity. The suggestions of the statutory auditors can assist the bank management in improving the effectiveness of internal audit/concurrent audit/inspection functions, etc. In this way statutory plays a very important role in regulating the banking companies.

- **Internal audit:**

Banks generally have a well-organized system of internal audit. There internal auditors pay frequent visit to the branches. They are an important link in internal control of the bank. The systems of internal audit in different banks also have a system of regular inspection of branches and head office. A separate department within the banks by firms of chartered accountants carries out the internal audit and inspection function.

- **<u>Concurrent audit:</u>**

Concurrent audit is the system which introduced by the RBI with the view that interval between the occurrence of transaction and it's over view kept to the minimum extent and examination of transactions by the auditors take place as soon as the transaction take place. It has perceived the effective means of control. The main view of concurrent auditors is to see that the transactions are properly recorded, documented and vouched.

- **<u>System audit:</u>**

In today's technological advancements, banking companies are using a well-organized computer system to perform their transactions. So, it is very necessary to conduct 'system audit' in order to evaluate the computer system for effectiveness.

System audit is the audit of such computer environment/system and comprises the following internal controls over EDP activities and with application controls specific control procedures over accounting applications/assuring that all transaction are recorded and authorized and completely, accurately, timely processed manner which in turn are verified by computer.

- **Revenue audit:**

Revenue audit refers to the audit of revenues/ incomes. In revenue audit of banking companies, auditors go through the various sources of revenues from which bank earn income. In revenue audit of banks, the auditor inspects that all the records are showing true and fair picture of revenues or not.

CONCLUSION

The project the position of Indian banking system as well as the principal laid down by the Basel Committee on banking supervision. This assessment was done in seven major areas, which are core principals, concurrent audit, internal audit, deposit, loan accounting and transparency and foreign exchange transaction. The project concluded that, given the complexity and development of Indian banking sector, the overall level of compliances with the standards and codes is of high order. This project gives the correct ideas about how the major areas can be found by way of effective auditing system i.e. errors, frauds, manipulations etc. form this auditor get the clear ideas how to recommend on the banks position. Project also contain that how to conduct of audit of the banks, what are the various procedure through which audit of banks should be done. Form auditing point of view, there is proper follow up of work done in every organization whether it is banking company or any other company or any other company there no misconduct of transactions is taken places for that purpose the auditing is very important aspect in today's scenario form company and point of view.