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CHAPTER I: Approach to Bank Branch Audit

Introduction

The banking system in India is perhaps, one of the largest in the world as far as its extensive branch network is concerned. The dynamic banking sector in the country has been constantly undergoing a change. With the rapid advancement in information technology and communication more and more branches have not only been completely computerised, but have also been networked to provide services comparable to those prevalent in the most advanced global economies.
The rapid changes in this sector have placed an additional responsibility on members of the auditing fraternity auditing the Indian banks and their numerous branches. The 'race' between the banks to publish the audited accounts resulting in very little time available to complete the audit of the branches has added to the onerous responsibility of the auditors. Our cup, of woe will be full if we also take into consideration the considerable time required from our end for documenting the audit process to satisfy the Peer Review Process.

A process statement for the audit of a bank branch will essentially comprise the following:

- Appointment and acceptance
- Plan for the audit
- Programme
- Refresher course for the audit team
- Organise the limited time available effectively
- Apply the appropriate audit techniques and conduct the audit. > Compiling the report
- House keeping with reference to working papers

1. Appointment & Acceptance

1.1 On receipt of the appointment letter, go through the same in detail and ensure that yourfirm 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.

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

1.3 Communicate with the previous auditor.

2. Plan for the Audit

2.1 Create a master file containing the original appointment letter and instructions received from thebank

2.2 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 auditreport

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

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

2.5 Send a questionnaire to the branch calling for specific details, which will help, in timelycompletion of audit. A specimen questionnaire is set out in Annexure

3. Program

3.1 Chalk out an audit programme taking into consideration the volume of work and the level of computerisation at the branch.

3.2 Do a compliance test of the internal controls to identify areas of weaknesses.

3.3 Based on the results of the compliance testing prepare a program for substantive testing

3.4The following areas require full checking irrespective of the level of internal controls.

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

3.5 It may be advisable to draw up a program separately for verification of advances with specific reference to the following

- Credit appraisal
- Sanction & disbursement
- Documentation
- Review & supervision
- House keeping

3.6 In order to verify the above, one needs to peruse the following

- Delegated powers
- Banks advance manual, circulars, guidelines etc
    - RBI Guidelines on lending
    - Borrowers proposal and respective credit file
- RBI inspection report, concurrent audit report and inspection report
- Watch list

3.7 Design a format for noting down the particulars of each advance 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 Annexure Prepare an Analysis sheet of advances to have an understanding of the Portfolio of the Branch advances. Format is given in Annexure.

3.8 Sample Data Sheet for Major Advances is given in Annexure.

3.9Sample Checklist for Advances for Housing Loans is given in Annexure.

4. Refresher course for the audit team

4.1 Unlike the audit of other entities a bank branch audit is done by most firms only during the month of April and the chances of remembering the various circulars and applicable accounting and auditing standards is not very right.

4.2 Even in the case of firms engaged in the concurrent audit of banks it is usually one or two of the audit assistants who are involved in the audit and as such the other members of the team may not be well versed in conducting a bank branch audit.

4.3 In the light of the above it may be worthwhile to have a half day workshop to familiarise theteam members with the following:

i. RBI circulars relating to income recognition, asset classification and provisioning norms.The latest master circular covering all these aspects is available in the RBI site (www.rbi.org.in).
ii. Guidelines issued to the auditors by the banks with reference to certificates to beissued 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.

5. Organising the limited resource – TIME – effectively

5.1 With most of the banks specifying April 10th as the deadline for completing the branch audit, time available has become a scarce resource.

5.2 As per the information available at present most of the banks have instructed their banks toallow the audit to be taken up before the close of the financial year.

5.3 The audit needs to be done in two stages – pre closure and post closure of books.

5.4 As a prelude to the first leg, a letter shall be sent to the branch along with the questionnaire about your plan to divide the audit in two stages and the records to be kept ready for auditing the respective stages. A sample letter is given in the Annexure.

5.5 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, paid and other major heads of income &expenditure can also be carried out.

6. Appropriate Audit Techniques

6.1 Almost all the large and medium branches have been computerised. In fact in major cities almost 100% of the branches have been bought under CBS.

6.2 It must be clearly understood that while computerisation of any process does not change the scope and objectives of audit, it certainly changes the methodology of audit.

6.3 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.

6.4 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

6.5 One can ask the branch to give the account statements that are required for review in the form of .sdf, .txt, .xml or .html files which can then be opened using MS Excel and various analysis can be done with the data. This will be particularly useful in branches where there is a shortage of systems and will also help in major accounts to be analysed offsite.

7. Compiling the Report

7.1 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)

7.2 Both the reports are to be submitted to the Central Statutory Auditors and the management for their consideration and consolidation.

7.3 Ensure that the audit team has carried out the audit as per the guidelines and in strict conformity with the audit programme and that no area has been left out before compiling the report.

7.4 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.

7.5 Issue written memos and obtain written representations/clarifications wherever considerednecessary.

7.6 Discuss the draft report in detail with the manger preferably in the presence of the officer in charge of advances and ensure that they fully understand your views.

7.7 It has been remarked by several Central Statutory Auditors in various forums 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.

7.8 Vague and general comments should be avoided.

7.9 Ensure that adequate attention is given to all the certificates to be issued.

7.10 Ensure that the required no. of copies of your reports are taken and sent to the various controllingauthorities as mentioned in the appointment letter.

8. Housekeeping with reference to working papers

8.1 The need for organising and preserving the working papers assumes greater significance in thelight of the recently introduced Peer Review Process. It is necessary to prepare and keep adequate working papers to show precisely

a) What work was done and by whom
b) What explanations and information was given and by whom; and
c) What decision on the various points was taken and by whom."

8.2 The details of what would come under the ambit of working papers has been detailed in thestatement as follows
The auditor is expected to maintain evidence of the work done by him and his staff. This is best achieved by a well–designed file for audit working papers, which should contain inter alia the following:

a) An audit programme duly completed, showing the nature of work, the extent of checking and the initials of the person who have done the work
b) Details of important queries raised in the course of audit and the explanations obtained.
c) Detailed schedules in respect of important items
d) Important confirmation received from third parties
e) Certificates obtained from management."

8.3 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 auditor’s report.

8.4 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

8.5 Working papers are the property of the auditors and should be retained for a reasonable periodto satisfy the professional and possible legal requirements.

8.6 Lack of proper/inadequate working papers have landed many professionals in trouble with theDisciplinary Committee of the ICAL

8.7 With the Peer Review process already in place the working papers assume greater relevanceand can be neglected only at one’s own peril.

CHAPTER II

Reporting requirements in Bank Branch Audit

Introduction

The statutory branch audit of a public sector bank is both onerous and rewarding. It is onerous because of the huge responsibility and the limited time available to complete the audit. However with a clear understanding of the reporting requirements and proper planning the assignment can be made easy and rewarding.

The end product of any audit is essentially the audit report. In the case of the audit of a bank branch, in addition to the audit report the auditor is expected to issue several other reports and certificates which have been steadily increasing over the years. The list of reports and certificates to be issued are set out below:

- Audit Report
- Long Form Audit Report
- Tax Audit Report
- Certificate regarding compliance with Prudential Norms Certificate on Capital adequacy
- Certificate on DICGC
- Certificate on Demand and Time Liability position and Cash Balance Claims in respect of capital subsidy for PMRY loans
- Certificate on Serious Irregularity (Fraud)
- Certificate on compliance with Jilani committee recommendations

Audit Report

The crux of the audit of a bank branch is to report on

- The True and fair view of the state of affairs of the branch
- The True balance of the profit or loss of the branch
- Whether the transactions of the branch is within the powers of the bank.

The audit programme must be suitably structured to ensure that the auditor obtains sufficient information and audit evidence to report on the above salient points. It is essential that the auditor examines

a) whether income on non performing assets is recognized in accordance with the income recognition norms prescribed by RBI
b) whether advances have been properly classified and appropriate provisions have been made in respect of sub–standard, doubtful and loss assets as per the asset classification and provisioning norms prescribed by RBI.
c) Whether all the transactions have been within the powers of the branch.

The audit report should be unambiguous and the financial impact of all qualifications or adverse comments must be clearly brought out in the audit report. In this context it is important to note that the auditor keeps in mind the concept of materiality. Generally the materiality limit is decided by the Central Statutory Auditors in consultation with the bank management and the same is mentioned in the closing booklet supplied to the branch auditors. The auditor must also ensure that all observations are discussed with the branch in charge before drafting his final report.

Long Form Audit Report

The Long Form Audit Report has been extensively dealt with in a separate section of this booklet

Tax Audit Report

A serious issue in tax audit is the clause dealing with deduction of tax at source. As the Income Tax Act has been amended to disallow expenditure in case of non deduction of tax at source from the asst year 2005–06, are we as auditors expected to examine each and every transaction requiring TDS and report on compliance or non compliance as the case may be.

The clause on depreciation requires special attention of the auditors, as invariably there are errors in the schedule.

The clause on Cash Payments on Expenditure & Repayment of Deposits in excess of Rs.20,000 requires special attention of the auditors, which should be test verified and the verification has to be backed up with Management Representation from the Branch.

Certificate on Capital Adequacy

It has been stated by many CSA's that the understanding of Capital Adequacy Ratio at the branch level is not at the required level and hence it is important for the branch auditors to check the return as comprehensively as possible.

Please ensure that

- the total advances as per the balance sheet ties up with the advances shown in the capital adequacy statement
- the credit balances in deposit/current accounts set off against advances are actually in the name of the borrower who has availed the advance.
- The deduction from loans and advances are made only to the extent of the deposit amount outstanding or loan outstanding whichever is lower.
- Credit balances are not deducted globally from the total advances figure.
- Wherever the branches are not able to provide the balance in respect of few accounts, it is prudent to obtain a representation to the effect and also give a note relevant to the fact.

Certificate on DICGC

All queries on DICGC will be met by the branch management with a stock reply "our bank has opted out of the scheme". However the branch is required to furnish the statistics for reporting in LFAR in respect of old pending claims and the auditor also has to issue a separate certificate for the same.

It must be kept in mind that recoveries effected in DICGC covered accounts have to be shared with the corporation and the responsibility to ensure that the same has been complied with has been cast on the branch auditors.

Certificate on compliance with Jilani & Ghosh committee recommendations

- Branch auditors to comment on the implerrtientation of the recommendations
- The checklist is to be filled up by the branch management and the auditor’s role is to comment on the implementation.
- Most of the recommendations can be reviewed simultaneously while carrying out the audit and compiling the LFAR.
- Ensure that you carefully go through all the questions before certifying the report.
- Take a representation from the management and state that you are certifying the implementation based on the said representation and your observations and checks.
- Ensure that inapplicable clauses are reported correctly as inapplicable.

Conclusion

Diligence is not only required in auditing and reporting but also in the maintenance of working papers since all practice units (PU's) are subject to peer review. Care must be taken to ensure that a letter of representation is taken from the branch management with respect to all crucial & critical matters and made part of the working papers. A sample Letter of Representation is given in the Annexure.

Chapter III

Prudential Norms on Income Recognition,

Asset Classification & Provisioning Pertaining to Advances

Introduction

The banking system in India is perhaps, one of the largest in the world as far as its extensive branch network is concerned. The dynamic banking sector in the country has been constantly undergoing a change. With the rapid advancement in information technology and communication more and more branches have not only been completely computerised, but have also been networked to provide services comparable to those prevalent in the most advanced global economies.

The rapid changes in this sector has placed an additional responsibility on the chartered accountants auditing the Indian banks and their numerous branches

Prudential Norms

The objective of the prudential norms is to move towards greater consistency and transparency in the published accounts of banks and to be in line with the best practices adopted internationally.

Based on the recommendations of the Narasimham Committee, the Reserve Bank of India issued a circular DBOD. BP.BC.129/21 04–043–92 dated April 27, 1992, under the heading Income recognition, asset classification, provisioning and other related matters. The circular set out the various norms for recognising income, classifying the advances into performing and non–performing and for making a provision for non–performing assets. These norms, which have since come to be called as the Prudentia/Norms, have been made more stringent during the last decade by issuance of over 50 circulars by the Reserve Bank of India, from the time these norms came into existence for the first time for the year ended 31St March 1993.

The norms seek to provide objectivity to the recognition of income, which before the introduction was to a large extent subjective. As per the norms the recognition of income should be based on record of recovery rather than on any subjective considerations.

The prudential norms also lay down the objective criteria to be followed uniformly and consistently by the banks for the classification of assets.

The long drawn bitter discussions or rather battle between the bank management and the auditors as regards the provision required for bad and doubtful debts has become a thing of the past thanks to the prudential norms. At present the provisioning has to be made on the basis of the classification of assets based on the period for which the asset has remained non–performing and the availability of security and the realisable value thereof.

Non Performing Assets:

NPA is an asset which ceases to generate income for the Bank. NPA is defined on the basis of facilities as follows.

a) In respect of Term Loans NPA is defined as a credit facility in respect of which the interest and/or instalment of principal has remained overdue for a period of more than 90 days.
b) In respect of Cash Credit or Overdraft, NPA is defined as an account which remains out of order for a period of more than 90 days
c) In case of bills, if the bill remains over due for a period of more than 90 days.
d) In case of short term duration crop advances, if Interest and/or instalment of principal remains overdue for two crop seasons.
e) In case of LT duration crop advances, if Interest and/or instalment of principal remains overdue for one crop season
f) In case of all other amounts such as Devolved Letters of credit, defaulted/ invoked guarantees, etc., any amount to be received remains overdue for a period of more than 90 days.

Income Recognition

Interest on advances has to be accounted based on record of recovery and not merely on accrual basis. Therefore, income should not be recognized on NPAs. However, in the case of advances–against deposits, NSC, IVP, KVP and LIC policies income can be recognized on accrual basis provided the required margin is maintained. Likewise, fees and commission earned on account of re–negotiation or reschedulement of loans can be recognized over the period of time covered by re–negotiated or rescheduled extension of credit.

Once an advance become NPA as at the close of any year, interest accrued and credited to income account in the previous years, should be reversed or provided for if the same has not been realized. Same treatment shall be given to fees, commission and similar income that have accrued but not realized.

Interest realized on NPAs can be taken to income account only if the credits in the accounts towards interest are not out of fresh/additional credit facilities sanctioned to the borrower concerned.

The Income Recognition norms will apply to Government guranteed accounts also.

Where there is no clear agreement for appropriation of recoveries in NPAs (i.e. towards principal or interest due), it should be seen that the accounting principles followed by the Bank in exercising the right of appropriation is uniform and consistent.

Asset Classification:

i. Categories of NPAs:

In order to determine the quantum of provisioning, Banks should categorise NPAs into three categories based on the period for which the asset has remained non–performing and the realisibility of the dues, as follows :

a) Standard Assets : Asset which is performing by way of operating within limits/Drawing power, limits which has been renewed before time, interest and principal payment are serviced regulary are to be classified as Standard Assets
b) Sub–standard Assets: Asset which has remained NPA for a period less than or equal to 12 months are to be classified as Substandard Asset.
c) Doubtful Assets: An asset that has, remained as Substandard for more than 12 months will be classified as Doubtful asset.
   Doubtful assets have to be classified again periodwise as D1 (Doubtful first year), D2 (Doubtful one to three years) and D3 (Doubtful more than three years). This will have a significant impact in the provisioning.
d) Loss Assets: A loss asset is one where loss has been identified by the Bank or external auditors or internal auditors or the RBI inspectors but the amount has not been written off fully. The asset is characterised by total erosion or near total erosion in the value of securities, complete stoppage of activities in the account or there is only a skeleton operation, etc.

PROVISIONING NORMS:

On the basis of classifications of assets as made above, provisions should be made on the NPAs. The primary responsibility for making necessary provisions in on the Bank Managements and Statutory Auditors. The assessment made by the RBI inspection, if any, should be considered while making provision by the Bank and Auditors. Moreover, RBI in order to narrow down the divergence, encourages the auditors to have dialogue with the RBI and the regional offices of RBI has been advised to forward a list of individual advance where the variance in the provisioning requirements between the RBI and the bank is noticed.

The statutory auditors are expected to take into account the assessment of the RBI while making provisions for loan losses.

LOSS ASSETS:

As per the norms loss assets have to be fully written off. If the assets are permitted to remain in the books of for or any reason 100% of the outstanding should be provided for in the accounts.

DOUBTFUL ASSETS:

In the cases of doubtful advances provision has to be made based on the age of the category ranging from 20% to 100% for the secured portion and 100% for the unsecured portion. Where ECGC/DICGC cover is available, the same should be considered only on the portion of the loan outstanding which is not covered by the securities available.

a) Unsecured Portion:
Portion of the advance, which is not covered by the realizable value of tangible security to which the bank has a valid recourse and the relisable value is estimated on a realistic basis, provision will be to the extent of 100 per cent as hitherto.

b) Secured Portion:

Period for which the advance has remained in 'doubtful' category	Provision requirement on secured portion
Upto one year	25%
One to three years	40%
More than three years	100%

The graded provisioning, (consequent to the reduction in the transition period from sub standard to doubtful category) that banks were allowed to make over a period of four years commencing from the year ended March 31, 2005 is no longer valid and the provisioning will have to be made as per the above table

SUBSTANDARD ASSSETS:

In the case of sub–standard assets a general provision of 15% on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available.

Further **unsecured exposure** identified as Substandard assets would attract additional provision of 10 %, i.e a total of 20% on the outstanding balance.

Unsecured exposure is defined as an exposure where the realisable value of the security, as assessed by the bank/approved valuers/Reserve Bank's inspecting officers, is not more than 10 percent, ab–initio, of the outstanding exposure. 'Exposure' shall include all funded and non–funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly discharged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters etc.

STANDARD ASSETS:

Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis:

a) Direct advances to agricultural and SME sectors at 0.25 per cent;
b) All other advances at 0.40 percent
c) Commercial Real Estate Sector – 1%

With a view to bringing down divergence arising out of difference in assessment of the value of security, in cases of NPAs with balance of Rs.5 crore and above stock audit at annual intervals by external agencies has been made mandatory. Collaterals such as immovable properties charged in favour of the ban should be valued once in three years by valuers appointed by the Bank. Where no stock audit is conducted or where the value determined by the stock auditor is lower than the stock statement submitted, the auditors should insist on 100% provision or for the short fall respectively.

FREQUENTLY ASKED QUESTIONS & CLARIFICATIONS

1) What is meant by "out of order"?

An account should be treated as out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

2) What is meant by Overdue?

Any amount due to the bank under any credit facility is overdue' if it is not paid on the due date fixed by the bank.

3) Whether a working capital account will become an NPA if the stock statements are not submitted regularly? What should be the period for which the stock statements can be in arrears before the account is treated as an NPA?

Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Considering the practical difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older' than three months would be deemed as irregular. A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days.

4) Whether an account will become an NPA if the review / renewal of regular / ad hoc credit limits are not done when due? What should be periodicity of review / renewal to decide the present status of an account?

Regular and ad–hoc credit limits need to be reviewed/regularized not later than three months from due date/date of ad–hoc sanction. In case of constraints such as non–availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/review of credit limits is already on and would be completed soon. Hence, an account where the regular/ad–hoc credit limits have not been reviewed or have not been renewed within 180 days from the due date/date of ad–hoc sanction will be treated as NPA.

5) Regularisation of the account around the date of balance sheet. Whether it will be in order to treat a borrowal account as 'standard', if it has been irregular for a major part of the year, but has been regularized near the balance sheet date?

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as nonperforming and may be classified as 'standard' accounts. However the asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the account can be treated as performing asset provided the banks furnish satisfactory evidence to the Statutory Auditors about the manner of regularization of the account to eliminate doubts on their performing status.

6) Whether NPA and prudential norms are applicable to all staff accounts?

The answer is in the affirmative. There is no specific exemption given to the staff accounts regarding classification as Non Performing Asset.

However, in the case of housing loan or similar advances granted to staff members where interest is payable after recovery of entire principal, interest need not be considered as overdue from the first month onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates and interest can be continued to be recognized inspite of non recovery.

7) Whether non recovery of interest in respect of Term Loans given for new establishments are having any exception?

In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes due only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence NPA with reference to date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

8) Whether non recovery of interest will result in a EMI Loan classified asset as NPA?

In the case of loans repayable in equated monthly instalments where a part of the interest is included in the instalment, NPA status shall be determined on the basis of non–payment of equated monthly instalments and not with reference to the date of debit of monthly interest.
However there may be errors in computation of EMI, which may technically qualify the advance to be NPA. But this may at the most attract a remark in the LFAR, and will not be treated as NPA as long as the instalments stipulated is recovered properly.

9) Whether an asset has to ge–compulsorily go through the various stages of classification of Substandard, doubtful 1, 2 & 3 or a loss asset? What can be termed as'significant credit impairment'?

It is not required. In case of serious credit impairment, such assets should be straightway classified as a doubtful/loss asset as may be appropriate. For example, if the realizable value of the security is less than 50 per cent of the value assessed by the bank it results in significant erosion in the value of security and such NPAs may be straightway classified under doubtful category and provisioning should be made as applicable to doubtful assets.
Certain advances such as Loans advanced under DRI category, Educational loans without security, PMRY loans, etc. can be classified as Loss asset directly and need not go through the gradation process, if the borrower is not traceable, or there is a bleak possibility of recovery.

10) When do you consider an asset as loss asset?

If the realisable value of the security, as assessed by the bank/approved valuers /RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset.
In case of willful defaults and when no instalment has been repaid since the disbursement of the advance, the account can be classified as Loss Asset. If the borrower is not forthcoming or traceable, even though on paper, the bank may have hypothecation of items purported to have been purchased by the borrower at the time of granting of loan, the account should be classified as a loss asset.

11) In cases of consortium accounts, whether the Lead bank's certificate regarding the status of the Asset is sufficient or whether the respective branch should do a classification?

With effect from the year 2003–04, asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects– having a bearing on the recoverability of the advances.

12) Will the answer be different, if the borrower has deposited adequate funds with the consortium leader/member of the consortium and the bank's share is due for receipt?

No. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks, and therefore, be treated as NPA.

The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

13) How should an account be treated if the borrower has facilities in more than one branch of the same bank?

If a borrower is enjoying credit facilities in more than one branch; the branch where the main accounts are maintained shall determine the asset classification after collecting the required information about the conduct of the account at other branches and communicate the asset classification and allocation of securities to the bother branches. The other branches shall classify the account accordingly.

14) How does an account to be treated if the asset has been taken over from another bank?

Where a Bank takes over a existing account for another bank the norms of asset classification to be followed by the taking over bank shall be the guiding principle.

15) What is the practice to be adopted by banks regarding appropriation of recoveries in NPA accounts?

In the absence of a clear agreement between the bank and the borrower for the purpose, banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

16) Is there is any specific point to be observed in respect of Agricultural Advances?

Reserve Bank of India vide its circular ref. 102/21.04.048/2003–04, has revised the norms with effect from September 30, 2004 all direct agricultural advances

A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.

A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each state.

Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him.

For classification as Short and Long Duration Crop, crops which have duration of less than one year is called as SHORT DURATION CROP and Crop duration of More than one year is recognised as LONG DURATION CROP.

17) Whether Agricultural allied activities are also eligible for the above norms?

It may be noted that agricultural activities like Dairy, Poultry, animal husbandry, fisheries, sericulture etc., are specifically excluded from the Agricultural Advances by RBI in its circular.

Hence for these activities the definition given for determination of NPA status as per 90 days norm shall be made applicable.

Hence in respect of agricultural loans, other than those specified and term loans given to non agriculturists, identification of NPAs would be done on the same basis as non–agricultural advances which, at present, is the 90 days delinquency norm.

18) Whether interest unpaid in respect of Agricultural Advances deserves any specific treatment with respect to prudential norms?

In the case of agricultural advances generally interest is payable along with the instalment and due date of the instalment is fixed synchronizing with the harvest season. Hence, if interest and/ or principal remains unpaid after it has become due for two harvest season but for a period not exceeding two half years, (subject to the revised norms of short duration and long duration) the account shall be classified as NPA.

19) Whether there any exception provided in respect of natural calamities?

Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure, conversion of the short–term production loan into a term loan or reschedulement of the repayment period and sanctioning of fresh short–term loan. In such cases of conversion or reschedulement of repayment of short term production loans of Agricultural borrowers, the term loan as well as fresh short term loan may be treated as Standard Asset and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms and conditions i.e. they shall be classified as NPA if interest and for instalment of principal as per rephrased/revised terms and conditions remains unpaid after it has become'due, for the relevant period.

20) In case of onlending system through Primary Agricultural Credit Societies/Farmer Service Societies, is there any exception?

In respect of agricultural advances as well as advances for other purposes granted by banks to ceded Primary Agricultural Credit Societies (PACS)/FSS under the on–lending system, only that particular credit facility granted to a

PACS/FSS which is in default, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS.

However, other direct loans and advances if any, granted by the bank to the member borrower of a PACS/FSS outside the on–lending arrangement, will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

21) How to treat balances in credit card accounts, wherever such kisan credit cards have been provided to farmers?

The Kisan Credit Card facility being in the nature advance for agricultural purposes, the prudential norms as applicable to such facilities would apply to the credit card accounts.

22) If a borrower have more than one facility and in respect of Term Loan, instalments are overdue and Cash credit is operated well within hit, whether the NPA norms will be applicable for the advances or for term loan only?

It has been clearly mentioned that the NPA and provisioning norms are not limtwise and it is borrowerwise. Hence, in case of a borrower who is having advances of Rs.100 lacs, one Cheque of Rs.1,000 discounted and becoming overdue and outstanding for more than 90 days, will result in the entire balance outstanding in respect of the borrower becoming NPA and provisioning norms will be duly applicable.

Attention of the auditor is required in respect of parking the dues of the borrower in respect of devolved letters of credit and invoked guarantees in a separate account which is not a regular sanctioned facility. As a result, these amounts will not be reflected in the principal operating account of the borrower and may skip the provisioning norms.

23) Whether the value of security as given in the stock statement and the ancient value of collateral security, can be considered as such for the purpose of provisioning?

Reserve Bank of India has clarified in its circular of adopting a uniform method of valuation of security as follows:

With a view to bringing down divergence arising out of difference in an assessment of the value of security it has been decided that in cases of NPAs with balance of Rs. 500 lakh and above.

a) The current assets and their valuation are looked into at the time of Statutory Audit/concurrent audit. However, in order to enhance the reliability on stock valuations, stock audit at annual intervals by external agencies has been made–mandatory.
b) Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.

24) When there is an advance payment of instalments in respect of term loan, if interest is not recovered, will it result in NPA?

Where the borrower has made advance payment of instalments fixed towards the loan and as on the balance sheet date, the loan account is regular, such loan account need not be treated as NPA even if technically interest is due for more than 90 days.

25) What are the IRAC applicable to Loans fully secured against deposits, NSCs., Insurance Policies, etc.?

Income Recognition: Interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

Classification: Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts.

Provisioning: Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs, gold ornaments, government & other securities and life insurance policies would attract provisioning requirements as applicable to their asset classification status.

26) Is there any exemption for Loan on Jewels from provisioning norms?

There is no exemption available for jewel loans. However in respect of jewel loans taken for the purpose of Agricultural

Purposes, the prudential norms as may be applicable to Agricultural Loans will be applicable.

27) Is there any exemption from provisioning norms in respect of Central/State Government guaranteed accounts?

The credit facilities backed by guarantee of central government though overdue should be treated as NPA only when the government repudiates its guarantee when invoked. However, this does not apply to interest and if interest is not recovered it should be treated as NPA.

In the case of State Government guaranteed loans the same should be classified as NPA if the gurantee is invoked and outstanding for more than 90 days.

28) What is the treatment of Assets falling under classification of Restructuring?

The classification of a Restructured account depends on the following guidelines

a. Restructuring done before commencement of commercial production
b. Restructuring done after commencement of commercial production but before the asset has been classified as sub–standard
c. Restructuring done after commencement of commercial production and after the asset has been classified as sub–standard.

	Rescheduling of Principal alone	**Rescheduling of Interest**
a) before commencement of production	Account will continue as Standard Asset provided the loan/credit facility is fully secured	Account will continue as Standard Asset subject to the condition that the amount ofsacrifice, if any in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.
b) after commencement of commercial production but before the asset has become sub–standard.	–do–	–do–
c) after commencement of commercial production but after the asset has become sub–standard.	Account will continue in the sub– standard category for specified period of one year provided the loan/credit facility is fully secured.	Account will continue in the sub–standard category for specified period of one year subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.

29) When can a NPA upgraded from Substandard to Standard asset?

If arrears of interest and principal are paid by the borrower in the case of Term Loans classified as NPAs, the account should no longer be treated as NPA and may be classified as Standard Assets.

Accounts classified as NPA may get upgraded any day during the year to Performing Asset (PA) under following circumstances:

a) In the case of loans and other accounts, the account is regularized by payment of arrears of interest and instalments.
b) In the case of cash credit/overdraft accounts, the overdrawals allowed have been regularised/ reimbursed or the party has started operating the account within limit/drawing power or the credits are enough to cover the interest debited.
c) In the case of bills limit, the individual bills, which were classified as NPA, have been realized/ recovered.
d) When a performing account was classified as NPA on account of irregularity in other accounts and such other accounts is/are regularized/recovered/closed.
e) After completion of one year of satisfactory repayment in the case of rephrased/restructured account where the rephasement/restructuring has been done after the account became a NPA.

30) Whether advances under rehabilitation approved by BIFR/TLI can be upgraded?

Banks are not permitted to upgrade classification unless the package of re–negotiated terms has worked satisfactorily for at least one year. Even the additional facilities sanctioned as part of the restructure plan shall be classified as Sub–standard or doubtful, as the case may be, if the recovery is not made as per the terms after one year.

31) Whether Interest can be provided on Assets classified NPAS?

Interest cannot be provided in respect of NPA accounts. However recoveries effected in the account can be recognized as income.

32) What is the effect of interest already recognized by the banks in respect of fresh NPAs identified on March by the bank or by auditors?

Interest already recognized has to be reversed to the extent not realized. Provisioning has to be considered at the end of the year after reducing the interest reversed.

Further Unrealised Interest of the previous year, in respect of the advances classified as NPA in the current year, has to be provided for.

33) Whether interest can be recognized as income if the interest is funded for an NPA account?

Income recognition in respect of the NPAs, regardless of whether these are or are not subjected to restructuring/ rescheduling/ renegotiation of terms of the loan agreement, should be done strictly on cash basis, only on realization and not if the amount of interest overdue has been funded. If, however, the amount of funded interest is recognized as income, a provision for an equal amount should also be made simultaneously. In other words, any funding of interest in respect of NPAs, if recognized as income, should be fully provided for. The same situation will arise in case of Interest converted into Shares or Debentures of a Company.

34) Whether the Availability of security for the loan or sufficiency of net worth of borrower/guarantor have any impact on provisioning norms?

The availability of security or net worth of borrower/guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, as income recognition is based on record of recovery.

35) Whether the recovery from NPAs are to be appropriated towards principal or interest?

In general, the amounts received on account of NPAs are to appropriated towards unrealized interest and taken to income. Exception to this rule is that, the recoveries in respect of One Time Settlements and Loss Assets, the recovery has to be adjusted against the book balance first and after the same is adjusted, interest has to be recognized.

36) List of circulars issued by Reserve Bank of India in connection with Prudential norms?

S.No.	Circular Reference	Subject matter
1.	DBOD.no.BP.BC.20/21.04.048/2008–09 dated 01.07.2008	Master circular for Prudential norms on IRAC
2.	DBOD.No.BP.BC.No.37 /21.04.132/2008–09 dated 27.08.2008	Prudential guidelines on restructuring of advances
3.	DBOD.No.BP.BC.No.93 /21.04.132/2008–09 dated 08.12.2008	Prudential guidelines on restructuring of advances
4.	DBOD.BP.No.104/21.04.132/2008–09 dated 02.01.2009	Prudential guidelines on restructuring of advances

CHAPTER IV

Long Form Audit Report – An Overview

Objective of LFAR

The Long Form Audit Report, which has been in existence for over a decade, underwent a revision in the year 2003.

The objective of LFAR is to

- Report on the qualitative aspects of the various systems and procedures in all areas of banking like Credit Management, House Keeping, etc.,
- Help the management and the regulatory authorities to identify the strength and weaknesses of the systems and procedures prevalent in the bank

LFAR and Main audit report – Distinction

The Main Audit Report and Long Form Audit Reports are two separate reports and it is imperative to consider whether any of the adverse comments made in the LFAR warrant a qualification in the main audit report. In other words while all qualifications in the main audit report will necessarily find a place in the LFAR, all adverse comments in the LFAR need not be a qualification in the main audit report. The auditor should use his judgment considering the facts and circumstances of the case.

The LFAR of the bank branches comprises of (i) a questionnaire, (ii) questionnaire applicable to specialized branches and (iii) the annexure for furnishing details of large/irregular /critical accounts. LFAR of a branch is of utmost importance for Central Statutory Auditors and hence care should be taken to ensure that the branch auditors do not treat it as a mere questionnaire to be filled up in a routine manner.

The approach to LFAR

The approach of the branch auditors should be to examine in detail the areas covered by the questionnaire and give detailed specific responses to the various queries contained therein to give real value addition to the management and to aid the central statutory auditors in framing their report.

The LFAR calls for a very proactive, positive and constructive approach from the auditors and in order to ensure a quality report, the branch auditors should study the various audit reports of the branch during the year like inspection report, previous statutory report, previous LFAR, RBI inspection report, EDP audit report, etc.

It must be borne in mind that LFAR should cover all aspects of the branch's functioning and is the end result of the audit team's efforts and reflects the professional competence of the auditor.

The comments in the LFAR should not be vague but should be specific. General observations like "limits not renewed in a few case', "in a few cases it was observed' and "some balances did not tally" should be avoided if not done away with totally.

Some observations of CSA's on the LFAR given y the Branch Auditors.

- Questions are answered with a mere "Yes", "No" or " Not applicable"
- Observations are not supported by specific instances
- Observations/Comments–on revenue items and old entries outstanding in respect of balance with RBI, SBI & Other Banks are not given.
- Break up of claims outstanding with DICGC and system thereof is not commented upon.
- Cases of non corporate entities enjoying working facility beyond Rs.10 lacs and not complying with RBI guidelines with regard to compulsory audit are not reported.
- Comments on Suspense Accounts not given.
- Critical comments on maintenance of books of account not given.

Action points for audit staff in respect of certain key areas of LFAR

1. **Cash**
    - To verify Daily Cash Balance Register/Scroll for the whole year. Check whether the cash balance exceeds the retention limit fixed by the controlling authorities. If so excess over and above the limit should be reported as an annexure.
    - Generally insurance is done at head office level. If so, just mention insurance is covered at head office level. If the insurance is covered at the branch level then the adequacy of coverage is to be reported.
    - Verify key register and daily cash balance register.

2. **Balances with RBI, SBI and other banks**
    - Verify the Trial Balance/General Ledger Abstract to verify whether the branch is having any accounts with RBI, SBI and any other bank.
    - If the branch has any bank accounts, verify the bank statements and the reconciliation statement to find out the unresponded items and report accordingly
    - To confirm whether a balance confirmation certificate is obtained and the same is correctly reflected in the reconciliation statement and report accordingly

3. **Advances**

This clause in the LFAR seeks the auditor's comments on the quality of credit appraisal, system as to sanctioning / disbursement, documentation and quality of review/monitoring/supervision.

The auditor's response to the questions under this clause may be based on the examination of all large advances and a test check of other advances. In respect of large advances, all cases of major adverse features, deficiencies etc., should be reported. In respect of other advances, the auditor may comment upon the relevant aspects generally, along with instances of situations giving rise to his reservations of adverse remarks. For this purpose, large advances are those in respect of which the outstanding amount is in excess of 5% of the aggregate advances of the branch or Rs.2 Crores whichever is less.

- Verify from the files whether the appraisal mechanism is followed in accordance with procedures.
- Obtain the list of loans sanctioned/renewed during the year and confirm that the same are within the delegated authority, else report accordingly.
- In respect of fresh advances during the year, obtain sanction ticket and ensure the compliance is done before disbursement.
- Go through the Sub ledger accounts of borrowers and analyse excess drawings and verify whether additional security was obtained.
- For advances sanctioned during the year, verify whether disbursements are made after execution of all documents.
- Verify the documents, and also for form 8 & 13 filed with ROC in of corporate borrowers.
- In respect of loans granted against security of the deposits, verify whether proper lien marking is made on the respective deposit ledger and respective deposit receipts. Report deviations only.
- Obtain Limit Register in respect of working capital advances and confirm that the accounts are duly renewed/ reviewed.
- Obtain the operational files of all the parties and confirm the statements are periodically obtained and scrutinized and drawing power is fixed appropriately.
- Obtain the inspection register and confirm the visits are done according to the procedure.
- Obtain the Stock and Insurance register and confirm the adequacy thereon.
- Obtain the relevant party files and ensure the compliance
- Obtain the prudential norms circulars from the branch and confirm the classifications.
- Obtain the relevant claim register and files and verify and report the outstanding claims.

4. Other Assets

1) Stationery & Stamps
    - To obtain the stationery register and verify the entries with receipts from H.O.
    - Verify the entries for periodical withdrawal of stationery items and the approval thereon for ensuring internal controls.
    - Test check the security items in the locker and compare the same with the registers maintained for the purpose. Missing items are to be reported.
    - Verify the authorizations for the periodical withdrawals of Security items and report any deviations thereon.

2) Suspense account/ Sundry Assets
    - Obtain the break up of outstanding items as at the year end and confirm that the same tallies with General Ledger Extract.
    - Obtain the Suspense Register and scrutinize the entries for any extraordinary/unusual items and also to confirm the periodical reversal/adjusting of the entries. Report any deviations thereon.

5. Liabilities

(1) Deposits

- To inquire with the bank officials and check whether the inoperative accounts have been segregated periodically and blocked for not allowing transactions.
- Ask for exceptional reports from bank for inoperative account and test check in few accounts whether any transactions were entered during the year under audit and if so, whether they were properly authorised.
- To verify the system of in–operative accounts as per guidelines. If any deviation to be reported.
- Obtain ledger extracts of days subsequent to the date of balance sheet and verify the relevant ledger balances to ascertain unusual large movements and report.
- Obtain the exception report from the Branch for matured Term Deposits at the end of the year and report it.

(2) Other Liabilities

- Obtain list of sundry deposits at the end of the year and confirm the same tallies with the Ledger extract.
- Report the number of items and amount as per the format given in the LFAR
- Obtain the Sundry Deposits register and scrutinize the same for any unusual entries and also for periodical reversal.

(3) Contingent liabilities :To confirm whether any un acknowledged contingent liabilities, if yes to be reported

6. Profit & Loss Account

- To test check interest provided by the branch for sample cases and discrepancies if any, shall be reported.
- Verify the updation of systems for the keying up of interest rates and ensure the correctness.
- Verify and confirm that income is recognised in respect of Non–performing assets, only to the extent of actual recovery. In case of any deviation, report the same.
- To confirm whether the system of interest on accrued on overdue /matured term deposits followed by the branch is in accordance with guidelines from controlling authorities, If any deviation to be reported.
- A comparative statement of various interest income/ expenditure and advances/ deposits as on the previous year and current year be prepared and compare. If there is any divergent trend, an explanation shall be sought and if it is satisfactory report as such

7. General

(1) Books and Records:

- Obtain the balancing books and scrutinize the same for proper preparation and authentication and report accordingly.
- Verify the balancing books regarding the last date of balancing between subsidiary ledgers and general ledger and report accordingly.
- Discuss with the Branch Sytems Officer and verify few records which are printed and report accordingly.
- Obtain systems manual from the Systems Officer at the branch and confirm that the data security measures are in accordance with guidelines of controlling authorities.
- Obtain the backup record register from Systems officer and confirm whether the branch is taking back–ups on daily basis. If not, to be reported
- To verify whether adequate contingency and disaster recovery plans in the branch.

(2) Reconciliation of Control and Subsidiary Records: Balancing Books are to be obtained from the branch and check whether balancing has been done and upto what date.

(3) Inter–Branch Accounts: Obtain inter branch reconciliation file, wherein statements are obtained periodically from Head Office and branch sends periodical statements. Confirm that the statements are responded regularly and report the fact of latest statement upto which responded.

(4) Audits / Inspections

- Enquire with Branch manager regarding any other audit during the year.
- Obtain the inspection file for confirming closure of file from controlling authorities.
- Note down the salient adverse comments from the other audit reports and check with branch management whether they have been rectified, else report non rectification.

(5) Frauds: Obtain from the Management the file relating to fraud detection and if no frauds has been discovered during the year, a statement to that effect may be obtained and kept on files.

(6) Miscellaneous

- A glance through of the general ledger balances over a period will be indicating whether any huge variance is there on any particular day being the end of the quarter/half year/year. If any variance is observed, it may be examined for window dressing and be reported, if required.
- Obtain the fixed assets files and register from the branch and verify the entries during the year with bills or branch

transfer notes.

CHAPTER V

CHECKLIST FOR LONG FORM AUDIT REPORT

S.No.	Particulars	Action points for Audit Staff	Special comments
1	**ASSETS:** **<u>Cash :</u>**		
	a) Does the branch generally carry cash balances, which vary significantly from the limits fixed by the Controlling Authorities of the Bank? Whether excess balances have been reported to the Controlling authorities of the Bank?	To verify Daily Cash Balance Register/Scroll for the whole year, whether the cash balances is exceeds the retention limit fixed by the controlling authorities. If so excess over and above the limit should be reported as an annexure.	In case of excess cash on many days, it is suggested to fix a revised cut off amount beyond the limit and report the few cases beyond the revised cut off amount.
	b) Does the branch hold adequate insurance cover for cash on hand and cash–in–transit?	Generally insurance is done at head office level. If it is so, just mention insurance is covered at head office level. If the insurance is covered by the branch level then the adequacy of coverage is to be reported.	"Peak level requirement has to be applied. Cash insurance details to be got and to verify if insurance especially in transit is sufficient.
	c) Is cash maintained in effective joint custody of two or more officials, as per the instruction of the controlling authorities of the Bank?	To verify the key Register to confirm whether cash is under joint custody of two or more branch officials and report accordingly (Yes / No).	In all these cases the concurrent/inspection report may be gone through to verify if there are any specific comment.
	d) Have the cash balances at the branch been checked at periodic intervals as per the procedure prescribed by the controlling authorities of the Bank?	To verify the Daily Cash Balance Register/Scroll to confirm the periodical checking by officials (Yes/No).	
2	<u>Balances with Reserve bank of India, State Bank of India and other Banks:</u>		
	a) Whether reconciliation is done on a regular basis instead of year end basis and intimated to Head Office correctly in the control returns	To verify the Trial Balance/General Ledger Abstract to verify whether the branch is having any accounts with RBI, SBI and any other bank. If the branch does not have any account with other banks, report "The Branch does not have any such account. If the branch has any account with other banks then obtain the statements for the year and to confirm whether reconciliation is being done at regular interval and report the same.	Study such as cash Transactions remaining outstanding in reconciliation, contra items outstanding in the account but not in the other account may be upon commented upon.
	b) Were Balance confirmation certificates	To confirm whether a balance	

	obtained in respect of outstanding balances as at the balances have been reconciled? The nature and extent of differences should be reported. c) The observation on the reconciliation statements may be reported in the following manner: i. Cash transactions remaining unresponded (give details) : ii. Revenue items requiring adjustments/write–off (give details) iii. Old outstanding balances remaining unexplained unadjusted. Give details for: outstanding for six months to one year–and one year and above. d) In case any item deserves special attention of the management, the same may be reported.	confirmation certificate is obtained and the same is correctly reflected in the reconciliation statement and report accordingly. Verify the bank statements and the reconciliation Statement • to find out the relevant items and report accordingly.	
	Money at call & Short Notice: Has the branch kept money at call and short notice during the year? If so, whether instructions / guidelines, if any, laid down by Controlling Authorities of the Bank has been complied with?	Normally it will be not applicable to Branch Audit.	
	Investments: A. For branches in India: a) Are there any investments held by the branches on behalf of Head Office/ other offices of the Bank? If so whether these have been made available for physical verification or evidences have been produced with regard to the same where these are not in possession of the branch?	This clause is applicable only those branches where the branch is holding the investment on behalf of Head Office. Obtain Investment register, if investment are held and verify the same physically, compare the same with the register and report the discrepancies if any. If there are no investments held, Report the same accordingly.	The fact that the Investments are held on behalf of H.O. needs to be specifically mentioned in the certificate. Steps should be taken to find out if the investments are held in the bank's name. Further in those cases where the investment certificate is not available but only the letter of allotment is available.
	b) Whether any amounts received as income on such investments have been reported to the Head office? c) In respect of investments held by the branches on behalf of Head office/ other offices of the bank whether any income is accrued/received and recognized as income of the branch contrary to the instructions of the controlling authorities of the Bank? d) Whether there are any matured or overdue investments which have not been encashed? If so, give details?	Verify the investment register whether any income on investment was received by the branch and if so to confirm same has been reported to HO, periodically. On confirming the receipt of income, confirm the Recognizing of income according to instructions of the controlling authorities and report any deviation thereon. Verify the investment certificates for any overdue items and report the same.	If the letter of allotment is outstanding for a longtime without receipt of certificate, it needs to be ensured in all such cases that the interest has been properly received. If not the genuineness of the investment will be in doubt to be commented upon. In case of investments in demat, confirmation from the Depository may be obtained. All branches will be required to furnish a certificate that the investments held by the branches have been physically verified by them. Further in case the branches have the investments in their books but claim that the certificates are held by H.O./ controlling offices, necessary confirmation from the H.O./

			Controlling offices has to be obtained.
	e) Whether the guidelines of the Reserve Bank of India regarding transaction in Securities have been complied with? f) Whether the Guidelines of the Reserve Bank of India regarding Valuation of Investments have been complied with?	To confirm with RBI guidelines, whether it has been complied. If no, details to be reported. ——do—— (Normally not applicable to the Branch Audit of Banks)"	
	<u>B.</u> <u>For Branches Outside India:</u> a) In respect of purchase and sale of investments, has the branch acted within its delegated authority, having regard to the instructions/guide–lines in this behalf issued by the Controlling authorities of the Bank? b) Have the investments held by the branch whether on its own account or on behalf of the Head office / other branches been made available for physical verification? Where the investments are not in the possession of the branch, whether evidences with regard to their physical verification have been produced? c) Is the mode of valuation of investments in accordance with the RBI guidelines or the norms prescribed by the relevant regulatory authority of the country in which the branch is located whichever are more stringent?		This clause is not applicable for audit of branches inside India.
	d) Whether there are any matured or overdue investments which have not been encashed? If so, give details?		
	Advances: (Detailed questionnaire as 'Appendix A', 'Appendix B' for specialized branches and 'Appendix C' for reporting on large / irregular / critical advance accounts is enclosed herewith	Refer the Appendix A,B & C	
	Other Assets: a) Stationery & Stamps: i. Does the system of the Bank ensure adequate internal control over issue and custody of Stationery comprising of security items (Term Deposit Reeipts, Drafts, Pay Orders, Cheque Books, Travelers, cheques,Gift Cheques etc)? Whether the system is being followed by the branch? ii. Have you come across cases of missing/lost items of such stationery?	To obtain the stationery register and verify the entries with receipts from H.O. Verify the entries for Periodical withdrawal of Stationery items and the approval thereon for ensuring internal controls. Test check the security items in the locker and compare the same with the registers maintained for the purpose. Missing items are to be reported. Verify the authorizations for the periodical withdrawals of Security items and report any deviations thereon.	The branches receive the stationery items from Head office and account in Other assets. The stationery consumed is written off to expenditure at the end of each half year. However this system may vary from bank to bank to segregate DD, Cheque etc. from the stationery. Hence the verification methodology has to be adapted accordingly.
	b) Suspense account / Sundry Assets: i. Does the system of the Bank ensure expeditious clearance of items debited to Suspense	Obtain the break–up of outstanding items as at year end and confirm same tallies with	This head is normally in respect of short term parking of all advance for expenses/

	Accounts? Details of old outstanding entries may be obtained from the Branch and the reasons for delay in adjusting the entries may be ascertained. Does your scrutiny of the accounts under various subheads reveal balances, which in your opinion are no recoverable and would require a provision/write off? If so, give details in the following format:	Ledger Extract. Report the break up in the format given below.	assets and has to be written off to expenses or transfer to asset on actual spending or acquisition. This head will also'have items of Deposits made for Rental, Electricity, Telephone, etc., which may be reported as such. Old outstanding items are to be written off to expenses. Advance for asset if any has to be capitalized and depreciation also has to be provided accordingly.
	ii. Does your test check indicate any unusual items in these accounts? If so, report their nature and the amount involved.	Obtain the Suspense Register and scrutinize the entries for any extraordinary/unusual items and also to confirm the periodical reversal/adjusting of the entries. Report any deviations thereon.	

Sundry Assets & Suspense Accounts

Head of Account	Total of items (3+5+7+9)	Total Amount (4+6+8+10) (Rs.)	Year –wise break up*							
			2011-12		2010-11		2009-10		2009 & earlier years	
	1	2	3	4 (Rs.)	5	6 (Rs.)	7	8 (Rs.)	9	10 (Rs.)
a) Sundry Advances (Employees)										
b) Sundry Advance (others)										
c) Festival Advance										
d) Clearing Cheques Retd./Clg. Vouchers Receivable										
e) Clearing suspense										
f) Claims paid pending recovery adjustment										
g) Total										

1	<u>LIABILITIES</u> <u>Deposits</u> a) Have the Controlling Authorities of the Bank laid down any guide lines with respect to conduct and operations of in–operative accounts? In the cases examined by you, have you come across instances where the guidelines laid down in this regard have not been followed? If yes, give details thereof.	To inquire with the bank officials and check whether the inoperative accounts have been segregated periodically and blocked for not allowing transactions. Ask for exceptional reports from bank for inoperative account and test check in few accounts whether any transactions were entered during the year under audit and if so, whether they were properly authorised. To verify the system of in–operative accounts as per guidelines issued by controlling authorities. If any deviation to be reported.	Many of the frauds in bank Branches are done in Inoperative accounts, wherein unauthorized operations are done. Hence it has to be ensured that any transaction is allowed in the inoperative account, only with due Authorization of designated officers/Manager. Test Check of verification of specimen signature in some cases may be done.
	b) After the Balance sheet date and till the date of audit, whether there have been any unusual large movements (whether increase or decrease) in the aggregate deposits held at the year end? If so, obtain the clarification from the management and give your comments thereon.	Obtain ledger extracts of days subsequent to the date of balance sheet and verify the relevant ledger balances to ascertain unusual large movements and report.	Branches may adopt to increasing the deposits or advances at the end of the year in collusion with the customers for window dressing. This is normally resorted in unutilized limits or in high volume SB accounts, which the customers will utilize on the last day and will remit on the next day.
	c) Are there any overdue/ matured term deposits at the end of the year? If so, amounts thereof should be indicated.	Obtain the exception report from the Branch for matured Term Deposits at the end of the year and report the same.	Normally deposits matured and overdue for more than three years are being transferred to H.O. depending upon the internal guidelines. Few banks have a practice of automatic renewal after a specific period and hence the verification methodology has to be adapted to suit the policy of the bank audited.
	<u>Other Liabilities:</u> Bills payable, Sundry deposits etc.	Obtain list of sundry deposits at the end of the year and confirm the same tallies with the Ledger extract.	Drafts issued by the branch are disclosed under this head but normally the branches do not maintain a break–up of the same. Hence it is suggested to report the same accordingly with a possible note of disclaimer
2	a) The number of items and the aggregate amount of old outstanding items pending for three years or more may be obtained from the branch and reported under appropriate heads. Does the scrutiny of the accounts under various sub–heads reveal old balances? If so, give details in the following format:	Report the number of items and amount as per the format given in the LFAR Obtain the Sundry Deposits register and scrutinize the same for any unusual entries and also for periodical reversal.	

Break up of other liabilities:

(Amount correct to a rupee) Branch code

Head of Account	Total of items (3+5+7+9)	Total Amount (4+6+8+10) (Rs.)	Year –wise break up*							
			2011-12		2010-11		2009-10		2009 & earlier years	
	1	2	3	4 (Rs.)	5	6 (Rs.)	7	8 (Rs.)	9	10 (Rs.)
a) Clearing suspense										
b) Suspense (excluding suspense in the nature of deposits)										
c) Suspense in the nature of deposits										
Total										

b) Does your test check indicate any unusual item or material withdrawals or deposits in these accounts? If so, report their nature and the amounts involved.	Obtain various sub registers maintained by the branch and scrutinize for unusual items thereon and report the same.	

Break up of Bills Payable (outstanding for over three years) :

	No. of entries (1)	Amount (2)
i) DDs payable		
ii) pay orders/ Bankers Cheques		
iii) stale DDs payable		
iv) stale Pos/ BCs payable		
Total		

3.	Contingent liabilities List of major items of the contingent liabilities (other than Constituents' liabilities such as guarantees, letters of credit acceptances, endorsements, etc.) not acknowledged by the branch?	To confirm whether any unacknowledged contingent liabilities, if yes to be reported.	Normally there will not be any item reportable under branches. But occasionally there may be legal disputes and if so report thereon.
i)	Profit & Loss Account a) Whether the branch has a system to compute discrepancies in interest / Discount and for timely adjustment thereof in accordance with the guidelines. laid down in this regard by the Controlling Authorities of the Bank? Has the test checking of interest revealed excess/ short credit of material amount? If so, give details thereof.	To test check interest provided by the branch for sample cases and discrepancies if any, shall be reported. Verify the updation of systems for the keying up of interest rates and ensure the correctness.	Since most of the bank branches are computerized, the interest is also computed by systems. The banks have a system of test checking methodology (not the sample check as auditors do) which may be obtained and verified for any huge discrepancies. A comparative statement of item–wise expenses and income may be prepared and verified for identifying the reason Increase in Profit / Loss over the previous year.
	b) Has the branch compiled withthe income recognition norms prescribed by RBI? (The auditor may refer to instruction of the Controlling authority of the Bank regarding charging of interest on NPAs).	Verify and confirm that income is recognised in respect of Non–performing assets, only to the extent of actual recovery. In case of any deviation, report the same.	

	c) Whether the branch has a system to compute discrepancies in interest on deposits and timely adjustment of such discrepancies in accordance with the guidelines laid down in this regard by the Controlling Authorities of the Bank? Has the test check of interest on deposits revealed any excess / short debit of material amount? If so, give details thereof.		Since most of the bank branches are computerized the interest is also computed by systems. Certain banks have a system of test checking methodology (not the sample check as auditors do) which may be obtained and verified or any huge discrepancies.
	d) Does the bank have a system of estimating and providing interest accrued on overdue / matured term deposits?	To confirm whether the system of interest on accrued on overdue / matured term deposits followed by the branch is in accordance with Guidelines from controlling authorities, If any deviation to be reported	Normally no interest is Provided on overdue /matured term deposits. Auditors are expected to report the fact as such
	e) Are there are any divergent trends in major items of income and expenditure, which are not satisfactorily explained by the branch? If so, the same may be reported upon. For this purpose, an appropriate statement may be obtained from the branch management explaining the divergent trends in major items of income and expenditure	A comparative statement of various interest income/ expenditure and advances/ deposits as on the previous year and current year be prepared and compare. If there is any divergent trend, an explanation shall be sought and if it is satisfactory report as such.	Normally, Interest has to move along with the change in deposits or advances. If there is any different trend, it has to be examined and explanation sought from the branch management.
	<u>General</u> 1. Books and Records: a) In case any books of accounts are maintained manually, does general scrutiny thereof indicate whether they have been properly maintained, with balances duly inked out and authenticated by the authorized signatories? b) Indicate the position relating to balancing of the books examined. c) In respect of computerized branches : Whether hard copies of daily reports llike exceptional transactions, Cash scroll, GL & PL, Daybook, Sub–day book, Dr. Balances, overdrawn etc. are printed regularly? Indicate the extent of computerization and the areas of operation covered?	Obtain the balancing books and scrutinize the same for proper preparation and authentication and report accordingly. Verify the balancing books regarding the last date of balancing between subsidiary ledgers and general ledger and report accordingly. Discuss with the Branch Systems Officer and verify few records which are printed and report accordingly.	Present circumstances, most of the branches are automated and hence this clause may be applicable few rural branches where accounts are manual or branches which have ALPMs. (semi computerized)

	Are the access and data security measures like pass words etc., and other internal controls adequate? Whether regular back–ups of accounts are taken on a daily basis and offsite storage are maintained? Whether soft copies of all types of accounts are maintained in CDs on half yearly basis? Whether adequate contingency and disaster recovery plans like fire extinguishers, fire alarms are there in the branches?	Obtain systems manual from the Systems Officer at the branch and confirm that the data security measures are in accordance with guidelines of controlling authorities. Obtain the backup record register from Systems officer and confirm whether the branch is taking backups on daily basis. If not, to be reported To verify whether adequate contingency and disaster recovery plans in the branch	This is a very vital item wherein the entire security of data can be misused. The backup has to be maintained in proper storage media such as Compact Disc and also the offsite storage has to be away from the location of the branch. Normally the fire extinguishers and fire alarms at the branch would have been expired and not renewed. This has to be verified and reported.
	Do you have any suggestions for the improvement in the system with regard to computerized operations of the branch?	If any suggestion on computerized operation to be reported	
	2. Reconciliation of Control and Subsidiary Records: Have the figures, as at the year end, in the control and subsidiary records been reconciled? If not, the last date upto which such figures have been reconciled should be given under the respective heads, of the following proforma :	Balancing Books are to be obtained from the branch and check whether balancing has been done and up to what date and to be reported	This may not be applicable in fully automated branches. In ALPM branches. This will not be applicable for those items which have been computerized. But the amounts are to cross checked with GL which will be maintained manually.

Balance as at 31.03.2012

Head of Account	Date	General ledger (Rs.)		Subsidiary Balancing (Rs.)		Amount of difference		Last date on which balanced
		Rs.	Ps.	Rs.	Ps.		Ps.	

Remarks

	3. Inter–Branch Accounts: a) Does a branch forward on a daily basis to a designated cell / Head office, a statement of debit / credit transactions in relation to other branches?	Obtain inter branch reconciliation file, wherein statements are obtained periodically from Head Office and branch sends periodical statements. Confirm that the statements are responded regularly and report the fact of latest statement upto which responded.	Inter–branch reconciliation is done at Head Office for all branches and the duty of the branch ends on responding to the entries given by Head Office.
	b) Does a check of the balance in the Head Office Account as shown in the said statement during and as at the yeat end reveal that the same is in agreement with the Head Office Account in the General Ledger. c) Are there any outstanding debits in the Head office account in respect of inter branch transactions? d) Does the branch expeditiously comply with/ respond to the communications from the designated cell/Head office as regards unmatched transactions? As at the yearend are there any unresponded/ uncomplied queries or communications? If so, give details. e) Have you come across items of double responses in the head office account? If so, give details. f) Are there any unusual entries in inter Branch account of branch if so, give details. g) Are there any old/large outstanding transactions/ entries at debits as at year end which remains unexplained in the relatable to inter branch adjustments?		But it is pertinent to note, this is a potential area of FRAUDS in banks. Hence a scrutiny of the statements is inevitable to identity any long pending unresponded items are available in the statements.

Inter branch Accounts (Year–wise break–up pending entries)
(Amount correct to a rupee)

Clearing Accounts					Other Accounts					
			Debit		Credit					
Year	No. of entries	Amount	No. of entries	Amount	No. of entries	Amount	No. of entries	Amount	No. of entries	Amount
	1	2	3	4	5	6	7	8	9	10
4 yrs & above										
3–4yrs										
2–3 yrs										
1–2 yrs.										
Upto 1 yr										
Balance as on 31.3.12										

	4. Audits/ Inspections Is the branch covered by concurrent audit or other audit / inspection during the year? In framing your audit report, have your considered the major adverse comments arising out of the latest report of the previous auditor, concurrent auditors, stock auditors or internal auditors or in the special audit report or in the inspection report of the RBI? State the various adverse features persisting in the branch though brought in this audit/inspection reports.	Enquire with Branch manager regarding any other audit during the year. Obtain the inspection file for confirming closure of file from controlling authorities. Also a glance through of the reports in detail can be done and salient adverse comments shall be noted and checked up with branch management to confirm whether they have been rectified, else shall be reported.	Branches having a total business (deposits + advances) of 50 Crores are normally covered by concurrent audit as per norms The relevant reports need not be taken as the basis; the statutory auditor is free to exercise his own diligence in framing the reports. But he cannot ignore the adverse comments made in the respective reports.
	5. Frauds: Furnish particulars of frauds discovered during the year under at the branch, together with your suggestion, if any, to minimize the possibilities of their occurrence.	Obtain from the Management the file relating to fraud detection and if no frauds have been discovered during the year, a statement to that effect may be obtained and kept on files.	The statutory auditor is responsible only for reporting of any frauds discovered during the year and is not expected to detect any fraud.
	6. a) Does the examination of the accounts indicate possible window dressing? b) Does the branch maintain records of all the fixed assets acquired and held by it whether thereof or depreciation thereon centralized? Where documents of titles in relation to branch or other branches are available at the branch, whether the same have been verified. c) Are there any matters which, you, branch auditor, would like to bring to the notice of the management or the Central Statutory Auditors? d) Is the branch a specialized one, if so, questionnaire in Appendix B' is to be answered? e) In case of large / irregular / critical overdrawn accounts whether detailed reports are furnished in Appendix C'	A glance through of the general ledger balances over a period will be indicating whether any huge variance is there on any particular day being the end of the quarter/ half year/year. If any variance is examined for window dressing and be reported, if required. Obtain the fixed assets files and register from the branch and verify the entries during the year with bills or branch transfer notes The auditors are free to express any suggestion for improvement of the branch operations, in this column. Refer relevant appendix. Refer relevant appendix.	The branches tend to obtain huge short term or call deposits at the end of each quarter for achieving targets, which may be examined. The branch may also tend to transfer the unutilized limits in cash credit accounts to the current accounts maintained by the same party or even a third party at the end of the year. Normally the office maintains the value of assets & depreciation. But the auditors are expected to confirm that the statements sent by controlling office matches with the records available at the branch. Apart from books and records also, any personal observation can be given such as insufficient of Watch& Ward staff, fire extinguishers validity, etc.

APPENDIX A

LONG FORM OF BRANCHES (Advances)

Region		Branch Name
Zone		B.I. Code

(The answers on the following questions may be based on the auditor's examination of all large advances and a test check of other advances. In respect of large advances, all cases of major adverse features deficiencies etc., should be reported. In respect of other advances, the auditor may comment upon the relevant aspects generally, along with instances of situations giving rise to his reservations of adverse remarks. For this purpose, large advances are those in respect of which the outstanding amount is in excess of 5% of the aggregate advances of the branch or Rs.2 crores whichever is less)

	a) Credit Appraisal Whether the bank has adequate information system for appraising the credit worthiness of the applicant	Obtain the relevant party's files and confirm that income tax returns / wealth tax / Sales Tax returns are obtained and they are matching with the Assets and liabilities statement provided by the party. Verify from the files the appraisal mechanism is followed in accordance with procedures.	Normally the branches are expecting the auditors to verify the documents from sanction ticket. But the auditors have a right to verify the pre–sanction papers also to prepare a report for these clauses. However this has to be restricted for advances sanctioned/ renewed during the year only.
	In your opinion, has the branch generally complied with the procedures/ instructions of Controlling authorities of the bank regarding loan applications, preparations of proposals for grant / renewal of advances, enhancement of limits, etc., including adequate appraisal documentation in respect thereof	Obtain the list of loans sanctioned/renewed during the year and confirm that the same are within the delegated authority, else report accordingly	The branch will be maintaining the delegated authority limits for advances, which may be obtained and utilized
	b) Sanctioning /Disbursement i) In the cases examined by you, have you come across instances of credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch? Are such cases reported to higher authorities? ii) In the cases examined by you, have you come across advances have been disbursed without complying with the terms and conditions of the sanction? If so, give details of such cases.	In respect of fresh advances during the year, obtain sanction ticket and ensure the compliance is done before disbursement	Certain banks have a practice of obtaining compliance certificate from external agencies like Auditors/ Lawyers. In such cases obtain the same and confirm.
	iii) In case of frequent over drawings beyond sanctioned limit whether additional collateral security if required is obtained from the party. If not give details of such cases.	Go through the Sub ledger accounts of borrowers and analyse excess drawings and verify whether additional security was obtained.	In computerized branches exception reports will be available for excess drawn accounts, which may be obtained and examined. The banks also have a system of reporting of excess drawals, which may be obtained and verified.
	C) Documentation i) In the cases examined by you, have you come across instances of credit facilities released by the branch without execution of all the necessary documents? If so, give details of such cases.	For advances sanctioned during the year, verify whether disbursements are made after execution of all documents	It is believed that the statutory auditors are not expected to see documents. But it is essential to verify to comply with reporting under this clause.
	ii) In respect of advances examined by you, have you come across instances of deficiencies in documentation, value of security and inspection thereof , non–registration of charges, non obtaining of	Verify the documents, and also for form 8 & 13 filed with ROC in of corporate borrowers.	The banks obtain only Equitable Mortgage and hence it is suggested that EC is obtained annually by the banks.

guarantees etc., if so give details of such cases.		
iii) Whether advances against lien of deposits have been properly granted by marking lien on the deposits in accordance with the guidelines of the controlling authorities of the bank.	In respect of loans granted against security of the deposits, verify whether proper lien marking is made on the respective deposit ledger and respective deposit receipts report any deviations only.	In case of computerized branches, confirm the lien marking in the system, so that deposits are not possible to be closed during the pendency of the loan.
d) Review / Monitoring Supervision: Is the procedure laid down by the controlling authorities of the bank for periodic review of advances including periodic balance confirmation / acknowledgement of debts, followed by the branch? Provide analysis of the accounts overdue for review\renewal between six months to one year and over one year	Obtain Limit Register in respect of working capital advances and confirm that the accounts are duly renewed / reviewed.	In computerized branches, exception report can be generated for the same and verified.
ii) Are the stock/book debt statements and other periodic operational data and financial statements etc., received regularly from the borrowers and duly scrutinized? Is suitable action taken on the basis of such scrutiny in appropriate cases? Whether book debt statements are duly certified by Chartered Accountant on quarterly basis, if not give details there of	Obtain the operational files of all the parties and confirm the statements are periodically obtained and scrutinized and drawing power is fixed appropriately	Sanction ticket may be verified for confirming the periodicity, which may vary from case to case. This may also have an effect of levying penal interest for non submissions. The auditor's certificate should be unqualified and is not to be vague
iii) Whether stock audit are conducted once in a year for borrowers enjoying fund based working capital limits of Rs.5 Crores and above, if not give details thereof.		Applicable for large branches only.
iv) Indicate the case of advances to non–corporate entities with limits beyond Rs. 25 Lakhs where the Branch has not obtained the accounts of borrowers duly audited by Chartered Accountants.		Auditors should clearly certify the statements for the true and fairness and vague certificates are not to be accepted.
v) Has the inspection or Physical Verification of Securities charged to the Bank been carried out by the Branch as per the procedure laid down by the Controlling authorities of the Bank?	Obtain the inspection register and confirm the visits are done according to the procedure.	
vi) In respect of advances examined by you, have you come across any deficiencies in value of securities and inspection thereof or any other adverse features such as frequent / unauthorized over drawings beyond limits, inadequate insurance coverage, etc.?	Obtain the stock and Insurance Register and confirm the adequacy thereon	Invariably, the insurance is done by the branch for the limit only and not on the average stock maintained by the party. This is serious, since average clause will be invoked in case of loss.
vii) In respect of leasing finance activities, has the Branch complied with the guide lines issued by the Controlling Authorities of the Bank relating to security creation, asset inspection, insurance, etc? Has the Branch complied with the accounting norms prescribed by the Controlling Authorities of the Bank relating to such leasing activities?	Obtain the relevant party files and ensure the compliance	These facilities are applicable only in exceptional branches.
viii) Are credit card dues recovered		

	promptly? ix)Has the Branch identified and classified advances into standard \ substandard \ doubtful \ loss assets in line with the norms prescribed by the Reserve Bank of India (the auditor may refer to the relevant HO instructions for identifications of NPAs and classification advances).	Obtain the prudential norms circulars from the branch and confirm the classifications.	Obtain the previous year NPA classification and ensure that they are not upgraded unduly.
	x) Where the auditor disagrees with the branch classification of advances into standard \ substandard \ doubtful \loss assets, the details of such advances with reasons should be given. Also indicate whether suitable changes have been incorporated \ suggested the Memorandum of changes. xi) Have you come across cases where the relevant Controlling Authority of the Bank has authorized legal action for recovery of advances or recalling of advances but no such action was taken by the Branch? If so give details of such cases. xii) a) Have all non performing advances been promptly reported to the relevant Controlling Authority of the bank ? Also state whether any rehabilitation programme in respect of such advances has been undertaken and if so, the status of such programme.		It is essential to list out the reclassification again, (instead of reporting to refer annexures to Main report), since this LFAR is separate from Audit statements submitted
	b) In case of re–phasement of borrowal account whether the re–phasement has been actually done in order to help the account to tide over the temporary crisis or otherwisegive instances xiii) Have appropriate claims for DICGC and ECGC/ Insurance and subsidies, if any, been duly lodged and settled? The status of pending claims giving year wise breakup of Numbers and amounts involved should be given in the following format : –	Obtain the relevant claim register and files and verify and report the outstanding claims.	Most of the banks have opted out of DICGC. Still old items are to be reported.

Particulars	Number	Amount Rs.
Claiming as at the beginning of the year (Give year wise details)		
Further claims lodged during the year		
Total (A)		
Amounts representing		
a) Claims accepted \ settled (Give year wise details)		
b) Claims rejected (Give year wise details)		
Total (B)		
Balance as at the yearend (Give year wise details)		
(A–B)		

	xiv) In respect of non–performing asset, has the branch obtained valuation reports from approved valuers for the fixed assets charged to the Bank once in three years, unless the circumstances warrant a shorter duration. xv) In the cases examined by you branch compiled with recovery policy prescribed by the controlling authorities of the with respect to compromise\settlement and write off cases? Details of cases of compromise\settlement and write off cases involving write offs\waivers in excess of Rs.50 lacs is to be furnished separately as annexure. Account wise/ case wise giving the following details. a) Outstanding balance of accounts in respect of which compromise proposal has been accepted. b) Amount at which Proposal has been accepted. c) Amount settled for. d) Amount remaining outstanding xvi. List the major deficiencies in credit review, monitoring and supervision.		

e) Guarantees and letter of credit

i. Details of outstanding amounts of guarantees invoked and refunded by the branch at the end of the year may be obtained from the management and reported in the following format:

a. Guarantees invoked, paid but not adjusted:

Sl.No.	Date of invocation	Name of the party	Name of beneficiary	Amount	Date of Recovery	Remarks

b. Guarantees invoked, but not paid:

Sl.No.	Date of invocation	Name of the party	Name of beneficiary	Amount	Date of Recovery	Remarks

ii. Details of the outstanding amounts of letter of credit and Co–acceptances funded by the branch at the end of the year may be obtained from the management and reported in the following format:

Sl.No.	Date of funding	Name of the party	Nature (LC / Co–acceptance etc.)	Amount	Date of Recovery	Remarks

LONG TERM AUDIT REPORT OF BRANCHES
(QUESTIONNAIRE APPLICABLE TO SPECIALISED BRANCHES)

These clauses are applicable to specialized branches having foreign exchange transactions, clearing transactions, etc. and has to be obtained and signed by the branch manager and has to be annexed by the Auditor alongwith his LFAR. Even though the signatory is the branch officials only, it is suggested that the Auditors verify the information filled herein below for prima facie errors, since this is attached as part of LFAR, even though not attached as part of LFAR, even though attested by the Branch Auditor.

APPENDIX – C
ANNEXURE TO THE LFAR (FOR LARGE / IRREGULAR / CRITICAL ADVANCE ACCOUNTS)

(To be obtained from the branch management by the Branch Auditors of branches dealing in large advance / Asset Recovery Management Branches). These reports are to be signed by the Branch Manager only but have to be annexed to the report and hence are verifiable by the auditors.

Chapter VI

Bank Audit in a Computerised Environment

Introduction

During the last decade, Information technology particularly the healthy synergy of computers and communications has practically affected every sector of the economy covering the entire spectrum of manufacturing and services and Banking is no exception to this pervasive impact of IT. The world has become a global village, thanks to advances in telecommunication. In this era of globalisation, billions of rupees can be moved from one part of the world to another at the touch of a computer mouse at the speed of light.

Banking operation in the previous era where paper dominated and where movement of funds were not so fast called for a certain ethos, a certain organisational structure and culture. The impact of information technology on banking calls for a totally different approach to audit.

The customer centric focus of banking operations and the fact that banks deal primarily with money has influenced increasing computerisation. The intensive controls that the banking sector is subjected to, makes it imperative that internal controls and systems get integrated in IT and are not apparent as in manual systems.

Banks by their very nature are focused on security, which is only natural considering the fact that they are dealing with other people's funds. The risk of fraud and cheating is always there. When we talk of security, controls and audit in the computerised banking environment, we have to take note of the new type of risks that arise because of the computerised banking environment.

It needs to be understood that technology changes the business processes and auditors are embarking on an un–chartered territory as far as controls are concerned. As a previous Central Vigilance Commissioner said, technology is in a way like Lord Vishnu, who is described as "bhaya krita bhaya nashana". He is both the 'creator of fear and also destroyer of fear'. Thus if technology can lead to frauds, it can also devise systems to check the fraud.

EDP Audit

An EDP audit is the process of collecting and evaluating evidence to determine whether a computer system

1. Safeguards assets
2. Maintains Data Integrity
3. Achieves organisational goals effectively
4. Consumes resources effectively.

It is evident from the above that an EDP audit encompasses the objectives of both the external and internal auditors.

In order to carry out an EDP audit the depth of knowledge required is extensive. Information System auditing involves, for example

- Application of risk oriented audit approaches
- Use of computer assisted audit tools and techniques (CATT)
- Application of National and International standards to improve and implement quality systems in software development
- Understanding the business objectives, goals and requirements
- Evaluation of System Development Life Cycle (SDLC)
- Understanding networking and communication technologies
- Assessing external and internal risks to security

- Logical access control

The objective of this paper is not to discuss the EDP audit but is to provide an overview of the audit approach and techniques to be employed to test the overall controls in a computerised bank branch.

Impact of Computerisation on Bank Audit

It must be clearly understood that while computerisation of any process does not change the scope and objectives of audit, it certainly changes the methodology of audit. In other words the 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 Drawing Power \ sanctioned limits during a specified period.

Review of Computer operations

It is very essential to understand the computer system used by the branch before an audit process and plan is drawn up.

There are branches which have a standalone PC which is used to compute interest and preparation of schedules for different types of accounts. This is the lowest level of computerisation and according to information available there are very few rural branches at this level of computerisation.

This paper considers branches, which are totally automated under Local Area Networking (LAN) where the branch is equipped with several workstations connected to a server located at the branch in a secure area. The data typically resides in the main server and the workstations are used to view, enter and query the data. Under this system a user works in a single window concept and can execute any work that he is authorised to do so.

The next stage of computerisation implemented in the new generation banks is interlinking of all branches and controlling office where a customer of one branch can operate his account from any other branch or even sitting in his own office or house.

Software

The software used by the bank at various branches may be developed in house or outsourced. The auditor needs to understand the package and take into consideration the various checks and controls available in it before drawing up the audit programme. Although it may not be possible for the auditor to learn the package completely within the short time available at his disposal, he must obtain an overall understanding by navigating through the software package.

Audit Process

The process to be adopted for auditing a computerised branch is:

1. Preliminary Work
   - Understanding the nature of books & records maintained in the system
   - Review the EDP/ Computer Audit report
   - Review the internal/concurrent/RBI inspection reports
   - Obtain answers for the questionnaire on systems audit from Systems–in–charge/Data Base Administrator/Branch Manager (A sample questionnaire is set out in Appendix A)

2. Evaluation of Internal Control Systems
   - Understand the inherent risks of computerisation
   - Check whether a significant part of the internal control system has been inbuilt into the system

3. Preparation of Audit Program for Compliance & Substantive Testing
   - Consider the weaknesses observed in the internal control systems
   - List all critical controls
   - Formulate test procedures

4. Execution of Compliance Testing
   - Ascertain he controls in operation
   - Verify their implementation Example: Discretionary powers

5. Execution of Substantive Testing
   - Obtain access to a terminal (Read only)
   - Test the controls manually and compare the manual workings with those generated by the system
   - Obtain screen printout and make them part of your working papers.

6. Discussions with the branch management.

7. Framing the final audit report and submission
   - Highlight the identified control weaknesses if any in the appropriate section of the report.

Key control areas to be verified

i. Check whether the branch has posted a system administrator and is there any system of changing the system administrator at periodic intervals

ii. Verify whether the branch is maintaining a password register, floppy register and Check sum register. A checksum is digit that is a numeric value of the database and ensures that no unauthorized person has tampered with the database.

iii. Verify whether the branches are having a dual key system wherein only the joint key custodians can boot the system.

iv. Check the procedures and documentation relating to activation and deactivation of users.

v. Obtain a print out of the list of users and check whether they are all currently working in the branch.

vi. Verify whether user ID allocated to different users are different and distinct from one another.

vii. Ensure that the system forces the user to change his password when he logs in for the first time

viii. Verify whether the system forces the user to change his password periodically.

ix. Verify whether the user has to log in fresh after a certain specified period of inactivity

x. Verify whether the account master and balance cannot be modified / amended /altered except by the authorized personnel.

xi. Verify the system for controlling the incomplete/part transactions at data entry stage itself.

xii. Verify whether there is a control to ensure that unauthorised transactions are not allowed to be entered and if entered are reported through exceptional reports.

xiii. Verify the control of setting the financial parameters like drawing power, sanctioned limits etc in the case of CC/ OD accounts.

xiv. Verify the control exercised by the system over custody and issue of security items.

xv. Verify the system for recording the stop payment and other standing instructions in the system and also the controls for altering the same.

xvi. Verify whether lien is marked in the system against fixed deposits pledged for taking loans

xvii. Verify whether all accounts (opening & closing) are duly authorized

xviii. Verify whether all the general ledger account codes authorized by head office alone are in existence in the system.

xix. Verify whether interest indicators are correctly entered in the interest master for all deposits and are changed whenever the rates are revised based on the circular from the controlling authorities.

xx. In the case of advances verify that the interest rate applied is as per the sanction order.

xxi. Test check manually both interest paid and interest received in case of large accounts and compare with computer generated amount to ensure that the rate of interest is properly applied.

xxii. Check whether exceptional transactions report regarding details of dishonored cheques, large withdrawals, overdrawn accounts etc are being authorized and verified on a daily basis by the branch officials.

xxiii. Discuss with the manager the system of handling exception reports.

xxiv. Verify the procedure followed for transfer of account from operative ledger to inoperative/dormant ledger.

xxv. Check whether the procedure for activating system deactivated and customer–deactivated accounts is the same.

xxvi. Verify whether charges like folio charges, minimum balance breach charges etc are collected / charged in the account by the system for all eligible accounts.

xxvii. Check what type of audit features is available. Review how the events are captured and how access levels are created, defined and maintained.

xxviii. Review the audit log maintained by the system. Check the policy of archiving the auditlog. If possible transaction log wherever necessary can be checked.

xxix. Verify the system and periodicity of back up of data.

xxx. Ascertain whether the backed up data is retrieved and tested

xxxi. Verify the control over the backed up data.

xxxii. Day begin and Day end figures be verified on test check basis.

Credit Information System

Most banks have a Credit Information System, which is invariably independent of the main software used by the bank. This Information system has inbuilt menu to generate a range of analytical reports specifically for audit purposes. The reports help greatly in assessing compliance with NPA norms.

A sample list of the reports generated by the CIS is listed below:

- Cash Credit accounts irregular for more than 90 days or last credit before 90 days
- Agricultural cash credit accounts irregular for two harvesting season or no credit for two harvesting season
- Term loan accounts where interest and / or principal is overdue for 90 days
- Substandard assets where security is less than 50% of outstandings
- Overdrafts irregular for 90 days or no credit for 90 days
- Cash credit accounts where renewal is due for more than 90 days
- Cash credit accounts where stock statement date is more than 90 days
- Substandard and doubtful asset and security less than 10% of outstanding
- Doubtful assets in SSI/SBF/C&I segments where primary security > 10% of outstanding
- State Government guarantee is invoked and date of invocation is less than 01. 11.2004
- Accounts guaranteed by other bank guarantee
- Cash credit accounts where interest not serviced

Administrator Password

The administrator password can be used to access the database directly and hence is to be used only in exceptional circumstances. The administrator password is kept in a sealed cover and forms part of the Branch Documents.

To check whether there has been an occasion to use the administrator password during the year under audit, peruse the branch document register to track the movement of the password. In case the password has been used, ascertain the purpose and the changes made to the database. It will also be wise to check that a new password has been generated and kept in a sealed cover along with the branch documents.

Effecting changes in Interest rates

Most banks have a programme, which automatically runs at the end of every month and generates a report that lists out the deposits and advances accounts where the interest rate has been changed. The report contains details of accounts affected, the old rate, the new rate and the effective date. A perusal of this report will indicate whether the interest rate changes have been properly incorporated in the system.

Inoperative Accounts

Once an account has been flagged as inoperative by the system, a transaction whether debit of credit can be passed only by a person with a supervisor password. The details of such transactions are printed out as exceptions at the end of the day. Check the control over such transactions as the area of inoperative accounts is prone to frauds.

ATM Transactions

The operations of the Automated Teller Machines must be understood clearly to identify weaknesses if any. Normally, at the end of the day the balances in deposit accounts are transferred to the ATM server. At the start of the next day the balances are updated to the branch server from the ATM server. In other words an ATM transaction during banking hours updates the data base in the branch server while during non banking hours the off site balances of the branch transferred to the ATM is updated. If the offsite balances in the ATM server are not updated to the branch server immediately after ' start of day operation' there is a distinct possibility of a depositor withdrawing money from his account manually from the branch without having sufficient balance.

In order to check whether the process of transferring and updating the balances are performed meticulously on a daily basis, one can check the daily 'log in' and 'log out' report. As the ATM is also designated as an user it should be one of the first to log in after the server has been started and the last to log out before the server is shut down. If a considerable time lag is noticed on a particular day between the server being up and the log in of the ATM then one needs to see whether it has resulted in any excess drawings from deposits accounts and identify the same.

Using EXCEL

MS Excel can be used for carrying out various analysis. In order to do this, request the branch management to provide the statement of the accounts chosen for analysis in a txt (text) or sdf (standard data format) format. These files can then be opened using Excel and various analysis carried out. You may meet with some resistance on this issue and the ranch management may inform you that they do not have the tools to convert the data into a text format. However, in most branches there is a provision to furnish the statement of account to the borrower or depositor in a floppy and using this tool the branch should be able to provide data in text format.

Using SQL

Structured Query Language (SQL) is a computer language for communication with databases. The communicating parties are typically a "front end" which sends a SQL Statement across a connection to a "back end" that holds the data. We can use SQL to obtain various reports or listings by querying the database. It is not necessary for us to know programming but we need to be clear about the conditions, the data to be analysed and the output format. The systems manager in the branch should be able to write a SQL provided we clearly specify the parameters.

Conclusion

It is imperative to understand and remember that even in the era of massive computerisation, audit is still primarily a process of collecting, analysing and evaluating evidence as per the needs of the assignment.

Computerisation has certainly changed the process of data collection and evaluation and to understand the changed methodology it is important for the members of our profession to gain an overall understanding of the key aspects of information technology, IT controls and learn to use CAAT to carry out the audit.

CHAPTER VII

Peer Review Requirements

The statement on Standard Auditing Practices (SA 230) –states: " The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles. The form and content of the documents to be maintained has been spelt out in this standard.

Mandatory Records

The mandatory documentation as envisaged by SA 230 is:

- Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.
- Working papers should be designed and properly organised to meet the circumstances of each audit and the auditor's needs in respect thereof.
- Working papers should be efficiently complete and detailed for an auditor to obtain an overall understanding of the audit.
- All significant matters, which require the exercise of judgment, together with the auditor's conclusion thereon, should be included in the working papers.

Ensure that the following are available in the bank audit file

1. Copy of letter sent to the previous auditors
2. Engagement letter as envisaged by SA 210
3. Audit plan
4. Audit program
5. Papers and records which would provide the basis for relying on the internal controls
6. The basis for deciding on the 'sample selection' for scrutiny
7. All confirmations and certificates wherever necessary
8. In areas where difference of opinion exists, the views of the organisation should be obtained in writing or minuted
9. Significant ratio and trend analysis
10. Significant audit observations culled out from other audit reports
11. Directive from Government/Regulatory authority, etc which have a bearing on the audit
12. Checklists duly filled up, indexed and cross referenced to the working papers
13. Note on resolution of major observations with specific reference to NPA & provisioning.
14. Management letter of representation

CHAPTER VIII

Annexure and Checklists

1. Branch Questionnaire
2. Sample Checklist for branch audit
3. Audit Programme for advances classification
4. Checklist on Advances
5. Analysis of Portfolio of Advances
6. Data Sheet for Major Advances
7. Sample Checklist for Housing Advances
8. Sample letter to be sent to Branches before taking up the audit
9. Checklist on EDP Review
10. Sample Management Representation Letter
11. Letter to the Previous Auditor
12. Format of Physical Cash Verification Sheet.

Questionnaire in connection with the audit of ________________ Bank

Branch : ___________________

I. 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 2.00 crores 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 3 years old. 11. List of non–corporate entities with advances in excess of Rs 10 lakhs. 12. List of major suit 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 in the format set out in the appendix. 17. Details of outstanding amounts of letters of credit & co–acceptances funded by the branch at the end of the year in the format set out in the appendix. 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 & expense heads between the current & previous years. Please give your comments / reasons for any abnormal variation. 24. Particulars of fraud if any discovered during the year **II. PMRY** 1. No. of loans granted during the year under PMRY. 2. Amount advanced 3. Subsidy claim amount **III. Tax audit** 1. Capital expenditure debited to Profit & Loss account, if any 2. Payment made to clubs	

a) for fees b) 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 1.04.2011–31.03.2012. 6. Split up – commission on LCs/Guarantees as follows year–wise for apportionment: 2011–12 2012–13 2013–14 2014–15 Total commission collected on Guarantees/LCs	

Date: Signature of Branch Manager

APPENDIX

1. Guarantees invoked, paid but not adjusted

Sr No.	Date of invocation	Name of the party	Name of beneficiary	Amount	Date of recovery	Remarks

2. Guarantees invoked, but not paid

Sr No.	Date of invocation	Name of the party	Name of beneficiary	Amount	Date of recovery	Remarks

3. LC's & co–acceptances funded by the branch

Sr No.	Date of funding	Name of the party	Nature (LC / Co–acceptance, etc.)	Amount	Date of recovery	Remarks

BANK AUDIT CHECK LIST

Name of the Bank: ______________

Name of the Branch: Reviewed by:

Check Points	Yes / No / NA	Done by	W.P. ref. No.
CASH			
1. Verify the cash balance on hand at the close of business hours on the last working day of the year or on the first working day of the subsequent year.			
2. If cash could not be verified as above, then check the cash on any subsequent date and re–work the cash on hand on the last date.			
3. Does the branch have an ATM.			
4. If so verify Cash at the ATM			
5. Verify the cash holding limit of the branch			
6. Verify the insurance available in respect of cash			
BALANCES WITH BANKS			
7. Verify the correctness of balances under this head.			
8. Obtain a copy of certificate of confirmation of balances from banks where moneys are kept by the branch.			
ADVANCES			
9. Verify whether the branch has complied with the requirements such as obtaining loan applications, preparation of proposals, grant / renewal of advances, enhancement of limits etc.,			
10. Verify whether any facilities have been granted beyond such delegated powers of the branch.			
11. If so, whether the same has been reported to the higher authorities.			
12. Verify all the fresh sanction / renewal / enhancement orders, issued during the year under review. Check whether the terms of sanction has been complied with in all cases.			
13. Check whether all the documentation formalities have been complied with before release of facilities by the branch.			
14. Check whether in the cases of corporate borrowers due charges have been registered with the Registrar of Companies.			
15. Have all the cases due for renewal been renewed. Obtain a list of cases due for renewal/ extension of tenability and the period of pendency.			
16. Verify the receipt of stock statements in all cases. Check that the follow up action of the branch is adequate.			
17. Check whether there is a system of conducting periodic stock audits. Obtain the list of cases where stock audit has not been carried out. Note the reasons assigned by the branch for such a lapse.			
18. Check whether the branch has obtained audited statements from non–corporate borrowers with limits in excess of Rs. 10 lakhs, as required by RBI.			
19. Check the procedure adopted by the branch for periodically verifying the assets charged to the bank.			
20. Verify the accounts to ensure that there are no frequent overdrawls, shortfall in the value of security			
21. Check whether the assets charged to the branch have been adequately insured.			
22. Does the bank carry out lease financing. If so, check whether RBIs requirements in respect of such transactions have been complied.			
23. Check whether the branch has a system of recovering the credit card dues promptly.			

24. Check whether the branch has complied with the Income recognition norms prescribed by RBI.
25. If not, have you made out a detailed working for proposing MOC.
26. Have you come across instances where the controlling authorities have recommended legal action for recovery of advances / recalling of advances while the branch had not done so.
27. Ensure that the branch has a system of reporting all cases of NPAs to the controlling authorities.
28. Obtain the list of cases where any rehabilitation program has been undertaken
29. Obtain data in respect of pending DICGC claims.
30. Has the branch furnished the relevant information required for the purpose of reporting in LFAR.
31. Check whether the branch has obtained valuation reports in respect of all NPAs.
32. Verify cases where there are compromise proposals and write offs.
33. Verify the list of guarantees invoked and funded by the branch.
34. Collect the data required for the purpose of reporting in the LFAR.

SUSPENSE & SUNDRY ASSETS

35. Verify the details furnished by the branch for the above items, with reference to old items requiring to be written off.
36. Verify whether there are any unusual entries put through these accounts.

PROFIT & LOSS ACCOUNT

37. Test check the interest paid/earned by the branch.
38. Verify whether the Income Recognition Norms stipulated by RBI have been complied with.
39. If not, have you suggested MOC
40. Verify whether the branch has a system of providing for interest on overdue deposits

BOOKS AND RECORDS

41. Check whether any records are maintained manually
42. In respect of computerised branches, ascertained whether a systems audit had been carried out.

RECONCILIATION OF CONTROL AND SUBSIDIARY RECORDS

43. Verify whether the control and subsidiary records have been reconciled at the year end.

AUDITS / INSPECTIONS

44. Ascertain the coverage of branch operations during the year by different audits.
45. Consider the major adverse comments made during such audits, while framing your report.
46. Obtain details in respect of Frauds committed during the year.

HEAD OFFICE ACCOUNT

47. Is the balance in agreement with the head office account in the GL.
48. Are there any outstanding debits in the HO Accounts in respect of IBIT.
49. Are there any old outstanding entries relating to IBIT, which remains un–explained.
50. Check the General Charges to ensure that only expenses genuinely related to the activities of the branch have been recorded.

ANNUAL RETURNS 51. Trace the balances from the Balancing Reports into the Annual Returns. 52. Did you come across any discrepancy between the Annual Return and the GL 53. If so, have you proposed a MOC 54. Check whether the provision recommended in the case of NPAs is in line with the norms prescribed by RBI. 55. Have you come across case of under / over provisioning. 56. If so, have you proposed a MOC 57. Obtain details of borrowers with outstanding of Rs. 2 crores and above in the prescribed format and check the same for correctness.			

SAMPLE AUDIT PROGRAMME FOR VERIFICATION OF INCOME RECOGNITION AND ASSET CLASSIFICATION

1. Obtain the list of NPAs of the branch as at the end of the previous year.

2. Verify those cases which has been identified by the branch as NPA

3. Confirm that the NPAs as at the end of last year continues as NPA (unless fully regularized or closed) and also confirm that the balance outstanding is not increased during the year.

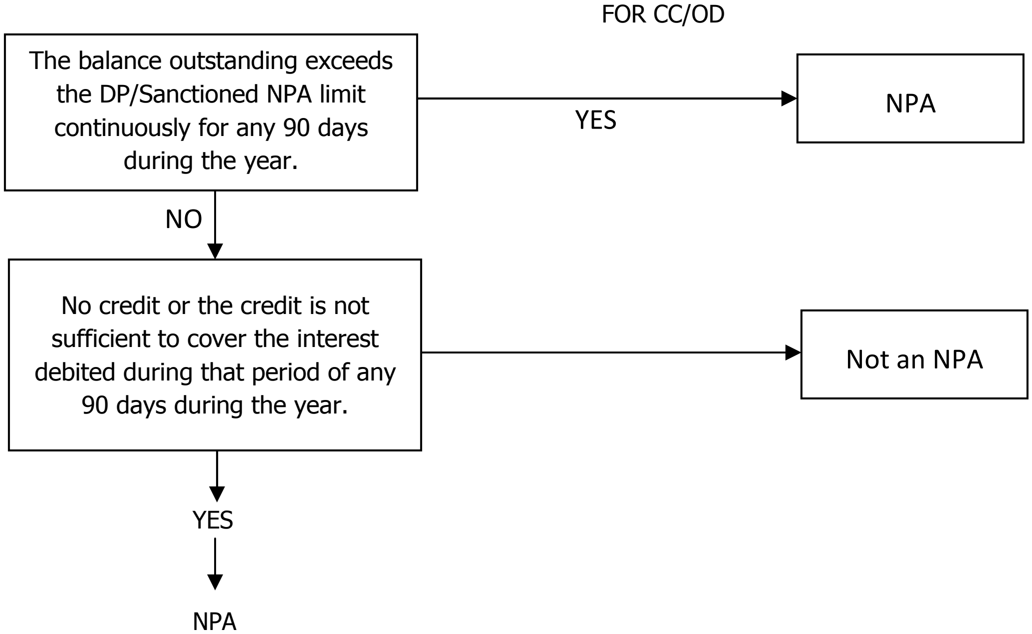
4. For identifying a Term Loan account as NPA:
   Check if Interest debited upto and including interest debited on 31st December of the year and principal due upto 31st December of the year is recovered in full before 31st March of that year.
   If so, it is not NPA

5. In respect of BP/BD facility verify if any bill due on 31st December 2011 is outstanding as on 31st March 2012 and if so, it will be NPA

6. In respect of other advances verify if the amount is due on or before 31.12.2011 and has not been received as on 31.03.2012. If so, it becomes a NPA

7. For identifying an CC/OD account as NPA verify as per flow chart given below:

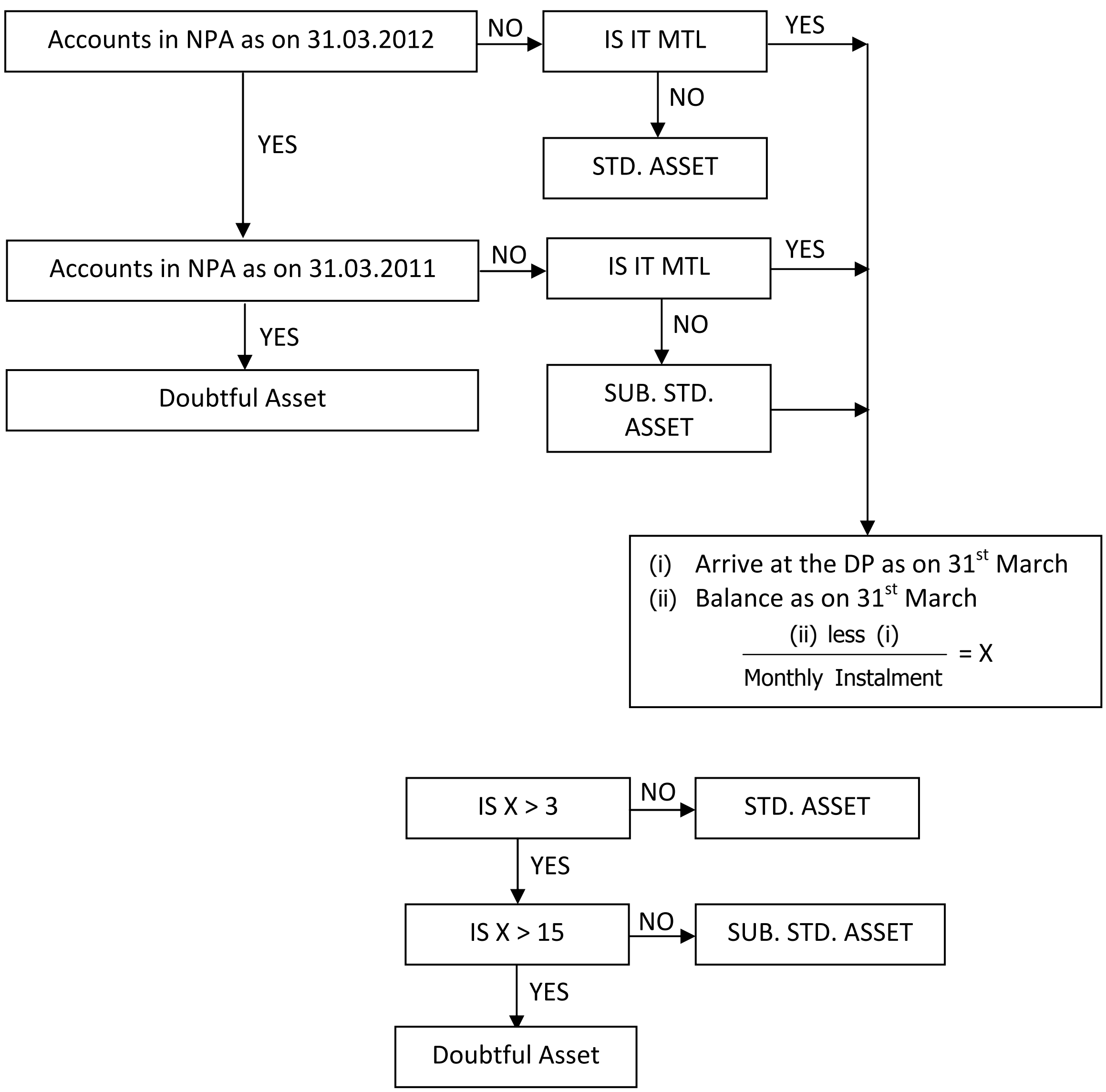
FOR CC/OD



Note:

1. If the account is a State Government guaranteed accounts also, NPA norms of 90 days will be applicable.
2. Central Government Guaranteed accounts will be continued to be exempt from provisioning norms. But interest will be recognized on recovery only.

ASSET CLASSIFICATION AS ON 31st MARCH 2012



CHECKLIST FOR VERIFICATION OF ADVANCES

Name of the Borrower	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
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 the 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 have 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															

Annexure II

________________________________ BANK

Branch __________________________ Figures ____________________

Analysis of advance portfolio as at _______________________

Facility	As per weekly Abstract				Accounts Verified				Remarks
	No. of A/cs	% of total	Balance	% of total	No. of A/cs	% of total	Balance	% of total	

Annexure III

Data Sheet on Advances

Chartered Accountants

Bank Name: ____________________ Branch: ________________

Name of the Borrower	Verified by
Constitution	1
Bank Classification	2
	Reviewed by

As at ____________

Acc No.	Account Type	LMT Expy / Sanc Dt.	Limit	DP / Theoretical Bal	A/c Balance	Irregular	Class. By Auditors

Sanctioned by

Security

Primary

Collateral

Insurance

Desc. of assets	Value	Expiry dt.	Endorsed ('I or x)

Comments

Write your descriptive comments on reverse

Check	DP Regr	Legal Valuation	RoC/F8, F13	RoA	Unit Inspn
√ or ×					

Bank Name: ______________________ Branch: __________________

CHECK LIST FOR VERIFICATION OF HOUSING LOAN

	Name of the Borrower							
	Account No.							
1.	Has an application in the prescribed form been received							
2.	Has legal opinion been obtained							
3.	Has it been ensured that seller has clear and marketable title to the property							
4.	Has EC been obtained							
5.	Has building permission from the concerned authority been obtained							
6.	Has the branch obtained a copy of the construction agreement							
7.	Is the builder an approved and reputed contractor							
8.	Has the margin money been routed through the banker							
9.	Has the branch inspected the proposed site							
10.	Has the necessary documents been executed by the borrower							
11.	Has the branch obtained the original document of purchase of land and a copy / original of the parent document							
12.	Has the loan been released in stages							
13.	Has the inspection been carried out in various stages by the branch							
14.	Has the certificates been obtained from registered valuers / engineers as regards completion of the various stages							
15.	Has the completion certificate been obtained							
16.	Has Equitable Mortgage been created							
17.	Has a fresh E.C been obtained at periodic interval							
18.	Has the property been insured							
19.	Have you verified the operation of the account							
20.	Have you noticed any irregularity in the operation							

Model Letter to be sent to Branch before audit

……….March ……...

To

The Branch Manager

…………..Bank

…………Branch

Chennai

Dear Sir,

Statutory Audit of your Branch for the year 2011 – 2012

We are appointed as Statutory Auditor of your branch. In response to the request made in the appointment letter, we have to take up the audit early. We will be taking up the audit in two phases and the first phase will be on 28th, 29th & 30th March and the second phase will be commenced on 3rd April 2012.

For smooth conducting of audit, we wish to have the following things in the first phase:

(i) Weekly Statements for the specified Fridays
(ii) Audit Report, LFAR and audited financial statements of the year 2011–12
(iii) NPA statement as on 31.3.2012
(iv) Inspection reports of your H.O. staff and TBA auditors
(v) Concurrent audit reports of all the months, if any.
(vi) Income Tax remittance challans for Tax deducted at source (For Tax Audit).
(vii) Stock / Book debts statements for CC account till Feb 2012.
(viii) Insurance Register along with the details
(ix) Documents and files relating to Advances sanctioned/renewed during the year Rs.5 lacs and above after latest inspection by your Head Office.

In order to facilitate quick completion of audit, we give below some of our important requirements, which you may kindly keep ready, prior to commencement of second phase of audit on 3rd April 2012 :–

1. One copy of Profit & Loss and Balance Sheet fully filled up (including Annexures & other details, schedules) for the year ending March 2012.
2. Loan Classification statements.
3. Previous two years loan Summary and Classification statements (for identifying doubtful debts).
4. Documents in respects of accounts sanctioned/renewed during the year. (as may be required specifically)
5. Circulars received form controlling office which will be useful for statutory audit, including interest rate etc.
6. Invoices for Fixed assets purchased during 2011–2012.
7. All documents mentioned in Audit booklet – (Documents to be certified).
8. LFAR duly filled in to the extent possible (One copy).
9. Details of LCs devolved & BGs invoked, if any

10. Details of accounts restructured / rescheduled, if any
11. Quarterly / half yearly returns for NPAs.
12. Exception Reports for the Year

We also request you to take specific interest in ensuring that the following items are properly taken care of:

1. Statement in respect of movement of NPAs, with detailed workings for all figures.
2. Detailed working papers for sectorwise classification of advances.
3. Detailed Working papers for Capital Adequacy Data (especially for credit balances figure in respect of borrowal accounts)
4. Making available relevant manual weeklies & the relevant days' computerized print outs of ledger balances.
5. Audited financial statements from all business borrowals accounts for the year 2007–08.

We are also required to certify separately on details advances over 1 Crore and the rating details for the last two years, and ALM data. We are also required to provide data respect of STANDARD ASSETS also with detailed break up to make global provision at various rates as per the new circular. Kindly make the above also ready for audit.

We request you to keep ready as many copies of statements, as may be required by your controlling offices, for signatures, at the time of finalization at the branch itself and avoid inconvenience to both of us, subsequent to completion of audit.

Thanking you,

Sincerely yours,
For…………………
Chartered Accountants

……………………..
Partner

EDP SYSTEMS REVIEW

Name of the Bank:	Branch:
Date of Review:	
Review Done By:	Questionnaire Answered By:

1. Is the account & operation of the branch fully computerized? 2. Is a login name & password essential to enter into the system? 3. Can a user login from a specified workstation only. 4. Has a minimum length been prescribed for a password? 5. What is the minimum length 6. Does the password have to be changed at least once during a specified period? 7. What is the specified period? 8. Have maximum number of attempts to login form a workstation been provided. 9. What is the specified number of attempts? 10. Can the system be accessed at all time on all days? 11. Can the system be accessed for a previous date for passing transaction? 12. Are there any restriction on individual users in terms of access to specified directories / files. 13. Are some menus password controlled? (For e.g. opening of an account, closing of account etc.) 14. Can anybody access the system software? 15. Does exception situation require a supervisory password in addition to operator password (e.g. Activating document a/c's, allowing excess drawings, etc.) 16. Has a user timeout been prescribed 17. Whether an entry / transaction can be rectified or altered without passing additional rectification entries. 18. After the EOD operation can the ledger be opened by • Operator • Supervisor If so is a log generated to record the event. 19. Is a record maintained of all log in & log outs. If yes who has access to the record. 20. Are operating instructions flashed on the screen when the account is accessed 21. Does the system check for cheque number range of operating instruction such as stop payment before processing a transaction 22. Does the system check the withdrawal with reference to the drawing power 23. In case the balance is likely to exceed the DP after the transaction, is a message flashed and transaction halted. 24. Can the halted transaction be processed by a supervisory password? 25. Has systems audit been conducted during the year. 26. Have the defects, if any, pointed out in the systems audit report been rectified. 27. Whether regular back ups are taken & stored off site 28. Is there a system to periodically check whether the date–stored offsite is readable. 29. Are the disaster Recovery plans in place for loss / encryption of data. 30. Obtain a list of hard ware and software used by the	

branch. 31. Was the software amended during the year 32. if so, under whose authority. 33. Whether any pre / post checks conducted. 34. If year–end accounting is on a separate partition, obtain logs or access to the yearend data to ensure data does not include transaction of the current year. 35. Whether the system is designed to automatically pass entries for Income Recognition Norms. 36. Whether RBI norms of provisioning are incorporated into the system, including the current amendments. 37. Obtain a list of exception reports that can be generated in the system. 38. What is the periodicity of these reports 39. Who reviews these reports? 40. Was any exception Report generated during year–end closing? If so, what reports were generated. Obtain a copy and review.	

BANK: ________________________ Branch: ________________________

Date: _____________________

XXXXXXXXX
Chartered Accountants
Address

Dear Sirs

Letter of Representation

This representative letter–is provided in connection with your audit of the financial statements of.......Branch, ………..Bank for the year ended March 31,………..for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the branch as on that date and on the results of the operations for the year then ended. We acknowledge Branch Management's responsibility for the true and fair presentation in the Accounts of financial position and results of operations in conformity with generally accepted accounting principles and the guidelines laid down by our head office and the various controlling authorities. We have produced all relevant records to your audit team for their scrutiny and necessary examination.

We confirm to the best of our knowledge and belief and as disclosed by books of accounts and record, the following representations made to you during the course of your audit

I. INCOME:

1. Interest and other income are recognized on accrual basis, except the following, which are recognized on cash basis
   (A) Interest and other income on Non Performing Assets as per norms prescribed by the Head Office.
   (B) Commission, Exchange on LC and BGs, Bills, Brokerage and Locker Rent.
   (C) Interest on overdue bill purchased/discounted.

2. Interest on all advances upto March 31,__________ , has been properly applied and accounted or in the books of account of the Branch. Necessary provision has been made for debits and credits in borrowal accounts from the last application date i.e.

3. Revenue leakage as pointed out by the Statutory Auditors/Concurrent Auditors/Inspectors of inspection Department of the Bank has been collected / accounted for.

4. No income relating to future years, except commission on DPGs, BGs, Locker Rent, as the case may be, have been credited to the Profit and Loss Account for the year ended on 31.03.____

5. All income earned during the years, except as stated above in paragraphs 1 to 4 has been credited to the Profit and Loss Account and no unearned income has been credited to the Profit and Loss Account for the year ended on 31.03.

II. EXPENDITURE:

6. Revenue Expenditure is accounted on accrual basis, except Property Tax, insurance charges and interest on overdue deposits and leave encashment. Necessary provision is made for revenue items kept under Sundry Debtors Account.

7. Interest on Deposits is properly accounted for up to March 31,_____. Necessary provision is made for further deposits received/paid on or after. No interest is provided on overdue/matured Deposits.

8. Bonus had been paid to all eligible employees as per the instructions of Head Office.

9. No expenditure of personal nature has been debited to the Profit and Loss Account for the year ended on 31.03. _____,

except those paid as per the rules and regulations of the Bank.

10. Payment towards expenditure in excess of Rs20,000/– are effected through account payee Cheques / DDs / Pay Orders or credited to the Current/Savings Account of the Payee and no cash payment is made.

11. Liabilities of any contingent nature have not been debited to the Profit and Loss Account for the year ended on 31.03.__

12. No capital expenditure is debited to the Profit and Loss Account. However as per the Bank's Policy depreciation is provided @ 100% on all fixed assets costing upto Rs 5,000/– each, acquired during the year.

13. Legal expenses incurred on suit filed accounts have been debited to Profit and Loss Account and other expenses are neither kept under Sundry Debtors nor debited to Customers' account.

III. ASSETS

14. Cash balances, Stamps and Stationery as on March 31, is physically verified and tallied with the amount stated in the Balance Sheet.

15. Cash and other valuable securities are adequately and comprehensively insured through a Blanket Policy taken by Head office

16. In respect of cash held in chest for and behalf of RBI, the insurance is the responsibility of Head Office.

17. Balances with other Banks and the Reserve Bank of India as at 31st March were reconciled and no amount of revenue nature is kept under reconciliation.

18. All advances stated in the Balance Sheet as at 31.03._ are fully recoverable and good, except those stated in IRAC returns.

19. Drawing power has been reworked on receipt of monthly Stock statements certified by the borrower.

20. Security values recorded in Returns are as per the latest valuation reports received.

21. All advances have been properly classified as Performing Assets. All Non–Performing Assets have been correctly classified, further as Sub–standard, Doubtful, Loss assets and the provisions have been correctly worked out as per the norms prescribed by the Head Office and furnished in IRAC returns. We further certify that all Loss assets have been classified as Loss assets only and not otherwise. Provision for doubtful assets shown in the IRAC returns is sufficient and no further loss is expected on this account.

22. All Restructured accounts have correctly and fully furnished in the Return of Restructured accounts including sacrifice made.

23. Fixed Asset Register has been properly maintained at the Branch. All Fixed assets have been physically verified and tallied with the Book Balances. All Fixed Assets shown in the Balance Sheet are in working condition.

24. Capital expenditure incurred only for the assets put to use have been fully capitalized and is not shown in Work in process/advances for capital works – Sundry Debtors.

25. All transfers–in and transfer–out of capital assets have been correctly accounted.

26. Only purchases of Fixed Assets have been shown as additions to Fixed Assets and no transfers – in of these Assets are included in the additions to Fixed Assets.

27. All sales of Fixed assets are correctly shown in the return of Assets sold. No transfer–out of Fixed Assets are included in this return.

28. Depreciation on Fixed Assets have been correctly provided as per the guidelines of Head Office.

IV. LIABILITIES

29. All known and accrued liabilities have been provided for in the accounts, except property tax, insurance charges, interest on overdue deposits and leave encashment.

30. All Liabilities stated in the Balance Sheet as at 31st March are existing and no infructuous Liabilities are included in the accounts.

V. TAX AUDIT:

31. There are no expenditure by way of penalty or fine for violation of any law for the time being inforce or for any purpose which is an offence or which is prohibited by law.

32. We confirm that all the payments of expenditure nature in excess of Rs.20,000 is paid by either A/c Payee Pay Orders/Drafts or by credit to the parties accounts maintained with us and no payments have been made otherwise in excess of the limits prescribed under Section 40 A (3) of the Income Tax Act.

33. We confirm that all the repayments of Deposits in excess of Rs.20,000 is paid by either A/c Payee Pay Orders/Drafts or by credit to the parties accounts maintained with us and no repayments of Deposits have been made otherwise in excess of the limits prescribed under Section 269 T of the Income Tax Act.

34. We confirm that Tax Deductible at source in respect of expenditure on Contractual Payments, Consultants are done at the rates prescribed in the Income Tax Act and remitted into the credit of the Central Government regularly except in the following cases :

S. No.	Nature of Payment	Date of Payment / Credit	Amount of Payment	Amount of Tax Deducted	Date of Remittance

35. We confirm that Tax Deductible at source in respect of Interest on Deposits in excess of the limits prescribed under Section 194–A are done and remitted to the Credit of the Central Government or the necessary declaration has been obtained from the Depositors except in the following cases:

S. No.	Details of Deposits	Amount of Interest	Amount of TDS	Date of Remittance	Details of Declaration

VI. OTHER MATTERS

36. The Branch was subjected/not subjected (strike wherever not applicable) to (a) Revenue Audits/ Internal Inspection/RBI Inspection/credit Audits. The previous Branch Auditors' Reports and LFAR and Compliance thereof are furnished to you during the course of Audit.

37. The effect of MOC, if any, for the previous year _____ is incorporated in the accounts of the current year ____

38. Information furnished in the annual closing returns is complete and correct.

39. No loans or advances or any other payment has been made to the directors/persons having substantial interest in the Bank or their relatives.

40. All documents relating to the advances of the Bank are properly filled up and not kept blank. All these documents are current and not barred by time. A list of borrowers whose documents are kept blank/time barred are as under.

S. No.	Loan No.	Name of the Borrower	Nature of Advance	Amount Outstanding	Date of Expiry of Documents	Reasons for keeping documents blank

41. The branch has not made any claim under DICGC Scheme. Also it has not collected / recovered any dues in respect of advances covered earlier under DICGC Scheme

42. The Branch is under Core banking Solutions system and all Books of Accounts and subsidiary records are balanced and there are no cross foot differences in any General Ledger Head.

43. The excess allowed during the year have invariably been reported to the controlling authorities.

44. Legal action has been initiated in all cases where the same has been approved by the controlling authorities except in the following cases

Units	Approval for legal action	Action directed	Pending

45. In all case of write off of advances, necessary approval has been obtained from controlling authorities. The details are:

Name of the customer	Amount	Action Directed	Approval Ref

46. There has been no fraud at the branch during the year under audit.

47. There are no claims against the branch not acknowledged as debt.

Thanking You,
Yours Faithfully,

For
Branch

Branch Head

Place:
Date:

COMMUNICATION TO THE PREVIOUS AUDITOR

(to be sent before accepting the appointment)

BY REGISTERED POST ACKNOWLEDGEMENT DUE

Date

To
XYZ & Co.,
Chartered Accountants,
(Address)

Dear Sir,

Sub:- Communication under Clause (8) of Part I of the First Schedule of The Chartered Accountants Act, 1949.
Ref:- Audit of M/S …….. Bank, ……. Branch for the Financial Year 2011-12.

In connection with the above reference subject, we wish to inform you that we have been appointed as the Statutory Auditor of M/s …………..Bank, ………….Branch for the Financial Year ending 31st March 2012.

We are informed that your Firm conducted the Statutory Audit for the previous Financial Year ending 31st March 2011.

In case, you have any objections on our taking up of the above professional work, we request you to kindly inform us the same.

Regards
For Chartered Accountants

Name of the Partner:
Designation:
Membership Regn No.:
Firm Regn No.

FORMAT OF PHYSICAL CASH VERIFICATION SHEET

Name of the Client :
Financial Year : 2011-2012
Area of Audit : Physical Verification of Cash

VERIFICATION OF CASH

Branch		Date & Time	
Cashier		Till Number (if any)	

PHYSICAL VERIFICATION

DENOMINATION		
	NOS.	**VALUE**
Rs. 1,000 X		
Rs 500 X		
Rs. 100 X		
Rs. 50 X		
Rs. 20 X		
Rs. 10 X		
Rs. 5 X		
Rs 2 X		
Rs 1 X		
COINS :		
Rs. 5*		
Rs. 2*		
Rs. 1*		
Rs. 0.50*		
Rs. 0.25*		
Rs. 0.20*		
Rs. 0.10*		
Rs 0.05*		
TOTAL		

Observations:

(a) Spoiled Notes:

(b) Other Observations:

The above cash has been physically verified and found in accordance with the books subject to audit.

AUDIT STAFF **BANK OFFICIAL**

Done by: **Reviewed by:**

CHAPTER IX: OTHER VERIFICATION ASPECTS

Prudential norms on income recognition, asset classification and provisioning relating to advances.

1. Non Performing Asset includes, in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

2. Funded Interest:
   (a) Funded Interest Term Loan is an extension of the Existing Loan Period by extending another loan for the repayment of the existing loan (both Principal & Interest portions) in cases where the borrower is unable to repay it, under justifiable circumstances.
   (b) Income recognition in respect of the NPAs, regardless of whether these are or are not subjected to Restructuring/ Rescheduling/ Renegotiation of terms of the Loan Agreement, should be done strictly on **Cash Basis**, only on realisation and not if the amount of interest overdue has been funded.
   (c) If, however, the amount of funded interest is recognised as income, a provision for an equal amount should also be made simultaneously.
   (d) In other words, any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.

3. **Provision in respect of Doubtful Assets:**

   (a) **Unsecured Portion:** 100% of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis.

   (b) **Secured Portion:**
   - Upto 1 year – 25%
   - 1 – 3 years – **40%**
   - More than 3 Years – 100%

4. **Provision in respect of Substandard assets:**

   (a) **General Provision:** A general provision of 15% on total outstanding should be made (without making any allowance for ECGC guarantee cover and securities available).

   (b) **Excess Provision:** The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10%, i.e., a total of 25% on the outstanding balance.

   (c) **Unsecured Exposure:**
   - It is defined as an exposure where the realisable value of the Security, as assessed by the bank / approved valuer / Reserve Bank's inspecting officers, is not more than 10%, ab-initio, of the outstanding exposure.
   - 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments).
   - 'Security' will mean tangible security properly discharged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters etc.

   (d) However, in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 20% instead of the aforesaid prescription of 25%. To avail of this benefit of lower provisioning, the banks should have in place an appropriate mechanism to escrow the cash flows and also have a clear and legal first claim on these cash flows.

Procedure for verification of Drafts Paid without advice.

This is in the nature of a **Suspense Account** for payments made for Drafts issued by other Branches, for which the relevant advice have not been received from them. The audit procedures are as under –

1. Examine the effectiveness of verifying the authenticity of the Draft & Specimen Signature of the signing authority, and the prima facie correctness and completeness of the draft in all respects.
2. Verify the system of correlating Drafts Paid where the relevant advices are subsequently received.
3. Examine the system of sending reminders to ensure that reminders are sent where advices are not received within reasonable time.
4. See whether the reasons for non–receipt of advices are immediately recorded.
5. Scrutinise the composition of the balances appearing in this account with particular reference to any long outstanding items.

6. Examine whether the items appearing in this account are subsequently cleared on receipt of the relevant advices from the Issuing Branches.
7. Verify whether the names and addresses of the payees of such Drafts are recorded separately for necessary follow–up and action in the event of any subsequent misdemeanor.
8. Obtain the confirmation of transactions relating to such outstanding cases.

Audit procedures for the verification of Capital of a Bank.

1. **Balances:** Verify the balances and increase as under –

Item	**To be verified based on**
Opening Balance of Capital.	Audited Balance Sheet of the Previous Year.
Increase in Authorised Capital during the year.	Special Resolution of Shareholders, MOA etc.
Increase in Subscribed / Paid–up Capital.	Prospectus, Other Offer Document, Reports of Registrars to the issue, Bank Statement, etc.
Fresh Contributions from Government (in case of Nationalised Banks).	Correspondence / Government Notification or Order, Bank Statement, etc.

2. **Disclosure:** See whether disclosure requirements as per Banking Regulation Act, are duly complied with.

For Nationalised Banks	**For Banks Incorporated outside India**	**For Banks Incorporated in India**
(a) Capital (fully owned by Central Government) (b) Capital owned by Government as on B/ Sheet date, including contribution from Government, if any, for participating in World Bank Projects, should be shown separately.	(a) Capital (the amount brought in by Banks, by way of Start–Up Capital as prescribed by RBI should be shown under this head) (b) Amount of deposit kept with RBI u/s 11(2) of the Banking Regulation Act, 1949.	(a) Authorised Capital (Shares of Rs…. each) (b) Issued Capital (Shares of Rs…. each) (c) Subscribed Capital (Shares of Rs…. each) (d) Called–Up Capital (Shares of Rs…. each) Less: Calls Unpaid Add: Forfeited Shares

3. **Other Aspects:**
   (a) Ensure compliance with Sec.12 of Banking Regulation Act, i.e. Subscribed Capital should not be less than 50% of the Authorised Capital, and Paid–Up Capital is not less than 50% of Subscribed Capital.
   (b) Ensure that the Capital of the Banking Company consists only of Ordinary Shares.
   (c) Verify whether the voting right of any person exceeds 10% of the total voting rights.

Capital Adequacy Ratio (CAR)

Capital Adequacy is the adequacy or sufficiency of capital resources of a Bank in relation to the risk associated with its operations. This adequacy / sufficiency expressed in %, is called as the Capital Adequacy Ratio (CAR) or Risk–Weighted Capital Ratio.

1. **Minimum CAR:** All Scheduled Commercial Banks (excluding Regional Rural Banks) as well as Foreign Banks operating in India should have and maintain a minimum CAR of 9% (notified by RBI)
2. **Computation:** CAR = [Capital Funds ÷ Risk–Weighted Assets and Off Balance Sheet items] × 100
3. **Capital Funds:** For computing CAR, Capital Funds are classified into 3 categories – (a) Tier I Capital, (b) Tier II Capital, and (c) Tier III Capital (not yet operative).
4. **Tier III Capital:** At the discretion of the national authority, Banks may employ Tier III Capital consisting of short–term subordinated debt, for the sole purpose of meeting a proportion of the capital requirements for market risks. At present, Banks are not allowed to raise Tier III Capital.
5. **Restrictions:** Banks in India cannot raise Capital Funds through the issue of – (a) Preference Shares, (b) Innovative Capital Instruments under Tier I Capital, and (c) Hybrid Debt Instruments under Tier II Capital.

Components of Tier I Capital

Tier I Capital (also known as **Core Capital**) provides the most permanent and readily available support to a Bank against unexpected losses. It is computed as under –

For Indian Banks	For Foreign Banks
Paid–Up Capital **Add:** Statutory Reserves **Add:** Other disclosed Free Reserves incl. Securities Premium & Capital Reserves arising out of surplus on sale of assets. **Less:** Equity Investments in Subsidiaries **Less:** Deferred Tax Asset under AS-22 **Less:** Intangible Assets **Less:** Current and Brought Forward Losses **Note:** In case of Public Sector Banks which have introduced VRS Scheme, the deferred revenue expenditure relating to VRS should not be reduced from Tier I Capital. As per New Regulatory Framework: **Add:** Innovative Perpetual Debt instruments limited to 15% of total Tier I Capital (& complying with other regulatory requirement) **Add:** Perpetual Non Cumulative Preference Shares **Add:** Others as may be notified **Less:** Any gain on sale arising at the time of securitization of standard assets (if recognized) Less: Minority Interest (to the extent specified) Less: 50% X Securitisation Exposures Less: 50% X Investments in Equity of Financial Enterprises (which are not consolidated in the books and which exceeds 30% of total equity of such Financial Enterprise)	1. **Interest Free Funds** from HO that are kept in a separate account in Indian Books specifically for the purpose of meeting the Capital Adequacy norms. 2. **Statutory Reserves** kept in Indian Books. 3. **Remittable Surplus** retained in Indian Books which is not repatriable so long as the Bank functions in India. 4. **Capital Reserve** representing surplus arising out of sale of assets in India held in a separate account and which is not eligible for repatriation so long as the Bank functions in India. 5. **Interest free funds** remitted from abroad to acquire property which is held in a separate a/c in Indian Books. **Note:** Net credit balance in the Inter Office Account with HO / Overseas Branches will not be considered as Capital Funds. However, debit balance in HO Account should be set–off against the Capital. As per New Regulatory Framework: 6. **HO Borrowings** in foreign currency by foreign banks operating in India (subject to conditions)

Note: Forex Translation reserve (under AS 11) is not an eligible capital fund under the new regulatory framework

Elements that are included under Tier II Capital in the computation of CAR.

Tier II Capital contains elements that are less permanent in nature or are less readily available, than those comprised in Tier I Capital. Calculation of Tier II Capital is the same for both Indian Banks and Foreign Banks. The amount under Tier II Capital is restricted to the amount under Tier I Capital.

Components / Elements of Tier II Capital

Item	Conditions for Inclusion
Undisclosed Reserves	(a) They should represent accumulations of Post–Tax Profits. (b) They should not encumbered by any known liability. (c) They should not be routinely used for absorbing normal loan or operating losses.
CPPS	Cumulative Perpetual (Non Convertible) Preference Shares should be fully paid–up and non–redeemable.
Revaluation Reserves	(a) They have to be reflected in the Bank's Balance Sheet as Revaluation Reserves. (b) They should be discounted at 55%, for inclusion in Tier II Capital.

Hybrid Debt–Capital Instruments	These have features of both an equity instrument and a debt instrument, e.g. Convertible Bonds. They can be included in Tier II Capital only if these instruments have close similarities to equity and are able to support losses on an on–going basis without affecting the going concern status.
General Provisions and Loss Reserves (includible only upto max. 1.25% of risk–weighted assets)	(a) They should not be attributable to the actual diminution in value or identifiable potential loss in any specific asset, and sufficient provision should have been made to meet all known losses and foreseeable potential losses. (b) Floating Provisions (i.e. general in nature and not made against any identified assets) can also be included within the overall 1.25% ceiling, if such provisions are not reduced from Gross NPA to arrive at the Net NPA.
Subordinated Debt (includible in Tier II Capital, only upto 50% of Tier I Capital)	(a) This includes Debt Instruments which are – (i) Fully Paid–Up, (ii) Unsecured, (iii) Subordinated to the claims of other Creditors, (iv) Free of restrictive clauses, and (v) Not redeemable at the initiative of the holder or without the consent of RBI. (b) Instruments with an initial maturity of less than 5 years, or with a remaining maturity of 1 year or less, should not be included as part of Tier II Capital. (c) Bonds issued by Public Sector Banks to VRS employees, net of VRS Deferred Revenue Expenditure, can be included as Tier II Capital, subject to RBI guidelines. (d) Such instruments should be discounted for inclusion in Tier II. Discounting should be based on the remaining maturity of instruments, as under – (i) Less than 1 year at 100%, (ii) 1 – 2 years at 80%, (iii) 2 – 3 years at 60%, (iv) 3 – 4 years at 40%, and (v) 4 – 5 years at 20%.
Investment Fluctuation Reserve (IFR)	(a) This can be included in Tier II, along with "General Provisions and Loss Reserves", but would not be subject to 1.25% ceiling applicable therein. (b) Banks, which have maintained Capital of 9% of risk–weighted assets, can transfer the balance in IFR, in excess of 5% of securities held in HTF and AFS Categories, to the Statutory Reserve, which is eligible for inclusion in Tier I Capital.
Innovative Perpetual Debt Instruments (IPDI) and Perpetual Non Cumulative Preference Shares (PNCPS)	(a) IPDI in excess of 15% of tier I capital may be included in Tier II and PNCPS in excess of overall ceiling of 40% ceiling prescribed may be included under Tier II capital, subject to the limits prescribed for Tier II capital.

The following will be deducted from Tier I Capital:

(a) 50% X Securitisation Exposures.
(b) 50% X Investments in Equity of Financial Enterprises (which are not consolidated in the books and which exceeds 30% of total equity of such Financial Enterprise)
(c) 50% X Investments of a subsidiary / associate bank in the securities of Parent bank

Further Investments in equity of Banks / FI / NBFCs / Primary Dealers should not exceed 10% of Tier I + Tier II capital (after adjustments). Any investment in excess of this limit shall be deducted at 50% from Tier I capital and 50% from Tier II capital.

What are Risk Adjusted Assets and Off Balance Sheet items (i.e. denominator in CAR)?

1. **Risk–Adjusted Assets:**
   (a) All assets of a Bank are not subject to the same degree of risk. Hence, the value of all Assets shown in the Balance Sheet and the assets not shown in the Balance Sheet (i.e. Off Balance Sheet Items) should be adjusted on the basis of degree of risk associated with such items.
   (b) **Risk Weights:** RBI has stipulated different Risk Weights (in %) to different classes / categories of asset.
   (c) **Computation:** Risk Adjusted Value = Nominal Value of the Asset Category × Risk Weight stipulated.

2. **Off Balance Sheet Items:**

(a) This includes Guarantees Issued, LCs, Interest Rate Swaps Contracts, Forward Exchange contracts, etc. Off B/S items should be reduced by Cash Margins / Deposits received / made in this regard.
(b) **Credit Risk Exposure** = Nominal Value × Credit Conversion Factor stipulated by the RBI.
(c) **Risk Adjusted Value** = Credit Risk Exposure × Risk Weights attributable to the relevant counter–party.

Audit procedure in relation to Reserves and Surplus of a Bank.

1. **Disclosure:** Reserves & Surplus of a Bank should be classified as – (a) Statutory Reserves, (b) Capital Reserves, (c) Securities Premium, (d) Revenue and Other Reserves, and (e) Balance in P & L A/c. Under (a) to (d) above, Opening Balance, Additions and Deductions during the year, are to be shown separately for each item.

2. **Transfer:** Sec.17 of the Banking Regulation Act requires transfer to Statutory Reserve, of 20% of Profits before declaring dividends. However, RBI has stipulated transfer of not less than 25% of the Net Profit before appropriations, (after adjustment / provision for bonus to Staff). Where a Bank is exempted from such transfer, the Auditor should examine the relevant documents granting such exemption.

3. **Audit Procedures:**
   (a) Verify the Opening Balances of various reserves based on the Previous Year's Audited Balance Sheet.
   (b) Examine the additions to / deductions from Reserves, with reference to Board Resolution.
   (c) Examine whether the fact of appropriation of any sum from the Reserve Fund / Securities Premium has been reported to the RBI within 21 days from the date of such appropriation. [Sec.17(2)]
   (d) Ensure that appropriation from Securities Premium A/c, if any, is as per legal requirements.
   (e) Verify compliance with Foreign Laws in respect of Overseas Branches, e.g. creation of Special Reserves.
   (f) Where dividend is paid by the Bank, see whether conditions as to eligibility criteria and quantum of dividend have been fulfilled.

Audit procedures for verification of "Deposits" in Bank Audit.

A. CURRENT ACCOUNTS:

1. Verify the balances of individual accounts on a sampling basis.
2. Examine whether the balances as per Subsidiary Ledgers tally with the related Control Accounts in the General Ledger. Verify the reconciliation statement prepared in this regard.
3. Verify the procedure for obtaining confirmation of balances periodically and test–check the confirmations received.
4. Ensure that Debit Balances in Current Accounts are not netted out on the Liabilities Side but are appropriately included under the head "Advances".
5. In respect of Inoperative Accounts – (a) see whether revival is done only under proper authority, and (b) identify cases of significant reduction in balances as compared to the previous year and examine the authorisation for such huge withdrawals.

B. SAVINGS BANK DEPOSITS:

1. Verify the balances in individual accounts on a sampling basis.
2. Examine whether the balances as per Subsidiary Ledgers tally with the related Control Accounts in the General Ledger. Verify the reconciliation statement prepared in this regard.
3. Test–check the calculations of interest. When interest has been computed on estimated basis in respect of SB Accounts (e.g. upto 25th March), ensure that such estimation is reasonable.
4. Pay special attention to inoperative SB Accounts (as given in Current Accounts above).

C. TERM DEPOSITS:

1. Verify whether Term Deposit Receipts and Cash Certificates are issued serially and accounted for in the register maintained for this purpose. Evaluate the adequacy of control over unissued forms.
2. Examine internal control over negotiation of rates of interest on Certificates of Deposits and over Agents / Employees collecting deposits.
3. Test–check the Registers with counterfoils of receipts issued & discharged receipts returned to the Bank.
4. Examine the reconciliation of Subsidiary Ledger & General Ledger for various categories of Term Deposits.
5. See whether provision has been made for interest accrued on Term Deposits upto Balance Sheet date.

D. DEPOSITS DESIGNATED IN FOREIGN CURRENCIES:

1. Examine whether RBI & HO instructions for acceptance & reporting of Foreign Currency Deposits are duly complied with.
2. See whether Foreign Currency Deposits (e.g. FCNR Deposits), have been converted into Indian Rupees at the rate notified by the Head Office.
3. Verify whether increase or decrease on account of the rate notified, has been taken to P & L Account.
4. Examine whether interest on deposits has been paid on the basis of 360 days in a year.
5. In case of conversion of FCNR(B) Deposits into NRE Deposits or vice–versa before maturity, see whether the provisions relating to premature withdrawal have been complied with.

E. OTHERS:

1. **Interest Accrued But Not Due:** Ensure that interest accrued but not due on deposits is shown under the head "Other Liabilities and Provisions" and not included with the relevant deposits.
2. **Overall Reconciliation:** Review the Bank's procedures in periodic correlation of outstanding deposits, with the cost of deposits.
3. **Window–Dressing:** See whether there are any instances of window–dressing for reporting in LFAR and qualification in main audit report (e.g. allowing overdraft to constituents, for withdrawal and placing in the same Bank as Deposits, thus inflating Advances (Assets) and Deposits (Liabilities), and subsequent reversal of the same in the next year).

68. How will the Auditor verify the Borrowings of a Bank?

1. **Disclosure:** See whether the Borrowings have been properly disclosed as – (a) Borrowings in India – from RBI, Other Banks, Other Institutions and Agencies, and (b) Borrowings outside India.
2. **Interest:** Examine the rate of interest paid / payable with reference to the duration of Borrowings.
3. **Vouching:** Verify Borrowings from RBI, Other Banks / Financial Institutions, etc. based on confirmation certificates and other supporting documents like agreements, correspondence, etc
4. **Re–discount:** See whether clear distinction has been made between 're–discount' and 're–finance' for disclosure of the amount under "Borrowings". Ensure that "re–discount" does not figure under this head.
5. **Call and Short Notice:** Verify whether the borrowings of money at call and short notice are properly authorised. [Call / Notice Money Borrowings should not exceed 100% of Capital Funds (i.e. Tier I + Tier II). However, Banks can borrow a maximum of 125% of Capital Funds on any day, during a fortnight.]
6. **Branch:**
   (a) Examine relevant documents to ensure that the Branch has been authorised by HO to borrow / retain other borrowings, and see that the terms of borrowings are within the authorization received from HO.
   (b) See whether the amount shown in Branch A/cs is properly classified based on security or otherwise.

Verification procedures in relation to audit of Other Liabilities and Provisions.

1. **Bills Payable:**
   (a) Evaluate the efficacy of the relevant internal controls in relation to Bills Payable. Enquire whether –
      - Whether standard printed forms with serial numbers are used,
      - Whether unissued forms are adequately protected and are in safe custody of a responsible official,

- Whether the system of coding and decoding are properly adhered to.
- Whether confirmations are sent in respect of TTs / DDs issued by a Branch.

(b) Ensure that only those DDs, TTs, Mail Transfers, Traveller's Cheques, Pay Orders, Banker's Cheques and similar instruments issued by the Bank, which are not presented for payment till the Balance Sheet date are included under this head.
(c) Verify an appropriate sample of outstanding items comprised in Bills Payable a/cs with relevant registers.
(d) Enquire the reasons for old outstanding debits in respect of drafts or other similar instruments paid without advice.
(e) Review the correspondences such as Responding Advices, Advices for Drafts paid etc. with other Branches after the year–end in respect of large value items outstanding on the Balance Sheet date.

2. **Inter–Office Adjustments (Credit):** Similar as for Inter–Office Adjustments (Debit). [Refer separate question above.]

3. **Interest Accrued:** Examine the interest accrued but not due on Deposits and Borrowings, with reference to the terms of various types of Deposits and Borrowings.

4. **Others (including Provisions):** These include the following items dealt with at HO Level – (a) Provision for Income Tax, etc, (b) Surplus in Provision for Bad and Doubtful Debts and Provision for Depreciation in Securities (in the nature of a Reserve), (c) Provisions towards Standard Assets, (d) Proposed Dividend / Transfer to Government, and (e) Exchange Gain on translation of Financial Statements of Foreign Branches.

Audit procedures to be followed by a Statutory Auditor of a Bank for audit of Contingent Liabilities.

A. GENERAL:

1. **Parties:** Ensure that exists a system whereby the non–fund based facilities or additional / adhoc credit facilities to parties are extended only to their regular constituents, etc.
2. **Adequacy of Controls:** Evaluate the adequacy of the Internal Control System, by verifying whether – (i) Transactions giving rise to Contingent Liabilities are executed only by authorised persons, (ii) Procedures laid down in this regard are duly complied with.
3. **Identification:** Examine the Accounting System and Internal Control System of the Bank to ensure that Contingent Liabilities are promptly and properly identified.
4. **Recording:** Perform substantive audit to establish the completeness of the recorded obligations, through confirmation procedures, and examination of relevant records.
5. **Year–end amounts:** Evaluate the reasonableness of the year–end amount of Contingent Liabilities in the light of previous experience and knowledge of the current year's activities.
6. **Import LC's:** In case of LC's for import of goods, see whether payment to the overseas Suppliers is made on the basis of shipping documents, which are in strict conformity with the terms of the LC.
7. **Trade Credit:** In case of guarantees in respect of any trade credit (Buyer's or Seller's Credit), ensure that the period of guarantees is co–terminous with the period of credit, reckoned from the date of shipment.
8. **Other Parties:** In case of non–fund facility or additional / adhoc credit facilities to other than its regular customers, ensure that concurrence of existing Bankers of such Borrower is obtained.
9. **Management Representation:** Obtain representation from the Management that –
   (a) All Contingent Liabilities have been included,
   (b) The disclosed Contingent Liabilities do not include contingencies which are likely to result in a loss / expense, thereby requiring a provision in the Financial Statements.
   (c) The estimated amounts of financial effect of the Contingent Liabilities are based on the best estimates in terms of AS – 29, including any possibility of any reimbursement.
   (d) In case of Guarantees issued on behalf of Directors, Sec.20 of Banking Regulation Act is not violated.
   (e) Such Contingent Liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote including the Management's justification for reaching such a decision in respect of those Contingent Liabilities.

B. SPECIFIC CONTINGENT LIABILITIES:

1. **Claims against the Bank not acknowledged as debts:**

(a) Examine relevant evidence, e.g. correspondence with lawyers, claimants, workmen's unions, etc.
(b) Identify the claims against the Bank by examining – (i) Board / Committee Minutes Book, (ii) Contracts / Agreements / Arrangements, (iii) List of pending legal cases, and (iv) Correspondence relating to taxes and duties.
(c) Ascertain the status of claims outstanding as at the end of the previous year from the Management.
(d) Review subsequent events to verify the completeness and valuation of claims.

2. **Liability on Partly Paid Investments:** In case the Bank holds Partly Paid Shares / Debentures / Other Investments, ensure that the uncalled amounts are shown as Contingent Liability in the Balance Sheet.

3. **Liability on account of Outstanding Forward Exchange Contracts:**
(a) Verify the outstanding Forward Exchange Contracts with the Register maintained by the Branch and with the Broker's Advice Notes.
(b) Examine the Register of Net Position to ensure that the net position in relation to each foreign currency is generally squared and not uncovered by a substantial amount.
(c) Verify the Net "Position" reported in the Financial Statements with the Foreign Exchange Position Report prepared by the Back Office.

4. **Guarantees given on behalf of Constituents:** Ascertain the adequacy of the Internal Control System for issuance of Guarantees by verifying whether –
(a) Guarantees are issued under proper sanctions.
(b) Limits for sanctioning of guarantees are adhered to.
(c) Margins are taken from customers as per prescribed procedures.
(d) Adequate physical controls exist over unused guarantee forms, e.g. custody, maintenance of records, periodical verification, reconciliation, etc.
(e) Examine the Guarantee Register to ensure that the prescribed procedure for marking off the expired guarantees is being followed.
(f) Verify guarantees with the copies of letters of guarantee issued by the Bank, and with counter–guarantees received from the customers.
(g) Verify the securities held as Margin, and see whether provision is required as per AS – 29.

5. **Acceptances, Endorsements and other Obligations: See Separate Question Below.**

6. **Other Items for which the Bank is contingently liable:**
(a) Examine whether commitments under all outstanding underwriting contracts have been disclosed as Contingent Liabilities, by examining the terms and conditions of the relevant contracts.
(b) Check bills re–discounted from the Register maintained by the Branch, and see whether all bills are marked off on payment at the time of maturity.
(c) See whether AS – 29 requirements are complied with in case of disputed tax liabilities.
(d) Examine the disclosure of interest rate swaps in the Financial Statements, i.e. whether real or contingent liability, depending upon the situations in each case, in accordance with AS – 29.

7. **Bills for Collection:**
(a) Ensure that only Outward Bills for Collection has been included in respect of each Branch, and that Bills drawn on other Branches are not included in Bills for Collection.
(b) Verify Outward Bills for Collection based on the Register maintained by the Bank.
(c) Examine collections made after the Balance Sheet date to confirm the existence and completeness of the Bills for Collection as at the Balance Sheet date.
(d) Ensure that the customer's account is credited only after the bill has actually been collected from the Drawee either by the Bank itself or through its agents, etc.
(e) Ensure that income in respect of bills outstanding at the Balance Sheet date is not recognised, as the commission accrues / becomes due only on collection of the bill.
(f) See whether the RBI guidelines in respect of co–acceptances of bills, are complied with.

Verification of "Acceptances, Endorsements and Other Obligations" appearing in the Balance Sheet of a Bank

1. **Items:** This item includes – (a) LC opened by the Bank on behalf of its customers, and (b) Bills drawn by the Bank's customers and accepted / endorsed by the Bank.

2. **Letters of Credit:**
   (a) Evaluate the adequacy of the internal controls over LC Forms e.g. custody, maintenance of records, periodical verification, reconciliation, etc.
   (b) Verify the balance of LC from the Register maintained by the Bank to ascertain the amount of LC and payments made under them.
   (c) Examine the guarantees of the customers, copies of the LC issued, & security obtained for issuing LC.

3. In respect of **Other Acceptances and Endorsements**, the following procedure may be adopted –
   (a) Examine the arrangements made by the Bank with its customers.
   (b) Test–check the amounts of bills with the register maintained by the Bank.
   (c) Verify whether such bills are marked off in the register on payment at maturity.

4. **Letters of Comfort:** Where Letters of Comfort has been issued, verify whether the Bank has incurred a potential financial obligation under such letter. If an obligation has been cast under Letters of Comfort, ensure that the amount has also been shown as a Contingent Liability in the Balance Sheet.

Audit programme of Income items of a nationalised Bank situated in a metropolitan city.

1. **Items of Income:** The Income of a Bank includes –
   (a) All sources of Interest and Commission Earnings,
   (b) Other Sources of Income like – (i) Locker Rent, (ii) Processing Charges, (iii) Incidental Charges on Cumulative Deposits / Inoperative SB Accounts, (iv) Service Charges towards issue of Duplicate Statement / Pass Book & CD Accounts, (v) Folio Charges from CD / Overdraft / Cash Credit Accounts, (vi) Penal charges on returned cheques.

2. **General Aspects of Income Verification:** The Auditor should examine and test–check relevant records to assure that –
   (a) Interest has been charged on all performing accounts, upto the date of Balance Sheet.
   (b) Interest rates charged in accordance with the Bank's internal regulations, RBI directives, and agreement with the respective borrowers, particularly in case of advances with floating interest rate basis.
   (c) Discount on bills outstanding on the Balance Sheet date has been properly apportioned between the current year and next year.
   (d) Interest subsidy received / receivable from RBI in respect of advances made at concessional rates of interest is correctly computed.
   (e) Interest on Inter–Branch balances has been provided at the rates prescribed by HO.
   (f) Interest on NPA's has not been recognised unless realised.
   (g) RBI Guidelines and AS – 9 requirements have been complied with, in respect of Income Recognition.

The **audit programme** given hereunder highlights some of the Income areas –

1. Loans and Advances:
   (a) **General:** Verify whether interest rate charged, sanctioned limit, nature of advances are written on top of the Ledger wherever applicable. Verify whether the above are duly authenticated.

(b) **Interest:** Inspect the sanction letters of Borrower's Accounts to ensure that interest is charged / applied in the account, at the correct rates.
(c) **Product:** Check whether the extractions of product for the number of days are correctly done. Scrutinise the Ledger Accounts of Cash Credits / Overdrafts, to ensure that the products of outstanding balances are extracted on a daily basis.
(d) **Computation:** Review the computation of interest and its debit to the accounts.
(e) **Belated Debit:** Verify that in case of late debit of interest, the relative products have been added to the following Quarter / Half year's products.
(f) **Packing Credit:** Where in respect of Packing Credit Advances the export does not materialize, examine whether normal rate of interest is charged for the very first day of advance.

2. **Processing Fees:** Examine whether the Bank charges and recovers the Processing Fees at the prescribed rate both at the time of initial processing and at each renewal.

3. **Penal Interest:** Verify whether the Bank charges Penal Interest in respect of accounts where the balances exceed Drawing Limit / Power, when installments are not paid on the due dates, etc.

4. **Inspection charges:** Verify whether the Bank recovers Inspection Charges in all eligible situations.

5. **Incidental charges:** In respect of Cash Credit / Current / Overdraft / Inoperative SB Accounts, verify whether the incidental charges at prescribed rates are levied and collected.

6. Demand Bills Purchased:
(a) Examine whether the Bank has recovered the Collection Charges at prescribed rate.
(b) Verify whether out–of–pocket expenses like postage are recovered in addition to Collection Charges.
(c) In case of DDs Purchased & Returned, examine whether the interest has been charged for the period from the date of purchase to the date of realisation giving due consideration to the transit period.

7. Inland Bills Discounted:
(a) Verify whether the Bank has recovered the Interest and Collection Charges at prescribed rate.
(b) Verify whether out–of–pocket expenses like postage are recovered properly.
(c) Check whether interest is correctly charged from the date of discount till the date of realisation.
(d) Ensure whether Overdue Interest has been charged for delayed payment.
(e) In respect of TTs realised, verify whether overdue interest has been recovered wherever applicable.

8. Bank Guarantee:
(a) Examine whether commission has been charged at the prescribed rates at the time of issue / renewal of guarantee for all guarantees including those extending beyond 1 year.
(b) Examine whether the Bank has charged commission for the claim period also.

9. Letter of Credit:
(a) Examine whether opening charges, re–instatement charges and commitment charges as specified are being charged for opening / restoring / revolving / non–revolving LC's.
(b) Verify the recovery of the negotiating commission.

10. Deposits:
(a) **Rate of Interest:** Verify whether the correct rate of interest has been applied on Existing / New / Renewed Deposits during the year.
(b) Premature Closure:
- In case of closure of Term Deposit before its maturity, examine whether interest has been re–calculated and the excess payment made earlier has been recovered.

- In case of Current / Savings Bank Account closed prematurely, verify whether the prescribed charges have been recovered.

(c) **Matured Deposits:** In respect of deposits matured during the year under audit, ascertain whether the maturity value has been correctly paid.

(d) **Monthly Interest Deposits:** Verify whether the Branch has paid the interest only at discounted values as per table, in case of Fixed Deposits with interest at monthly rests.

(e) **Recurring Deposits:** In case of Recurring Deposits, ascertain whether the Bank has duly recovered penalty for late deposits of instalments. Also verify whether the same have been duly noted in the Recurring Deposit Register.

Audit of Expenditure items of a Bank.

1. **General Aspects of Expenditure Verification:** The Auditor should examine and test–check relevant records to assure that –
   (a) Interest has been charged on all Deposits and Borrowings, upto the date of Balance Sheet.
   (b) Interest rates charged in accordance with the Bank's internal regulations, RBI directives, and agreement with the respective Depositors.
   (c) Payment of Brokerage is properly authorised.
   (d) Discount on bills outstanding on the Balance Sheet date has been properly apportioned between the current year and next year.
   (e) Interest on Inter–Branch balances has been provided at the rates prescribed by HO.
   (f) Expenditure incurred and paid are within the powers to the Branch Manager.
   (g) Where Branch Manager has exceeded his powers, confirmation / ratification has been obtained from appropriate Controlling Authorities.

2. **Audit Procedures:**
   (a) Assess the overall reasonableness of the figure of Interest Expense, by working out the ratio of interest on different types of Deposits and Borrowings, to the average quantum of the respective liabilities during the year.
   (b) Compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years, and analyse any material differences.
   (c) Check the calculation of Salaries & Allowances etc, on a sample basis, with relevant agreements / awards.
   (d) Vouch the Operating Expenses incurred for a few months, on random sample basis, paying special attention to the efficacy of controls, availability of supporting vouchers, etc.
   (e) Perform analytical review by comparing the ratio of various items of Operating Expenses to Total Income, and comparison of amounts with previous years' figures.

Audit considerations in Foreign Exchange Transactions of Banks

1. **Translation:** See whether recording of transactions and re–statement of year–end balances, wherever required, has been done at the appropriate exchange rates.
2. **Classification:** Examine the classification into – (a) Integral Foreign Operations (IFO), and (b) Non–Integral Foreign Operations (NFO). Foreign Branches of Indian Banks and Offshore Banking Units set up in India by Banks should be classified as NFO, whereas Representative Offices of Banks abroad will be an IFO.
3. **Inter–Branch Transactions:** Ensure that transactions between the position–maintaining Branches and other Branches are accounted properly as inter–Branch transactions.
4. **Profit / Loss:** See whether profit / loss arising from forex transactions have been accounted for correctly.
5. **Guarantees:** Verify the Guarantees against exports paying special attention to – (a) caution–listed exporters, (b) Legal Department approval, (c) counter–guarantees on performance, advance payment etc, (d) accounting entries at the BC Selling rate, and (e) risk–weight assessment and capital adequacy.
6. **Reconciliation:** Verify the reconciliation of Nostro accounts with special attention to – (a) periodicity of reconciliation, (b) reporting to Controlling office, (c) old outstanding items, (d) random–check of the method of reconciliation, (e) provision required for debits outstanding in Mirror Account and Nostro Accounts, and (f) HO permission for set–off of long outstanding credits and debits.

7. **Deposits:** Verify that in the case of deposits designated in a foreign currency, the repayment has been done at the rate of prevalent on the maturity date.
8. **Country Risk:** Evaluate the Country Risk in respect of forex transactions, and examine the provision requirements thereof.
9. **Deals Verification:** Examine Deals with respect to – (a) Deal Slips, (b) Confirmation from counter–parties, (c) Rate scan counter check, (d) random scrutiny of audit trail from the system, (e) nature of settlement, and (f) claim of overdue interest at FEDAI announced rates.

Vostro & Nostro accounts - Meaning

Aspect	NOSTRO Accounts	VOSTRO Accounts
Meaning	(a) In order to be able to put through forex transactions, Banks maintain stocks of Foreign Currencies in the form of Bank Accounts (usually Current Accounts) with their Overseas Branches / Correspondents. (b) A Foreign Currency Account maintained by Indian Banks at their Overseas Centre is designated by it as NOSTRO Account.	A Foreign Bank in another country maintains stocks of Indian Rupees with their Indian Branch / Office / Correspondent. Such Indian Rupee A/cs are designated as VOSTRO Account. It is as good as any other account in the local currency.
Relation	"Our Account with You"	"Your Account with Us"
Example	A Bank in India maintaining a US Dollar Account with its New York Office / Branch / Correspondent, is designated by the Indian Office as NOSTRO Account.	A Bank in Germany maintaining a VOSTRO Account in Rupee Terms with an Indian Bank.

Declaration of Dividend by Banks

Banks can declare dividend upto **the rates (as may be notified by RBI)** dividend–payout ratio, without obtaining prior approval from RBI, subject to compliance with the following –

1. **Eligibility Criteria:** The following conditions should be satisfied –
   (a) The Bank should have – (i) CAR of atleast 9% for preceding 2 completed years and the accounting year for which it proposes to declare dividend, and (ii) Net NPA Ratio less than 7%. (However, dividend can be declared if current year CAR is atleast 9% and NPA ratio is less than 5%.)
   (b) The Bank should comply with – (i) Sec.15 & 17 of Banking Regulation Act, (ii) RBI guidelines / regulations, including those for creating adequate provisions for impairment of assets, staff retirement benefits, and transfer of profits to Statutory Reserves.
   (c) The Proposed Dividend should be payable out of current year's profit.
   (d) RBI should not have placed any explicit restrictions on the Bank, for declaration of dividends.

2. **Quantum of Dividend:** The following guidelines are relevant –
   (a) Dividend Payout Ratio (i.e. Dividend Payable in a year excluding Dividend Tax ÷ Net Profit during the year), should not exceed 40%, and shall be as per the matrix prescribed.
   (b) Extra–ordinary profits / income, if any, shall be excluded in calculating the Net Profit, in calculating the Dividend Payout ratio.
   (c) Financial Statements should be free of any qualifications by the Statutory Auditors. In case of any qualifications, Net Profit should be suitably adjusted while computing the Dividend Payout ratio.

3. **Board Oversight:** Bank's Boards should take the following aspects into account, while proposing the dividend – (a) interests of all stakeholders, (b) interim dividend paid, (c) inspection findings of RBI on divergence in identification of NPA's, shortfall in provisioning etc, (d) auditor's qualifications on accounts, (e) Basel II Capital requirements, and (f) Bank's long–term growth plans.

4. **Reporting:** Banks should report to RBI, the details of dividend declared during the accounting year, within a fortnight after declaration of dividend.

Verification of the Provision for Taxation

1. Verify whether all necessary adjustments in Financial Statements as required by the Memorandum of Changes given by the Branch Auditor, has been given effect to.
2. Ensure that Net Interest on inter–Branch transactions is reversed on consolidation.
3. Verify whether the items that are accounted for at HO are properly taken into account.
4. In respect of Bad Debts and Provision for Bad and Doubtful Debts, verify whether the requirements of the Income Tax Act, 1961 are complied with.
5. See whether Sec.43D of the Income Tax Act is complied with in respect of Interest Suspense Account.
6. Ensure that DTAA's are considered wherever applicable, in the computation of tax for transactions with Foreign Branches of the Indian Banks.
7. In respect of deduction of HO Expenditure for Non–Resident Banks, examine compliance with Sec.43C.
8. Verify the computation of Net Wealth and of the Wealth Tax.
9. Ensure compliance with Interest Act, 1974 in respect of computation of Interest Tax liability.

Audit of Consolidation of Branch Returns / Accounts.

The duties of Central Statutory Auditor in consolidation of Branch Returns are as under –

1. See whether consolidation of Branch Returns has been done correctly.
2. Verify whether the interest on inter–Branch balances and other related items have been reversed during consolidation. Also, see if asset–transfer between branches have been cancelled on consolidation.
3. Review the Notes on Accounts in Branch Returns, and observations of Branch Auditors in their Main Report and LFAR.
4. Pay special attention to large advance accounts which are operated at more than one Branch, since individual Branch Auditors would not be in a position to have a overall review of the same.
5. Review the memoranda of changes and ensure that they are consolidated separately. Examine whether the consolidated memoranda of changes are incorporated in the consolidated pre–audit Balance Sheet.
6. In respect of material amounts relating to unaudited returns, ensure that a disclaimer / qualification is made in the Audit Report.
7. In case of non–receipt of return from any Branch, make a suitable disclaimer / qualification in the Report.
8. In respect of Overseas Branches, verify – (a) whether currency translation has been done properly, (b) provisions for losses is adequate, considering remittance restrictions if any, (c) effect of local regulations in the country of operation on the Branch's accounts.

FAQs

What are "Non–Performing Assets" (NPA)? When does an Asset become NPA?

1. Meaning:

(a) Non–Performing Asset is a credit facility (advance) that ceases to generate income for a Bank.

(b) The interest and / or instalment of principal in respect of such an Advance have remained 'Overdue' or 'Out–of–order' for a specified period of time.
(c) Any amount due to the bank under any credit facility is said to be 'Overdue' if it is not paid on the due date fixed by the Bank.
(d) An account should be treated as 'Out–of–order' if the outstanding balance remains continuously in excess of the sanctioned limit / drawing power.
(e) Banks can classify an account as an NPA only if the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter.

2. Time Limits: An advance / asset will be treated as NPA considering the following time limits **–**

(a) **Term Loans:** Interest and / or Instalment of principal has remained overdue for a period exceeding 90 days.
(b) **CC / OD:** The account has remained out–of–order for a period exceeding 90 days.
(c) **Bills Purchased & Discounted:** The Bill remains overdue & unpaid for a period exceeding 90 days.
(d) **Agricultural Advances / Loans:** Interest and / or Instalment of principal is overdue for –
  - two crop seasons, in case loans granted for Short Duration crops,
  - one crop season, in case loans granted for Long Duration crops (i.e. more than 1 year)
(e) **Other Accounts:** Any amount to be received is overdue for a period of more than 90 days.
(f) **Erosion in the value of security / frauds committed by Borrowers:** Banks can directly classify these accounts as Doubtful Assets or Loss Assets, irrespective of the period for which the account has remained NPA.

What are the exceptions to the general rule of treating an advance as NPA?

1. **Borrower wise Vs. Facility wise:** NPA should be determined borrower–wise and not facility wise. Even if any one of the Credit Facilities granted to a borrower becomes NPA, all the facilities granted to that borrower will be regarded as NPA irrespective of the performing status of other facilities.
2. **Net Worth of the Borrower:** Net Worth of the Borrower / Guarantor should be considered to treat an advance as NPA, as the income recognition is based on the recoveries from an advance account.
3. **Availability of Security:** Availability of security is not relevant to determine the performing status of an advance, subject to certain exceptions.
4. **Regularisation before Balance Sheet date:** Where an account has been regularized before the Balance Sheet date by payment of the overdue amount through genuine sources, the account should not be treated as NPA. However, if such payment is due to transfer of funds between accounts or sanction of additional facilities, then the advance shall continue to be treated as an NPA.
5. **Take–out Finance:** Under a take–out finance arrangement (i.e. funding of long–term infrastructure projects), the Lending Bank should apply the prudential norms in the usual manner so long as the account remains on its books.
6. **Consortium Advances:** Where a loan has been advanced by a consortium of banks, then each individual Bank may classify the advance based on its own record of recovery and other aspects having a bearing on the recoverability of the advances.
7. **Temporary Deficiencies:** CCs / ODs need not be classified as NPA due to existence of temporary deficiencies like inadequate Drawing Power, non–submission of Stock Statements, non–renewal of limits on the due date, outstanding in excess of allowed limit, etc. However, where regular / advance credit limits have not been renewed / reviewed within 180 days from the due date / date of adhoc sanction, the account will be treated as NPA.
8. **Advances to "On–Lending" Arrangement:** In respect of loans / credit facilities granted under "On–Lending" arrangement, to Primary Agricultural Credit Societies (PACSs) / Farmers Service Societies (FSSs), only the particular credit facility granted to a PACS / FSS which is in default should be classified as NPA. Other credit facilities granted to the PACS / FSS will not be treated as NPA. This exemption does not extend to credit facilities granted outside the "On–Lending" system.
9. **Advances with Moratorium:** Where moratorium is available for payment of interest and / or repayment of instalment, then interest / instalment becomes "due" only after the end of moratorium / gestation period.
10. **Staff Loans:** In respect of Advances to Staff, where the interest is payable after recovery of principal, the interest becomes overdue only upon default in payment of interest on the due date.

11. Agricultural Advances affected by Natural Calamities:

Where natural calamities impair the repayment capacity of agricultural borrowers, the Lending Bank can – (i) convert Short–Term Production Loan into Term Loan or (ii) re–schedule the repayments and sanction fresh Short–Term Loan. In such cases, the Term Loan and the Fresh Short–Term Loan are treated as current dues, and need not be classified as NPA.

Both the Term Loan and the Fresh Short–Term Loan would be treated as Fresh Loans and accordingly the guidelines for identifying a NPA shall apply.

12. **Advances Guaranteed by Central Government:** Advances guaranteed by Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. Hence, Central Government Guaranteed Advances, even if overdue, would be a "Standard Asset". However, interest on such advance will be recognised as income only if realized.
13. **Advances Guaranteed by State Government:** For the year ended 31.03.2006, these advances would attract Asset classification and provisioning norms if interest, principal or any other amount remains overdue for more than 90 days (180 days for year ended 31.03.2005).
14. **Advances Guaranteed by EXIM Bank:** To the extent payment has been received from EXIM Bank, the advance may not be treated as NPA for asset classification and provisioning purposes.
15. **Export Project Finance:** Where the Foreign Importer has paid the amount to the Bank abroad, but it cannot be remitted due to war, strife, etc, the asset classification (as NPA) may be made after 1 year from the date the amount was deposited by the Importer in the Bank abroad.
16. **Advances against Term Deposits, NSC, KVP, LIC etc:** Such advances need not be considered as NPAs and interest on such advances may be taken to Income, provided adequate margin is available in the account. However, provisioning norms (0.25% for Standard Assets) will apply based on their asset classification status.

Discuss the income recognition norms in relation to interest from advances.

A. INCOME RECOGNITION NORMS:

1. **General Rule:** Generally, Banks should recognise income like interest, fees and commission on accrual basis, provided it is reasonable to expect its ultimate collection.
2. **Income from NPAs:** Banks should recognise interest on NPA only on Cash basis i.e. when such interest is actually realised / received.
3. **Commission / Other Income:** If interest income is recognised on cash basis, then commission and other such income with respect to the same borrower, which has been recognised on accrual basis in the previous year but has not been realised, should be reversed or provided for with respect to previous year.
4. **First time NPAs:** If a Loan / Advance is treated as NPA for the first time, interest accrued which has not been realised but credited to the Income Account should be reversed or provided for.
5. **Source of Credits:** It should be ensured that the credits in the account towards interest are not out of fresh / additional credit facilities sanctioned to the Borrower concerned.
6. **Take–out Finance:** If the lending Bank classifies a Take–Out Finance as NPA based on its record of recovery, then it can recognise income only when the same is realised from the borrower / taking–over institution (if the agreement so provides).
7. **Central Government Guaranteed Advances:** Interest on such Advances should not be taken to income account unless it has been realised.

B. EXCEPTIONS:

1. **Advances Secured against Certain Instruments:** Interest on Credit Facilities secured against Term Deposits, NSC, IVP, KVP and LIC, may be taken to Income Account on due dates provided adequate margin is available in the respective accounts.
2. **Appropriation of Recoveries in NPAs:** Interest partly realised in NPAs can be taken to income. However, such credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers.
3. **Re–negotiated / Re–scheduled Loans:** Fees and Commission earned by Banks as a result of re–negotiation / re–scheduling of outstanding debts should be recognised on accrual basis over the period covered by the re–negotiated or re–scheduled extension.

C. OTHER POINTS:

1. There is no restriction on Banks to use their own discretion in debiting interest to an NPA account, or taking the same to Interest Suspense account, or maintaining only a record of such interest in proforma accounts.
2. In the absence of a clear agreement between the Bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), Banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

Write short notes on Asset Classification and Provisioning Norms for Loans and Advances.

For the purpose of provisioning, Banks should classify their Advances into – (1) Standard Asset, (2) Sub–Standard Asset, (3) Doubtful Asset and (4) Loss Asset, with the following provisioning norms – for more details refer the Master Circular on Provisioning.

Write short notes on restructuring of advances.

1. **Types of Restructuring:** Restructuring of advances can be classified into the following four types:
    a. Restructuring of advances extended to industrial units.
    b. Restructuring of advances under the Corporate Debt Restructuring (CDR) Mechanism
    c. Restructuring of advances extended to Small and Medium Enterprises (SME)
    d. Restructuring of all other advances.

2. **Eligible Accounts:** Banks may restructure the accounts classified under 'standard', 'sub- standard' and 'doubtful' categories.

3. **Initiation:** Normally an application for restructuring (alteration / changes in the original loan agreement) is made by the debtor. However, the process of restructuring can also be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.

4. **Establishing Financial Viability:** An account will be taken up for restructuring only when the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them on a case-by-case basis. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects / activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns / action.

5. **Ineligible Customers:**
    a. **Black-listed Customers:** The borrowers indulging in frauds and malfeasance will not be eligible for restructuring. However banks may review the reasons for classification of the borrowers as willful defaulters and if satisfied about the credibility, such accounts may be restructured with the Board’s approval.
    b. **Sick Industries:** BIFR cases are not eligible for restructuring without their express approval. CDR Core Group in the case of advances restructured under CDR Mechanism / the lead bank in the case of SME Debt Restructuring Mechanism and the individual banks in other cases, may consider the proposals for restructuring in such cases, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.

6. **Asset Classification Norms:**
    a. Banks cannot restructure accounts with retrospective effect.
    b. **Classification under proposal:** While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply. The process of re- classification of an asset should not stop merely because restructuring proposal is under consideration. The asset classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring / rescheduling / renegotiation. In case there is undue delay in sanctioning a restructuring package and in the meantime the asset classification status of the account undergoes deterioration, it would be a matter of supervisory concern.
    c. **Classification:** The accounts classified as 'standard assets' should be immediately re- classified as 'sub-standard assets' upon restructuring. The NPA, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories.
    d. **Additional Finance:** Any additional finance may be treated as 'standard asset', up to a period of 1 year after the first interest / principal payment, whichever is earlier, falls due under the approved restructuring package. If the

restructured asset does not qualify for upgradation at the end of the above specified one year period, the additional finance shall be placed in the same asset classification category as the restructured debt.

e. **Subsequent Restructuring:** In case a restructured asset, which is a standard asset on restructuring, is subjected to restructuring on a subsequent occasion, it should be classified as substandard. If the restructured asset is a sub-standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion. However, such advances restructured on second or more occasions may be allowed to be upgraded to standard category after one year from the date of first payment of interest or repayment of principal whichever falls due earlier in terms of the current restructuring package subject to satisfactory performance.

7. **Income Recognition Norms:** Interest income in respect of restructured accounts classified as 'standard assets' will be recognized on accrual basis and that in respect of the accounts classified as 'non-performing assets' will be recognized on cash basis.

8. **Provisioning Norms:**
   a. **Normal Provisioning** on all restructured advances as per the existing guidelines.
   b. **Additional Provision:** To recognize the decrease in value of asset, the difference between the fair value of the loan before and after restructuring (discounted at BPLR rate on the date of restructuring) is provided for in the books.

9. **Special Regulatory Treatment for Asset Classifications:**
   a. This treatment is applicable only for those customers carrying on important business activities. This is not applicable for consumer and personal advances, advances classified as capital market exposures & advances classified as commercial real estate exposures.
   b. **Features:**
      i. As an incentive for quick implementation of the package, if the approved package is implemented by the bank within 90 days from the date of receipt of application (or 120 days from the date of approval under the CDR mechanism) the asset classification status may be restored to the position which existed when the reference / application was made to the CDR Cell.
      ii. Standard asset will not be downgraded to substandard category upon restructuring and the asset classification of the sub standard / doubtful accounts will not deteriorate upon restructuring.
   c. **Conditions:**
      i. The dues to the bank are fully secured (This is not applicable for SSI with outstanding less than Rs 25 Lakhs and other Infrastructure projects).
      ii. The unit becomes viable in 7 years (10 years if it is engaged in infrastructure activities).
      iii. The repayment period of the restructured advance including the moratorium, if any, does not exceed 10 years (15 years in the case of infrastructure advances)
      iv. Promoters' sacrifice and additional funds brought by them should be a minimum of 15% of banks' sacrifice.
      v. Personal guarantee is offered by the promoter except when the unit is affected by external factors pertaining to the economy and industry.
      vi. The restructuring under consideration is not a 'repeated restructuring'.

Write short notes on Corporate Debt Restructuring (CDR).

1. **Meaning:** CDR Mechanism is a non–statutory, voluntary system based on Debtor–Creditor arrangement or Inter–Creditor Arrangement. It applies to multiple Banking Account / syndicate / consortium with an outstanding exposure of Rs.10 Crores and above (both fund–based and non–fund based), by Banks and Financial Institutions.

2. **Categories:** Category 1 CDR is applicable only for "Standard" and "Sub–Standard" accounts. Category 2 CDR applies to "Doubtful" accounts. "Stand–Still" clause (i.e. both parties commit themselves not to take recourse to any legal action during the 90 / 180 days period) would be applicable to all Debtor–Creditor arrangements.

3. **Asset Classification:** During pendency of the case with CDR system, the usual asset classification norms would continue to apply. If the approved restructuring package is implemented within 4 months from the date of its approval, the asset classification status may be restored to its position which existed when the reference was made to the CDR Cell (i.e. any deterioration in the asset classification status may be reversed).

4. **Auditors' Duties:**
   (a) Study / Review the credit appraisal made at the time of sanction of the advance, and latest renewal / review report of the Borrower Account, to gain knowledge on the history of the account and its present position.
   (b) Review the operations in the account, and examine whether periodic statements like stock statements, Balance Sheet, Audit Reports, etc. are received promptly.
   (c) Review the latest position of the Borrower Account based on individual credit facilities sanctioned and the outstandings in the accounts.
   (d) Review the present classification of the Borrower Account, and ascertain whether the account has slipped into NPA category or not, irrespective of whether the Lender Bank has classified the account as NPA or not.
   (e) Study the rehabilitation program approved by the CDR Cell and its effect on rehabilitation, revised payment schedule, sacrifices made by the Bank, etc. Review the asset classification in light of the above.
   (f) See whether the Bank has disclosed details of CDR in its Notes on Accounts.

Write short notes on SME Debt Restructuring (CDR) mechanism.

1. This mechanism will be applicable to all the borrowers which have funded & non-funded outstanding up to Rs.10 crore under multiple /consortium banking arrangement.
2. Under this mechanism, banks may formulate, with the approval of their Board of Directors, a debt restructuring scheme for SMEs within the prudential norms laid down by RBI. Banks may frame different sets of policies for borrowers belonging to different sectors within the SME if they so desire.
3. The bank with the maximum outstanding may work out the restructuring package, along with the bank having the second largest share. Banks should work out the restructuring package and implement the same within a maximum period of 90 days from date of receipt of requests.
4. The SME Debt Restructuring Mechanism will be available to all borrowers engaged in any type of activity.
5. Banks may review the progress in rehabilitation and restructuring of SMEs accounts on a quarterly basis and keep the Board informed.

As a Statutory Auditor of a Bank, how would you verify the "Sacrifice" on NPAs for which Corporate Debt Restructuring (CDR) has been undertaken?

Computation of Sacrifice	Auditors' Duties
• In case of rescheduling of accounts under CDR mechanism, the element of interest is to be computed in Present Value (PV) terms. • The Sacrifice is computed as the difference between – PV of future interest income reckoned based on the current BPLR as on the date of restructuring plus the appropriate term premium and the credit risk premium for the borrower category on the date of restructuring, and (b) Interest charged as per the restructuring package discounted by the current BPLR as on the date of restructuring plus appropriate term premium and credit risk premium as on the date of restructuring.	• Check the appropriate credit risk premium for the specific borrower category for all restructured accounts. • Ascertain appropriate rate of discount. • Check the computation of PV interest and the Sacrifice Amount. • See that the entire amount has been written off or provided for, in case sacrifice is positive. • Verify provision of adequate security coverage of loan in case restructuring of principal amounts.

Discuss the audit procedures involved in verification of Advances.

1. **Internal Controls:**
   (a) Evaluate the efficacy of Internal Controls in relation to Advances considering factors such as system to evaluate the credit worthiness of the borrower, sanctioning, documentation, etc. to determine the nature, timing and extent of substantive procedures required.
   (b) Examine Internal Audit / Concurrent Audit / Inspection / Other Audit Reports, to identify adverse comments on any Borrower's Account, and action taken by the Bank in respect of the same.
   (c) Inspect the latest available confirmation statements received from Borrowers.

2. **Subsidiary & Control Accounts:**
   (a) Ascertain the status of balancing of Subsidiary Ledgers relating to Advances.
   (b) Verify that the Total of Balances in the Subsidiary Ledgers is agreed with the Control Accounts in the General Ledger.
   (c) Reconcile the Total of Statement of Advances with balances as per General Ledger / Subsidiary Ledgers.
   (d) Cross–check a few select balances of Advances as per the Statement of Advances with balances in the relevant Advance Account in the Subsidiary Ledger.

3. **Ledger Scrutiny:** Scrutinise the operation of the Advance accounts to ensure that –
   (a) There is a healthy turnover in the account,
   (b) Time limit is not generally exceeded,
   (c) Account is not becoming stagnant,
   (d) Customer is not drawing against deposits which are not free from lien,
   (e) Interest and Principal have been serviced properly,
   (f) Account is not window–dressed by running down Overdrafts at the year end and again drawing further Advances in the next year.

4. **Documentation:** Evaluate the adequacy, completeness and legality of the loan documents by examining them. Various documents to be examined are –
   (a) Document evidencing creation e.g. Partnership Deed / Trust Deed / Certificate of Incorporation,
   (b) Loan Application Form,
   (c) Credit Review / Processing Note & Remarks,
   (d) Sanction Letter,
   (e) Mortgage Deed, Letter of Equitable Mortgage, Letter of Intent, Endorsement in Vehicle RC, Copy of Charge registered with ROC,
   (f) Demand Promissory Note (DPN),
   (g) Loan Agreement, Hypothecation Agreement,
   (h) Guarantor's Statement,
   (i) Periodical Stock Statements, Financial Statements, Audit Reports, Security Inspection Reports, and
   (j) Other documents, based on the type of loan.

5. **Security:** Examine whether the advances are properly classified in the Balance Sheet into –
   (a) Advances Secured by Tangible Assets,
   (b) Advances Covered by Bank / Government guarantees,
   (c) Unsecured Advances.
   (d) Verify whether the security is legally enforceable by ensuring that the necessary legal formalities regarding documentation, registration, etc are complied with.
   (e) Examine whether the security is in the effective control of the Bank.
   (f) Examine to what extent the value of security, assessed realistically, covers the amount outstanding in the advance.

6. **General:**
   (a) Check the calculation of Interest on selected Advances.
   (b) Examine whether the Outstanding Advances represent the actual amount due to the bank
   (c) Ensure that all Advances have been recorded in the Bank's books and no advances are unaccounted.
   (d) Verify whether RBI / HO Guidelines and recognised accounting policies / practices, are adhered to in the classification, disclosure and description of Advances.
   (e) Conduct suitable enquiry & obtain representations from Branch Management in respect of Advances, in view of LFAR requirements.

SPECIFIC ADVANCES:

1. **Priority Sector Advances:** Test–check each category of advances (i.e. Sub–standard, Doubtful, etc.) in respect of each type (Tubewell Loans, Buffalo Loans etc.) of such loans.
2. **Advances covered DICGC / ECGC Guarantees:** Examine whether the claims have been properly lodged with them and followed–up. Evaluate the adequacy of provision in this regard by reviewing the ageing statement of claims.
3. **Seasonal Advances:** If Advances are given to finance crop movements, tea gardens, etc, review the pattern of balances to verify whether the high balances during the season gradually comes down and is fully paid later.
4. **Consumer Advances:** In case of Advances for Construction of Houses and / or Purchase of Consumer Durables, test–check a few advance accounts in each category of Advance in each type.
5. **Consortium Advances:** Ensure that the classification of such Advance for purposes of Income recognition and Provisioning is based on the Bank's own record of recovery.
6. **Inter–Bank Participation Scheme:**
   (a) Examine whether the classification of the Inter–Bank Participation Certificate is correct.
   (b) Ensure that in respect of Risk Sharing Basis, the issuing Bank has shared the loss due to short–realisation of the Advance.
   (c) In case of Non–Risk Sharing Basis, examine whether the issuing Bank has paid the full amount due under the participation certificate on maturity irrespective of any default by the borrower.
   (d) If the Issuing Bank is the Auditee, ensure that – (i) For Risk Sharing Basis, amount of the participation certificates is disclosed as Advances Received from the participating banks and has reduced the aggregate advances by such amount, and (ii) For Non–Risk Sharing Basis, certificates issued are shown as Borrowings.
   (e) If the Participating Bank is the auditee, ensure that the both for Risk Sharing and Non–Risk Sharing Basis, amount of the participation certificates is shown as part of its Advances.

What precautions should an Auditor take when auditing Secured Advances?

1. Ensure that an Advance is treated as full secured only to the extent of value of the security. Where the security covers only part of the advance, verify whether that part only is classified as secured and the remaining amount is classified as unsecured.
2. Examine whether the Advances covered by Bank / Government Guarantee is included in Unsecured Advances to the extent the outstandings in these advances exceed the amount of guarantees.
3. In classifying Advances as Secured, examine whether the Primary Security has been applied first and value of the Collateral Security is taken only for the residual balance
4. In respect of advances which are not fully covered even after considering the Primary Security and Collateral Security, verify whether, to the extent of Bank / Government Guarantees available, the Advance is classified as 'Covered by Bank / Government Guarantee' and the balance if any is treated as 'Unsecured'.
5. Where more than one facility is granted to a single borrower, ensure that shortfall in the value of Primary Security in one credit facility is set off –
6. first against the residual value of Primary Security of the other facility (or facilities, as the case may be).
7. next out of the value of Collateral Securities of the first mentioned advance.
8. In respect of common Collateral Security for multiple advances to a Borrower, verify whether the value of Collateral Security is applied proportionately to the shortfall in the value of Primary Security in any one or more of the borrowal accounts.
9. Ensure that advances covered by ECGC / DICGC guarantees is treated as covered by guarantees only to the extent of guarantee cover available.
10. Examine whether the amount received from DICGC / ECGC and kept in Sundry Creditors account pending adjustment is deducted from advances.
11. Where an account which is fully secured by the securities the margin in which is lower than that stipulated rate, ensure that such advances is treated as fully Secured for Balance Sheet presentation.
12. Ensure that all documentary bills under delivery–against–payment terms for which the documents are with the Bank on the Balance Sheet date are classified as 'Secured'.
13. Check up whether documentary bills under delivery–against–acceptance terms remaining unaccepted as at the Balance Sheet date are classified as secured.
14. Examine whether the accepted bills are classified as 'Unsecured' unless collaterally secured.

How will you verify Advances secured by Stock Exchange Securities and Other Securities?

1. **Authority:**
   (a) Obtain the list of Approved and Unapproved Securities (for lending purposes), and ensure that Advances made against approved securities only. In respect of Advances made against unapproved securities, ensure that special sanction of the appropriate authority has been obtained.
   (b) Ensure that the Bank has not made any Loan / Advances against its own shares, which is prohibited u/s 20 of the Banking Regulation Act.
2. **Security:**
   (a) Ascertain as to whether such securities are registered / assigned in Bank's favour, wherever required.
   (b) See whether the Bank has obtained mandates from the borrowers in its favour for collection of dividends, etc.
   (c) Where the securities are lodged for registration / assignment and the amounts involved are material, examine the evidence of lodgement such as certificates / acknowledgements from the Companies concerned.
   (d) Where securities are registered in the name of persons other than the Borrower, ensure that the Bank has obtained a Letter of Guarantee from the borrower to the securities and / or Letter of Renunciation from the Registered Holder.

3. **Market Value**: Examine the Stock Exchange Securities and verify their Market Value in the same manner as in the case of Investments. In respect of Quoted Securities transacted infrequently and Unquoted Securities, verify the Market Value on the Balance Sheet date by scrutinizing the Financial Statements of the Issuer Company.

How will you verify / examine / audit Advances against Goods?

1. **Sanction:** Examine the sanction letter and note the important terms and conditions of the Advance.
2. **Stock Statements:** Verify the quantity and value of goods hypothecated based on the Stock Statements received from the Borrower. Test–check the Godown Registers and examine the valuation of goods to ascertain the reasonableness of the same.
3. **Inspection:** Ascertain as to whether the premises of the Borrowers are periodically visited by the Bank Officials to verify the quantity as per the periodic statements.
4. **Stock Audit:** See whether the Bank has got a system of obtaining Stock & Receivables Audit Report in respect of such Advances. If so, review the Stock Audit Reports and identify adverse comments, if any.
5. **Hypothecation / Pledge:** Examine the Letter of hypothecation and Certificate of Registration of Charge. In respect of goods pledged (i.e. placed in possession) with the Bank, check the statement received from the Borrower regarding the quantity and value of goods pledged by him.
6. **Insurance:** Examine the Insurance Policies (against fire and other risks) for their validity, adequacy, etc. Also ensure that the policies are made in favour the Bank.
7. **Documents of Title:** Inspect the documents of title to goods like Bill of Lading, Dock Warrant, Railway Receipts etc, to ensure that they are endorsed / registered in favour of the Bank.
8. **Third Party Certificates:** Where the hypothecated goods are in possession of third parties like Clearing Agents, Warehouse–Keepers, etc, examine the certificates regarding quantities held and their valuation.

Discus the procedure for verification of Advances against Gold Ornaments & Bullion.

1. Inspect and weigh the Gold Ornaments and Bullion on the Balance Sheet date, on a test basis.
2. Examine the Valuer's Certificate regarding the net gold content of the ornaments and their valuation.
3. Cross check the valuation of Gold with reference to its Current Market Price.
4. In case of Gold Bars and Silver Bars, ensure that the mint seals are intact.

47. Mention the special points that will receive the attention of Bank's Auditor in verification of Advances against Life Insurance Policies. N 99

1. **Policy:** Ascertain that the Insurance Policy has been lodged with the Bank.
2. **Assignment:** Inspect that the policy to verify whether the same has been assigned in favour of the Bank, and such assignment has been registered with the Insurer.
3. **Premium:** Examine whether latest premium has been paid on the policies (based on premium receipt) and whether they are in force (i.e. has not lapsed)
4. **Age:** Ascertain whether the age of the assured has been admitted. The Insurer may refuse to pay claim and hence it is important therefore to see that the same is admitted.
5. **Surrender Value:** Examine the certificate of Surrender Value issued by the Insurer, to ensure that the amount of advance is within the Surrender Value of the policy.
6. **Unpaid Premia:** Where Surrender Value is subject to payment of certain premia, verify whether amount of such premia has been deducted from the Surrender Value.

48. What are the procedures involved in audit of advances against Immovable Property?

1. **Legal Opinion:** Examine Title Deeds and Legal Opinion obtained by the Bank to ensure that prima facie, the Borrower has a clear and unencumbered title to the property. Also examine the status of Plan Approval, Nil Encumbrance Certificate, and other legal requirements in this regard.
2. **Mortgage:** In case of Equitable Mortgage, examine the memorandum of deposit. In respect of English Mortgage, examine the Mortgage Deed and review the Legal Opinion on the Title Deed and Mortgage Deed.
3. **Other Documents of Title:** In respect of advances against immovable properties the title deeds of which are not in the name of the Borrower, examine the evidence regarding the right or interest of the borrower in the property mortgaged, e.g. Power of Attorney, Share Certificate of Co–Operative Group Housing Society, No Objection Certificate from the Society / Lessor (in the case of leasehold properties) for offering the property as security, etc.
4. **Insurance:** In case of Advances in respect of Buildings, see whether General Insurance Premium on Buildings has been debited to the Borrower's Account and that the policy is in force. See whether the Insurance Policy is assigned in favour of the Bank.
5. **Valuation Reports:** Review the Valuation Reports of Architects / Valuers to ascertain whether the value of the property covers the amount of advance.

49. Discuss the procedure for verifying Advances against other assets.

1. Bank's Own Deposit Certificates:

(a) Inspect the Term Deposit Certificates to ensure that they are properly discharged.
(b) Examine whether the lien of the Bank is marked on the certificates and also in Bank Register.

2. Hire Purchase Documents:

(a) Ensure that such advances are classified as secured if the goods are hypothecated. Where there is no hypothecation, examine as to whether the advance is classified as unsecured.
(b) Verify agreement between the Seller and Purchaser, the endorsed Promissory Notes of the Purchaser, and the guarantee of the Insurance Company.
(c) Examine the basis of calculating Drawing Power and compare actual balance with Drawing Power.

3. Plantations / Standing Crops:

(a) Verify the agreement with planters or farmers and the title deeds.
(b) Check whether these are classified as secured against the crop and / or fixed assets of the plantation.
(c) Review the estimate of the crop, by examining the yield records of the garden / plantation for past few years.
(d) Ascertain whether crop is properly insured against natural calamities & other disasters such as hail, etc.

4. **Packing Credit to Exporters:**
   (a) Verify the Letters of Credit lodged by Exporters with the Bank.
   (b) Examine whether such advances are adjusted against discounting the Bill of Exchange drawn by the Exporter on the Foreign Buyer.

5. **Third Party Guarantees:**
   (a) Examine the Promissory Notes executed by the Borrowers.
   (b) Review the Guarantee Bonds and the Demand Promissory Notes executed by the Guarantors to verify the third party liability. Ensure that the guarantee is in force on the Balance Sheet date.

50. As Branch Auditor of a nationalised Bank, how would you verify Advances to DOTCOM Companies? M 01

1. **Internal Controls:** Assess the existence, adequacy and effectiveness of the controls on assessment of the Borrower's credit–worthiness, and obtaining sanction from the appropriate higher authorities.
2. **Sanction:** Examine the sanction letter to verify whether it contains – (a) borrowing limit, (b) nature of security, (c) margin to be kept, (d) interest, (e) terms of repayment, and (f) other related matters, if any.
3. **Execution of Documents:** Verify whether all the necessary documents such as Agreements, Letters of Hypothecation, Demand Promissory Notes, etc are executed before the advances are made.
4. **Loan Documents:** Review the following loan documents to ensure that they are in order – (a) Certificate of Incorporation / Commencement of Business (for Public Limited Companies), (b) Board Resolution, (c) Shareholders Resolution in cases covered u/s 293(l)(d) of the Companies Act.
5. **Borrower Evaluation:** Examine the Business Plan of the Company with special reference to ascertain as to where the revenue model is in place. Verify whether the Company depends only on outside funding or can self generate funds.
6. **Security:**
   (a) Verify whether the advance is secured.
   (b) Examine enforceability of such security
   (c) Verify whether necessary legal formalities are complied with.
   (d) Examine whether the security is in the effective control of the Bank.
   (e) Verify whether the value of security, assessed realistically, covers the amount outstanding in the advance.
7. **Mortgaged Security:** Where the security is in the form of mortgage, examine the following documents – (a) Mortgage Deed in case of English Mortgage, (b) Letter of intent to create mortgage in case of Equitable Mortgage, (c) Evidence of Registration of Charge with ROC.
8. **Account Scrutiny:** Analyse the operation of the advance account of the Company to ensure that there is a healthy turnover in the account and no untoward / abnormal movements. Also review whether interest and principal is serviced regularly. Examine whether any cheques deposited / issued by the Borrower have been returned due to "insufficiency of funds".
9. **Account Analysis:** Examine the following aspects in the Advance Account –
   (a) Frequency and the amounts of credits – to ensure that they are commensurate with sanctioned limit and the nature and volume of business of the borrower.
   (b) Unusual items in the account – to identify any unhealthy trends and to carry out further examination
   (c) Large year–end transactions – to identify any irregularities in these accounts.
   (d) Post Balance Sheet date transactions – to identify any window dressing in the accounts
10. **Statements:** Review the periodic statements (Stock / Book Debts Statements etc.), Cash Flow Statements, latest Financial Statements, etc. to evaluate the recoverability of advances.
11. **Provisioning:** Ascertain whether proper provisioning norms have been applied in view of non–observance of terms, irregular payment of interest and default in repayment of instalments, if any.

51. How will you verify Bills Purchased and Discounted?

1. Verify the Registers of Bills Purchased and Discounted to see whether Bills are correctly classified and all relevant details such as the nature of the bills and documents are entered therein.
2. Carry out physical verification of bills in the possession of the Bank.
3. Examine the SBP / SBD Register and the party–wise Register of Bills maintained by the Bank to ensure that – (a) Bills purchased / discounted from different parties are in accordance with the agreements entered with them, and (b) Total of outstanding bills of each party is not in excess of the sanctioned limit.
4. Examine whether any bills have become overdue. In respect of overdue bills, ascertain the reasons for the delay and the action taken by the Bank.
5. See whether all the outstanding Bills are taken to the Balance Sheet. Ensure that the Bills Purchased and Discounted are shown separately in the Balance Sheet as a part of "Advances".
6. Ensure that bills and documents accompanying the bills are properly endorsed and assigned in favour of the Bank.
7. Verify whether the bills are held along with the documents of title. In respect of documentary bills, examine whether the related RRs / TRs are held along with the invoices / hundies / bills.
8. Scrutinise the bills collected after the Balance Sheet date to obtain assurance regarding completeness and validity of the recorded bill amounts.
9. Where the bills purchased or discounted by the Bank are re–discounted with RBI / IDBI / SIDBI, ensure that such bills are included under Contingent Liabilities and not under Advances.

52. Describe the procedure for verification of "Documentary Bills Purchased account" reflected in the Balance Sheet of a Bank. N 96

1. Examine the sanction advice and verify whether all the conditions contained therein are being followed properly.
2. Physically verify all the Bills in the possession of the Bank and ensure that all documents of title are in order and are also in the custody of the Bank.
3. Review the covering letters under which the Bills have been sent for collection to ensure that the proper documents of title were with the Bank as on the date of the account.
4. Verify as to whether the advance is re–classified as Unsecured, as soon as the bills are accepted by the Drawee as on acceptance of these bills, the documents of title should be delivered to the Drawee.
5. Verify as to whether in respect of bills remaining uncollected after the due dates, the advances are re–classified as Unsecured.
6. Verify as to whether any party is misusing the facility by submitting bills that are subsequently returned unpaid.
7. Check the computation of discount of the bills.

Cash & Bank Verifications

DISCLOSURE REQUIREMENTS

Sch. 6: Cash and Balances with RBI	Sch.7: Balances with Banks, & Money at Call & Short Notice
I. **Cash in Hand** (including foreign currency notes) II. **Balances with RBI** i. in Current Account ii. in Other Accounts	**I. In India** (i) Balances with Banks – (a) in Current Accounts, and (b) in Other Deposit Accounts. (ii) Money at Call and Short Notice – (a) with Banks, and (b) with Other Institutions. **II. Outside India** (i) in Current Accounts (ii) In Other Deposit Accounts (iii) Money at Call and Short Notice

AUDIT PROCEDURES

A. CASH IN HAND:

1. Visit the Branch at the close of business on the last working day of the year, or before the commencement of business on the next day, for carrying out physical verification of cash. If not, carry out the physical verification of cash, as close o the Balance Sheet date as possible.
2. Verify the Cash kept in different departments / locations (e.g. Extension Counters) simultaneously.
3. Evaluate the effectiveness of internal controls regarding – (a) Daily Verification of Cash, (b) Maintenance of Cash related registers and Vault register, (c) Custody of Cash, (d) Custody of Keys, (e) Daily Cash holding and retention limit of the Branch.
4. Ensure that a global insurance policy has been taken for safety of cash from theft or burglary, and such policy is effective.
5. Pay special attention to the following – (a) bigger sample size for larger denomination notes, than that in case of smaller denomination notes, (b) ensuring sealing of all bundles produced for audit verification, (c) full counting of loose / soiled notes, (d) counting or weighment of coins, as per RBI guidelines.
6. Obtain a certificate indicating denomination–wise cash balance as per Cash Verification. Notes / Coins in sealed packets may be accepted based on written representation from the Branch, and cross–checked with subsequent entries in the Books of Account.
7. Ensure that the Cash Balance as physically verified tallies with the balance shown in the Cash Book and Cash Balance Book. In case of verification of Cash prior or subsequent to the Balance Sheet date, a prepare a Reconciliation Statement, to arrive at the Cash Balance as at the Balance Sheet date.
8. Count / Inspect the Foreign Currency Notes held and see that they are converted at the Market Rate prevailing on the Closing Date.
9. Where the Branch operates a Currency Chest, ensure that Currency Chest balance is not mixed up with the Cash Balances of the Branch. Also examine the internal controls relating to Currency Chest Operations, and reconciliation with Link Office.

B. BALANCES WITH RBI:

1. Verify the Ledger Balance in each account with – (a) Bank Confirmation Certificates from RBI, and (b) Reconciliation Statements at the year–end.
2. Review the Reconciliation Statement, paying special attention to the following –
3. Cash Transactions remaining unresponded,
4. Revenue items requiring adjustments / write–offs, and
5. Old Outstanding balances remaining unresponded / unadjusted for more than 1 year.

C. BALANCES WITH OTHER BANKS (other than RBI): The procedure applicable for verification of Balances with RBI, as given above, should be adopted, with the following special points –

1. Review the Reconciliation Statements to ensure that –
   (a) No debit for charges or credit for interest is outstanding, and all items which ought to have been taken to Revenue Account for the year have been so taken, (particularly when Bills collected, etc. are credited with net amount and entries for interest etc. are not separately made in the statement of a/c).
   (b) No cheque sent / received for clearing is outstanding.
   (c) All bills / outstanding cheques sent for collection and outstanding on the Balance Sheet date have been credited subsequently.
2. Examine year–end large transactions in inter–Bank accounts, to ensure that there is no window–dressing.
3. In case of balances in Deposit Accounts, examine the original Deposit Receipts. Also enquire whether the account concerned is in the nature of a Deposit Account.
4. Verify the Balances with Banks outside India, in the above manner, and see that they are converted at the Market Rate prevailing on the Balance Sheet date.

D. MONEY AT CALL AND SHORT NOTICE:

1. Verify whether there is a proper system of authorisation for lending money at call and short notice. Examine compliance with HO Instructions / Guidelines in this regard.
2. Verify Call Loans, with – (a) Certificate of the Borrowers, and (b) Call Loan Receipts held by the Bank. See whether the balances as per the Call Loan Register tally with the Control Account in the General Ledger.
3. Examine subsequent repayments received from Borrowing Banks, to verify the amounts shown under this head at the year–end.
4. Ensure that Call Loans made by the Bank are not netted off against Call Loans received by it.

5. See that money–market lendings for more than 6 days are not classified under this head, but as "Deposits" or "Advances", depending upon the nature of lending and the parties to whom the money has been lent.
6. See whether – (a) interest has been properly accrued and accounted for, on year–end outstanding balances of call / short notice money, & (b) brokerage on such deposit & call loans do not violate RBI guidelines.

Statutory Liquidity Ratio

1. **Statutory Liquidity Ratio:**
   (a) U/s 24 of the Banking Regulation Act, RBI can prescribe the SLR for Scheduled Commercial Banks in specified assets. The value of such assets shall not be less than such percentage (not exceeding 40%) of its total demand and time liabilities in India as on the dates as may be notified by RBI. The assets so kept as reserves shall be valued as per the method of valuation prescribed by RBI.
   (b) The SLR so prescribed shall be kept in any of the following securities by the bank (a) Cash, (b) Gold & in (c) Unencumbered investment which will be referred to as "Statutory Liquidity Ratio (SLR) securities"

2. **Auditor's Duty:** The Bank's Statutory Central Auditor should verify the compliance with SLR requirements on 12 odd dates in different months of a financial year not being Fridays, and report to –(a) the Bank's Top Management, and (b) RBI. The Statutory Auditors should verify and certify that all items of outside liabilities, as per the bank's books had been duly compiled by the bank and correctly reflected under DTL/NDTL in the fortnightly/monthly statutory returns submitted to RBI for the financial year.

3. **Aspects:** The Statutory Auditor has to examine the following aspects in SLR compliance verification –
   (a) the correctness of the figure of the Demand and Time Liabilities (DTL) position in India at the close of the business on the reporting Friday relevant to the date selected by the Auditor,
   (b) maintenance of Liquid Assets as prescribed u/s 24 of the Act, on the selected date considering the DTL position on the relevant reporting Friday.
   (c) The Statutory Auditors should also certify that all items of outside liabilities are correctly reflected under Demand & Time Liabilities / Non Demand & Time Liabilities in the fortnightly / monthly statutory returns submitted to RBI for the financial year.

4. **Audit Procedures:**
   (a) **RBI Circulars:** Obtain the relevant circulars / instructions of the RBI with respect to DTL.
   (b) **Audited Branches:** Request the Branch Auditors to verify – (i) the correctness of the Trial Balance relevant to the 12 selected dates, and (ii) the cash balance at the Branch on the selected dates.
   (c) **Unaudited Branches:** Test–check the returns obtained from unaudited branches, to identify any obvious errors or omissions or inconsistencies. Specify the number of unaudited branches and state in his report that he has relied on the returns received from the unaudited branches to form his opinion.
   (d) **Consolidation:** Examine the consolidations prepared by the Bank, on the relevant dates, and trace the figures from the Branch Returns to the consolidation, for test–checking the arithmetical accuracy. See whether the consolidation includes information from all the Branches.
   (e) **Cash / Gold etc.:** **See Note 1 below**.
   (f) Inclusion / Exclusion from Liabilities: See Note 2 below.
   (g) **Provisions for Expenses:** State in his report that provisions for expenses & liabilities / interest are not included in the computation of DTL as they are made only at the year–end / periodic intervals.

Note 1: Cash, Gold etc.: In computing the amount of Liquid Assets, see whether –

Cash	**Securities**
The following items have been treated as Cash – 1. Deposit with RBI u/s 11(2) of Banking Regulation Act, by a Banking Company incorporated outside India. 2. Cash or balances maintained in India by a Banking Company other than a Scheduled Bank with itself or with RBI or by way of net balance in Current Account in excess of the	1. Dated securities as may be notified by RBI 2. Treasury Bills of the Government of India; 3. Dated securities of the Government of India issued from time to time under the market borrowing programme and the Market Stabilization Scheme

amount required u/s 18 of Banking Regulation Act, balances in other accounts with banks and notified financial institutions, money at call and short notice, advances to banks, 3. Balances maintained by a Scheduled Bank with RBI in excess of amount required u/s 42 of RBI Act. 4. Net balance in Current A/cs maintained in India by a Scheduled Bank, 5. Balances maintained by a RRB in Call or Fixed Deposit Account with its Sponsor Bank. 6. **Valuation of Gold:** Price of Gold does not exceed its Current Market Price.	4. State Development Loans (SDLs) of the State Governments issued from time to time under the market borrowing programme 5. Any other instrument as may be notified by the RBI. 6. **Valuation of Securities:** Value of approved securities have been made at Cost Price, Market Price, Book Value or combination thereof, as specified by RBI.

Note 2: Inclusion / Exclusion from Liabilities: Ensure the following –

Items excluded from Liabilities	Incl. in Liabilities
1. Amounts received from DICGC and ECGC towards claims for guarantees invoked and held pending adjustment of the same towards the related advance. 2. Amounts received from Court Receiver. 3. Amounts received from Insurance Companies as a result of excess claim etc. on ad–hoc settlement of claims, pending Court judgement. 4. Net income tax provision. 5. Paid up capital, reserves, any credit balance in the Profit & Loss Account of the bank, amount of any loan taken from the RBI and the amount of refinance taken from Exim Bank, NHB, NABARD, SIDBI. 6. The liabilities arising on account of utilization of limits under Bankers Acceptance Facility (BAF). 7. District Rural Development Agency (DRDA) subsidy of Rs.10,000/- kept in Subsidy Reserve Fund account in the name of Self Help Groups or subsidy released by NABARD under Investment Subsidy Scheme for Construction/Renovation/Expansion of Rural Godowns. 8. Net unrealized gain/loss arising from derivatives transaction under trading portfolio. 9. Income flows received in advance such as annual fees and other charges which are not refundable. 10. Bill rediscounted by a bank with eligible financial institutions as approved by RBI. 11. Provision not being a specific liability arising from contracting additional liability and created from profit and loss account.	1. Net credit balance in Branch Adjustment a/cs including those relating to Foreign Branches. 2. Interest on Deposits, Bills Payable, Unpaid Dividend, Suspense Account Balances as at the end of the first half year reversed in the beginning of the next half year. 3. Participation Certificates issued to other banks, the balances outstanding in the blocked account pertaining to segregated outstanding credit entries for more than 5 years in inter-branch adjustment account, the margin money on bills purchased / discounted and gold borrowed by banks from abroad, also should be included in ODTL.

Verifying Fixed Assets

1. **Accounting:** Ascertain whether the accounts in respect of Premises and / or other Fixed Assets are maintained at the Branch or at HO. Where acquisition / disposal is done at the Branch, but accounting is done at the HO, see whether the details thereof have been properly communicated to HO.
2. **Documents of Title:** Verify the location of documents of title or other documents evidencing ownership of Fixed Assets. Where the title deeds are held at HO or some other location, obtain a written representation to this effect from the Branch Management and report the same to the Statutory Central Auditor by a suitable Note in his Report.
3. **Vouching:** Verify Opening Balance of Premises with reference to schedule of Fixed Assets, Ledger or Fixed Asset Register. Verify into acquisition of new premises with reference to authorisation, title deeds, record of payment, etc. Examine the capitalisation and amortisation of Lease Premium, in respect of Leasehold Premises.
4. **Transfers:** Examine proper accounting (along with Accumulated Depreciation) where Fixed Assets (Furniture, Equipments, etc.) are transferred from one Branch to another.

5. **Subsidiary Records:** See whether the balances as per Fixed Assets Register reconcile with that of the General Ledger and the Financial Statements. Verify whether the balance of Control Account in the General Ledger agrees with Subsidiary Records and Fixed Assets Register.
6. **Revaluation:** Where Fixed Assets / Premises are revalued, examine the – (a) appropriateness of the basis of revaluation, and (b) compliance with AS – 10 and AS – 28 requirements.
7. **Self–Constructed Assets:** Where new assets are self–constructed, verify the same with reference to authorisation and documents such as contractor's bills, work order records and record of payments. Also see whether the payments / advances are shown under a separate heading, till the asset is completed.
8. **Compliance:** Examine compliance with Sec.9 of Banking Regulation Act, whereby a Banking Company (not nationalized Banks) is prohibited from holding any immovable property, except such as is required for its own use, for any period exceeding 7 years from the date of acquisition thereof.
9. **Movable Assets:** In respect of movable Fixed Assets, examine the system of recording the movements, as well as adequacy of physical verification procedures.
10. **Software:** See whether the accounting treatment of expenditure on intangibles, computer hardware and software is in accordance with – (a) AS – 10 & AS – 26 requirements, and (b) RBI Guidelines.
11. **Classification:** See whether the Fixed Assets have been classified in the accounts.
12. **Sale of Assets:** Verify the copy of Sale Deed and receipt of the Sale Value in respect of Fixed Assets sold during the year. Review the Books to ensure that the Original Cost and Accumulated Depreciation on the assets sold have been correctly adjusted, and Profit / Loss has been correctly stated.
13. **Depreciation:** See that depreciation has been computed in accordance with the Bank's accounting policy. See whether AS – 19 and RBI Guidelines have been followed in respect of Leased Assets.

Verifying Inter Office Adjustments

1. **Classification:** Ensure that the Inter–Branch Accounts are sub–divided into segments or specific areas such as – (a) Demand Drafts Paid, (b) Inter Branch Remittances, (c) Head Office Account, etc.
2. **Controls:** Evaluate the system of reconciliation at the Head Office to ascertain whether –
   (a) There is adequate control over receipts and monitoring of daily Branch Statements,
   (b) There is an effective system of identification of errors in the daily Branch Statements,
   (c) Action is initiated immediately for correction of errors noticed,
   (d) Differences in opening & closing balances of consecutive daily statements are corrected on daily basis,
   (e) The system ensures segregation of error data, and
   (f) Branches respond promptly to error advices and make necessary rectification.
3. **Closing Balance:** Verify the Closing Balance paying special attention to the origin and validity of old outstanding unmatched entries. Obtain confirmation in respect of transactions relating to outstanding entries. Also, inquire into any reversal entries that indicate possibility of irregular payments or frauds.
4. **Ageing Analysis:** Obtain year–wise break–up for debit and credit amounts separately, in respect of unreconciled entries.
5. **Reconciliation:** Scrutinise the Reconciliation Statements prepared by the Bank, with special attention being paid to high–value items and old outstanding items. Review the steps taken / proposed to be taken by the Bank Management for clearing outstanding entries.
6. **Drafts:** Examine whether all payments of Drafts are matched with the credits in books.
7. **Cash in Transit:** Enquire into the reasons in respect of Cash–in–Transit, encashment of Dividend Warrants / Refund Orders, etc. which remains pending for more than a reasonable period.
8. **Write–Offs:** Ensure that the cut–off amount regarding small differences in the register are reasonable.
9. **Interest:** Test–Check the computation of Interest on Inter–Branch Transactions. However, this interest income / expense, will get squared off in the consolidation, and will not affect the

Miscellaneous Verifications

Item	Auditors' Duties
Interest Accrued	1. See whether the following are recognised only if there is reasonable certainty of their realization – (a) Interest Accrued but not due on Investments and Advances, and (b) Interest Due but not collected on Investments. 2. Verify whether the RBI guidelines in this regard are duly complied with. 3. In respect of interest on Government Securities, Debenture Bonds, etc. which accrues from day to day, ensure that interest accrued is calculated and recognised in the account books to the extent of such accrual on the Balance Sheet date.
Advance	1. See whether TDS on Fixed Deposits and other products / services is properly handled at the Branch

Tax / TDS		Level. 2. Scrutinise the quarterly TDS returns (filed on computer–readable media) and ensure compliance with the Income–Tax Act, 1961.
Stationery & Stamps		1. Evaluate the existence, effectiveness and continuity of Internal Controls, in relation to stationery of security items like Term Deposit Receipts, Drafts, Pay Orders, Cheque Books, Traveller's Cheques, Gift Cheques etc. 2. Verify the stationery of Security Items and Stamps on Hand as at the year–end with the Bank's books. Any shortage should be enquired into, since it may result in fraud and misuse causing heavy loss to the Bank. 3. Verify whether the cost of stationery and stamps consumed during the year are charged to the P&L A/c, and examine compliance with HO instructions in this regard.
Other Assets		1. Verify Non–Banking Assets Acquired in Satisfaction of Claims, with reference to the relevant documentary evidence, e.g. terms of settlement with the party, order of the Court or the award of arbitration etc. 2. Ensure that the ownership of the property legally vests with the Bank. Where any dispute or other claim on the property exists, examine whether the recording of the asset is appropriate. 3. If any dispute arises subsequently, verify whether a provision for liability or disclosure of a Contingent Liability is appropriate as per AS – 29 requirements. 4. Ensure that such assets are recorded at the lower of – (a) Amount of debt settled against the same, and (b) Net Realisable Value. AS – 10 is not applicable for such assets, except when held for Bank's own use. 5. Ensure compliance with Sec.9 of Banking Regulation Act, as regards holding period of such assets (i.e. 7 years).

1. **Interest–Free Staff Advances:**
   (a) Verify Non–Interest Bearing Staff Advances with reference to the relevant documentation.
   (b) If any security has been furnished, verify the availability, enforceability and valuation of such security.

2. **Security Deposits:** Examine Security Deposits with – (a) various authorities (e.g. Telephone, Electricity, etc.) and (b) with Others (as Rent Deposit etc.), based on relevant documents containing terms and conditions, and receipts obtained from the parties concerned.

3. **Suspense Account:**

Contents	**Auditors' Duties**
(a) Amounts temporarily recorded until its precise nature is determined, (b) Amounts pending transfer to the appropriate head of account, (c) Debit balances on payment of Interest / Dividend Warrants pending reconciliation of amounts deposited by the concerned Company, and payment by various Branches on this account, & (d) Amounts of losses on account of frauds awaiting adjustment.	(a) Examine the details of old outstanding entries under this head, and pay special attention to unusual items. (b) See if the outstanding balances comprised in Suspense Account require a provision / write–off.

4. **Prepaid Expenses:**
   (a) Verify whether the basis of allocation of expenditure to different periods is reasonable.
   (b) See whether the allocation of discounting and re–discounting charges paid by the Bank to different accounting periods is in consonance with the accounting policy followed for the Bank as a whole.

5. **Debit Balances on Government Account:**

Contents	**Auditors' Duties**
This head includes payment of Pension, Public Provident Funds, Compulsory Deposit Scheme Payments, etc, for which the branch is reimbursed by Government through a designated branch.	(a) Examine and review the ageing statements of these items. (b) Ascertain the recoverability of old outstanding items. (c) Verify whether the claims for reimbursement with the Government, have been lodged properly.

Restructuring / Rescheduling of Advances

Introduction

Restructuring of advances by banks (other than those restructured under a separate set of guidelines issued by the Rural Planning and Credit Department(RPCD) of the RBI on restructuring of advances on account of natural calamities) are classified into the following four categories.

(i) Restructuring of advances extended to industrial units.
(ii) Restructuring of advances extended to industrial units under the Corporate Debt Restructuring (CDR) Mechanism
(iii) Restructuring of advances extended to Small and Medium Enterprises (SME)
(iv) Rrestructuring of all other advances.

The major difference in the above mentioned four guidelines is based on whether a borrower is engaged in an industrial activity or non industrial activity. According to the prudential norms, while the accounts of borrowers engaged in Industrial activity continues to be classified in the existing asset classification upon restructuring, the benefit is not available to borrowers engaged in non industrial activity except to SME borrowers.
The master circular on prudential norms has identified three stages at which restructuring / rescheduling / renegotiation of the terms and conditions of the credit facility can be effected. The tree stages are

a. before commencement of commercial production
b. after commencement of commercial production but before the asset has been classified as sub standard
c. after commencement of commercial production and after the asset has been classified as sub standard.

Corporate Debt Restructuring (CDR)

The master circular envisages the restructuring credit facilities granted, to corporates engaged in industrial activities, under consortium / multiple banking /syndication under the CDR scheme.

The corporate borrowers with outstanding fundbased and non–fund based exposure of Rs. 10 crore and above are eligible to come under this scheme.

Debt Restructuring mechanism for Small amid Medium Enterprises (SME)
The following facilities can be rescheduled under the SME mechanism –

a) All non–corporate SMEs irrespective of the level of dues to banks.
b) All corporate SMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank.
c) All corporate SMEs, which have funded and non–funded outstanding upto Rs. 10 crore under multiple/ consortium banking arrangement

Classification on restructuring

A standard account on being restructured should be downgraded to sub standard category is the general principle laid down by the prudential norms save for the exemptions provided to industrial units under CDR or SME mechanism as set out below.
In the first two stages involving rescheduling of principal alone, the account will continue to be classified as standard assets provided the loan is fully secured

Where the interest element is also rescheduled, the account can be continued to be classified as standard provided the amount of interest sacrifice measured in present value terms, is either written off or provided for.

In case of principal rescheduling of accounts in the third stage, the account will continue to be classified as sub standard for a specified period of one year, provided the loan is fully secured. In case of interest sacrifice the above condition will apply for the account to be continued in sub standard category for the specified period of one year.

The substandard accounts which have been subjected to restructuring etc., whether in respect of principal instalment or interest amount, will be eligible to be upgraded to the standard category only after the specified period i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period.

However, if there is not satisfactory performance after the specified period the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre–restructuring payment schedule.

Banks cannot reschedule /restructure /renegotiate borrowal accounts with retrospective effect.

Banks are not expected to repeatedly restructure/ reschedule the amounts due to them unless there are very strong and valid reasons which warrant such repeated restructuring/rescheduling. Restructuring in all cases should be based on viability parameters.

Recent Changes

The RBI has issued a series of circulars extending certain concessions in classification of restructured accounts. The details of the circulars are set out below:

1. DBOD No. BP.BC. No 37/21.04.132/2008–09 dt Aug 27,2008
2. DBOD No. BP.BC. No 93 /21.04.132/2008–09 dt Dec 08,2008
3. DBOD No. BP.BC. No 104/21.04.132/2008–09 dt Jan 02,2009
4. DBOD No. BP.BC. No 105/21.04.132/2008–09 dt Feb 04,2009

Eligibility Criteria & conditions for special treatment

1. Banks can restructure only accounts classified under `standard', 'sub–standard, and `doubtful' categories.

2. Banks not restructure with retrospective effect.

3. The formal consent of the borrower must be obtained. However the bank can initiate the process in deserving cases.

4. The financial viability must be established. (Viability benchmarks may include Return on Capital Employed, DSCR, etc)

5. There must be reasonable certainty of repayment by the borrower.

6. Borrowers indulging in fraud or malfeasance are not eligible. However in the case of wilful defaulters, banks may review the reasons for such classification and satisfy itself that the borrower is in a position to rectify the default before restructuring the account.

7. BIFR cases can be restructured only with their express approval.

8. The restructuring package must be implemented within a period of 120 days.

9. The account must NOT be an NPA as at Sept 01, 2008

10. The application for restructuring must be received before Mar 31, 2009,

11. The restructuring package must be implemented by June 30, 2009

Borrowers ineligible for Special Regulatory Treatment

The following categories are **NOT** eligible for the special regulatory treatment for asset classification.

1. Consumer and personal advances
2. Advances classified as Capital market exposures.

Special Treatment available

1. An existing 'standard asset' will not be downgraded to the sub–standard category upon restructuring.

2. The asset classification of the sub–standard/doubtful accounts during the specified period, will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period.

However, these benefits will be available subject to compliance with the following conditions:

i) The dues to the bank are `fully secured' as defined in **Annex 2**. The condition of being fully secured by tangible security will not be applicable in the following cases:
   (a) SSI borrowers, where the outstanding is up to Rs.25 lakh.
   (b) Infrastructure projects, provided the cash flows generated from these projects are adequate for repayment of the advance, the financing bank(s) have in place an appropriate mechanism to escrow the cash flows, and also have a clear and legal first claim on these cash flows.

(c) Full security cover is also not essential for WCTL in the case of `standard' and `sub–standard' accounts provided the unsecured portion of the WCTL is provided for as under
Standard assets – 20%
Sub standard assets – 20% during the first year to be increased by 20 % every year until the specified period

ii) The unit becomes viable in 10 years, if it is engaged in infrastructure activities, and in 7 years in the case of other units.

iii) The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances.

iv) Promoters' sacrifice and additional funds brought by them should be a minimum of 15% of banks' sacrifice.

v) Personal guarantee is offered by the promoter except when the unit is affected by external factors pertaining to the economy and industry.

AGRICULTURAL DEBT RELIEF SCHEME, 2008

Introduction:

The Scheme was introduced by The Finance Minister, in his Budget Speech for 2008–2009, The Scheme was introduced to give relief for the agriculturists who have been debt stricken and who have not been able to adhere to the repayment stipulations of various banks and financial institutions.

This scheme is in addition to the earler scheme introduced in the year 2004, which was more directed to specific districts notified under Drought Affected areas and was applicable for all farmers.

Applicability:
The present scheme is applicable for direct agricultural loans extended to all farmers including . But for the purposes of determining the benefit of waivers, reliefs and the extent the farmers have been divided into three categories as "marginal farmers", "small farmers" and "other farmers"

Small and marginal Farmers are eligible for Debt Waivers whereas other farmers are eligible for Debt Relief. The Farmers can be the owners or a tenant or share cropper of the respective lands.

S. No.	Particulars	Marginal Farmer	Small Farmer	Other Farmer
1.	Definition	Having lands upto 1 hectare – 2.5 acres	Having more than 1 hectare and upto 2 hectares – 5 acres	Having Land more than 2 Hectares
2(a)	Short Term Production Loan			
	– Eligible Amount	Principal and Interest as per cut off dates & the restructured loans as per earlier debt relief schemes	Principal and Interest as per cut off dates & the restructured loans as per earlier debt relief schemes	Principal and Interest as per cut off dates & the restructured loans as per earlier debt relief schemes
	– Waiver	Fully waived	Fully waived	–
	– Relief	–	–	25% of the eligible amount provided 75% is paid by the borrower. In respect of specified revenue districts the relief is restricted to Rs. 20,000
	Eligibility for further Loans	Will be eligible for fresh loans to the extent of waived amount	Will be eligible for fresh loans to the extent of waived amount	Will be eligible for fresh loans upon paying 1/3rd of his share of OTS
2(b)	Investment Loan			
	– Eligible Amount	Principal and Interest **that is overdue** as per cut off dates & the restructured loans as per	Principal and Interest **that is overdue** as per cut off dates & the restructured loans	Principal and Interest **that is overdue** as per cut off dates & the restructured loans as per

		earlier debt relief schemes In case of the Loans which have been classified as NPA interest will not be eligible	as per earlier debt relief schemes In case of the Loans which have been classified as NPA interest will not be eligible	earlier debt relief schemes In case of the Loans which have been classified as NPA interest will not be eligible
	– Waiver	Fully waived	Fully waived	–
	– Relief			25% of the eligible amount provided 75% is paid by the borrower. In respect of specified revenue districts the relief is restricted to Rs. 20,000
	Further Loan eligibility	Will be eligible for fresh loans to the extent waived amount	Will be eligible for fresh loans to the extent waived amount	Will be eligible for fresh loans upon paying full amount of his share of OTS
	Further Interest Levy	No interest will be leviable on eligible amount after 29.2.2008	No interest will be leviable on eligible amount after 29.2.2008	No interest will be leviable on eligible amount after 29.2.2008. But OTS fails, due to non–payment of his share, the interest will be leviable after 30.6.09
2(c)	Investment Credit (for allied activities)	Principal Loan obtained is not exceeding Rs. 50,000	Principal Loan obtained is not exceeding Rs. 50,000	Principal Loan obtained is exceeding Rs. 50,000
2(d)	CUT OFF DATES:			
	Loans disbursed before	31.03.2007	31.03.2007	31.03.2007
	Amount overdue as on	31.03.2007	31.03.2007	31.03.2007
	Remaining unpaid on	29.02.2008	29.02.2008	29.02.2008

Amounts falling overdue after 31.12.2007 in respect of investment credit will be recoverable along with interest. However a re–schedulement may be done in accordance with the normal policies of the bank.

Ineligible Accounts:

- Advances given against pledge or hypothecation of agricultural produce other than standing crop
- Agricultural finance given to corporates, partnership firms, societies other than cooperative credit institutions specified in the Act, and any similar institution.
- Loans disbursed prior to 31st March 1997

Additional conditions for further loans for Other Farmers:
• Other farmers shall provide an undertaking to pay the OTS amount in not more than three instalments, out of which 1/3rd has to be paid in first two intalments. The dates for three instalments shall be 30'h September 2008, 31st March 2009 & 30th June 2009. On payment of this amount, the relief amount shall be credited to the respective borrower's account.

Audit Points:

- Classification of farmers is on the basis of total loans under control either on own or jointly with others, at the time of sanction of the Loan irrespective of the change in situation subsequently regarding ownership or possession.
- Loan against Kisan Credit Card will also be eligible for this relief
- Multiple loans taken by a farmer will be considered as different loans and will be considered for relief or waiver accordingly.
- The clarity regarding Branch Auditors' Responsibility for the certification of the statements for the purpose of claiming Debt Relief from Central Government is yet to be sorted by the Banks. In case the Banks decide to take the certification from Branch Auditors, the signatories are to keep a checklist for the verifying the details and comply with the same. The scheme also envisages a situation whereby a Special Audit may be directed by Central Government in case of a necessity. This has to be borne in mind by the Auditors while executing the attest function on the certificates.