

AUDIT OF BANKS

Question 1

- (i) *What do you understand by Long-form Audit Report?* (2 Marks)
- (ii) *As the concurrent auditor of Nagpur Main Branch of XYZ Bank Ltd. state the issues which have to be considered in the audit of advances.* (6 Marks) (November 2008)

Answer

- (i) The long form Audit Report has to be furnished by the auditor of a bank in addition to the audit report as per the statutory requirement. The matters which the banks require their auditor to deal with in the form of Long Form Audit Report have been specified by Reserve Bank of India.
- (ii) The items to be covered in the current audit of advances of a bank are as follows:
- (a) Ensure that loans and advances have been sanctioned properly (i.e. after due scrutiny and at the appropriate level).
 - (b) Verify whether the sanctions are in accordance with delegated authority.
 - (c) Ensure that securities and documents have been received and properly charged/registered.
 - (d) Ensure that post disbursement supervision and follow-up is proper, such as receipt of stock statements, instalments, renewal of limits, etc.
 - (e) Verify whether there is any mis utilisation of the loans and whether there are instances indicative of diversion of funds.
 - (f) Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions.
 - (g) Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates.
 - (h) Ensure proper follow-up of overdue bills of exchange.
 - (i) Verify whether the classification of advances has been done as per RBI guidelines.

- (j) Verify whether the submission of claims to DICGC and ECGC is in time.
- (k) Verify that instances of exceeding delegated powers have been promptly reported to controlling/Head Office by the branch and have been got confirmed or ratified at the required level.
- (l) Verify the frequency and genuineness of such exercise of authority beyond the delegated powers by the concerned officials.

Question 2

How will you evaluate the Internal Control system in the area of Credit Card operations of a Bank?
(5 Marks) (November 2009)

Answer**Evaluation of Internal Control System in the area of Credit Card Operations in a bank:**

- (a) There should be effective screening of applications with reasonably good credit assessments.
- (b) There should be strict control over storage and issue of cards.
- (c) There should be a system whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- (d) There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- (e) Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.
- (f) All the reimbursement (gross of commission) should be immediately charged to the customer's account.
- (g) There should be a system to ensure that statements are sent regularly and promptly to the customer.
- (h) There should be a system to monitor and follow-up customers' payments.
- (i) Items overdue beyond a reasonable period should be identified and attended to carefully. Credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- (j) There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

Question 3

- (a) *While auditing the Branch of a Bank you are required to examine Inter Branch adjustments. Which points require your special attention?*
(6 Marks)

(b) *How do you examine claims against the Bank not acknowledged as debts?*

(4 Marks) (May 2010)

Answer

(a) Special points to examine Inter Branch adjustments:

The following points require special attention in the examination of Inter Branch transactions.

- (i) While verifying the closing balance, special attention should be paid to the origin and validity of old outstanding unmatched entries, particularly debit entries. The auditor may also seek confirmation of transactions relating to outstanding in appropriate cases.
- (ii) Whether there are any reversal entries indicating the possibility of irregular payments or frauds.
- (iii) Whether the balances include any items in the nature of cash in transit included in this head which remain pending for more than a reasonable period. This is because such items are not expected to remain outstanding beyond a very small period during which they are in transit.
- (iv) Whether transactions other than those relating to inter branch transactions have been included in inter branch accounts. Any unusual items put through inter branch accounts as well as old or large entries outstanding in Inter branch accounts should be carefully looked into. The auditor should also seek explanations from the Management in this regard in appropriate cases.

(b) Examination of claims against the Bank not acknowledged as debts:

The auditor should examine the relevant evidence, for example correspondence with lawyers, claimants, workers/officers and workmen's/officer's unions. The auditor should also review the minutes of the meeting of the Board of directors/committees of the Board, contracts, agreements and arrangements, list of pending legal cases and correspondence relating to taxes, duties etc., to identify claims against the bank. The auditor should ascertain from the management the status of claims outstanding as at the end of previous year. A review of subsequent events would also provide evidence about completeness and valuation of claims.

Question 4

Write a short note on reversal of income under bank audit. (5 × 4 = 20 Marks) (November 2010)

Answer

Reversal of Income

If any advance, including bills purchased and discounted, becomes Non-Performing Assets as at the close of any year, the entire interest accrued and credited to income account in the past

periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).

Question 5

“An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank.” Define the criteria for classification of non-performing assets.

(8 Marks) (May 2011)

Answer

Non-Performing Assets: An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

Criteria for the classification of a Non Performing Asset (NPA) is a loan or an advance where

- (i) Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan.
- (ii) The account remains “out of order” in respect of an Overdraft/Cash Credit (OD/CC).
- (iii) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- (iv) The instalments of principal or interest thereon remain overdue for two crop seasons for short duration crops.
- (v) The instalment of principal or interest thereon remains overdue for one crop season for long duration crops.
- (vi) The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitization dated 1st February, 2006.
- (vii) 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.