REVISION NOTES
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BANK AUDIT REVISION NOTES CA INTER

Chapter Weightage- 4 to 8 Marks

Refer full fledged notes or ICAI Module before revision notes

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SR No	List of questions (Highlighted questions are past exam/RTP/MTP questions)
1.	RBI-Act as Bank of our country
2.	Principal Enactments governing bank audit
3.	Types of Audit Report
4.	Matters to be discuss with engagement team
5.	Audit report- Nationalised Bank
6.	Long Form Audit Report
7.	Reporting of fraud to RBI
8.	Risk Management process requirement
9.	Modes of Creating security
10.	Classification of Advances as NPA – Criteria
11.	Advance under consortium
12.	Erosion in value of security/Fraud
13.	NPA in case of Agricultural advances
14.	Evidence in case of advances
15.	Evaluation of Internal control in case of advances
16.	Income Recognition criteria in case of advances
17.	Reversal of income
18.	Verification of interest expenditure
19.	Audit procedure- Provision & Contingencies
20.	Audit Procedure – Operating Expenses

Q1) RBI Acts as a central bank of our country

- Development & Supervision of Financial institution in India
- Regulate & determine Credit Policies
- Issue & regulate Currency
- Banker to CG, SG & other banks
- Regulate commercial & other banks
- Power to Inspect any bank
- *6 Points (Hint- major points related to bank)*

Q2) Principal enactments governing Bank Audit

- Banking Regulation Act, 1949
- Regional Rural Bank Act, 1976
- Companies Act, 2013
- Reserve Bank of India Act, 1934
- SARFAESI Act, 2002
- State Bank of India Act,1955
- Prevention of Money Laundering Act, 2002
- Information Technology Act, 2000

Shortcut-BR CR SS PI

Q3) Types of Audit reports to be issued

- Statutory Central Auditor issue Main+ other report
- IFCOFR 143(3)(1)
- LFAR
- SLR Compliance
- Treasury Operations
- Income recognition, Asset classification & Provision
- Serious irregularities
- Ghosh & Jilani committee
- Adverse credit-deposit ratio

Q4) Matters to be discussed with engagement team (3 Main Points to be discuss before start of Audit, every point to be documented)

- **Purpose**
  - Understanding of bank & its environment
  - Internal Control
  - Potential of Material Misstatement if Financial statements (Big errors).
- **Benefits of Discussion**
  - Team can share insights
  - Exchange of information about business risk
  - Understanding of effect of results of risk assessment procedure
  - NTE of further audit procedure
- **Matter to be discuss**
  - Error- Likely to occur or identified in prior years
  - Method-fraud may be carry out by bank/others in A/c balance or disclosure
  - Audit Response to – 3 Risk SEP (Engagement, Pervasive, Specific)
  - Professional Skepticism (Alert Mind) to be maintain
  - Indication of Material Misstatements (error which affects decision of users of balance sheet) alert

Q5) Audit Report of Nationalised Bank

- Report to CG
  - Opinion on FS- gives T&F view or not
  - Information & explanation-satisfactory
  - Transaction-within power of bank
  - Return from branch- Adequate
  - Any other matter

Hint – O RITA …. Audit report mai Kya aaega ?

Q6) LFAR- Long Form Audit Report

- LFAR in addition to main report
- It is a statutory requirement
- Matters-specified by RBI
- Submit-before 30th June
- A* can provide Summary of key observation

(A*-Auditor)

Q6)Reporting of Fraud to RBI (Point of answer SA 240+SA250+Co. Act, 2013)

- RBI Circular provide (Note - guideline is simplified here)

➢ Accounting professional-in internal or external audit process-finds anything susceptible (doubtful)-from which A* finds fraud or excess power or smell any foul play (criminal) transaction-then refer matter to regulator (Government or SEBI etc)- if not done the person is liable for action

- Circular applicable-all commercial except regional rural bank
- A*-should evaluate system as whole and not all transaction
- SA 250- follow duty of confidentiality while reporting of non compliance of law
- SA 240- A* responsible for reasonable assurance that FS are free from material misstatement
- Sec 143(12)- If A* has reason to believe that fraud-Committed by-Co./officer/Employee-report to CG as prescribed

Points for understanding

SA 240- states responsibility of A* regarding fraud-

SA 250- States that auditor should not share information regarding client to outside party

Circular- Auditor has any doubt regarding fraud or criminal or unfair transaction then he should inform same to regulator otherwise he can be liable for action

Q8) Understanding the risk management Process (what should be there in bank's risk management process?)

- TCWG Involvement

➢ Approved risk management policy by TCWG

➢ Policy consistent with

✓ Management expertise

✓ Regulatory requirement

✓ Objective of business

✓ Strategy

✓ Capital strength

✓ Risk

check MR OSCR (policy kesa ho, MR OSCaR bole waisa)

- Identification, measurement & monitoring risk

➢ Identify- risk – significantly affect-goals & objectives

➢ Measure and monitor-against limits

- Control Activities

➢ Segregation of duties (SOD)-(e.g. cash entry and cash deposit by 2 different person)
➢ Verify + Approve transaction (e.g. verify and approval of all transaction by head)
➢ Setting of limits (egg transaction above 2000 can not be done in cash)
➢ Reporting & approval of exceptions (e.g. report transaction above 2000 in cash to head monthly)

- Reliable information System (what kind of system is required?)

➢ System-which provide adequate – Financial, operational, compliance info.- timely basis to Management &TCWG (e.g. MIS on weekly basis)

- Monitoring Activities

➢ set up- unit which – assess risk models, methodologies,& assumption to measure and monitor risk

Hint (point shortcut-I Take Care Risk Management)
** TCWG (those charged with governance)means- CFO, CEO and heads of organisation*

Q9) Modes of creating security (If que if for 4 marks mention 4 modes)

Mortgage -Registered- Deed signed by mortgagor- charge on property created by bank-Equitable-Mere delivery of title or other documents
Pledge - Delivery of goods to bank-to create a charge-legal ownership remains with pledger-bank gets interest in goods
Hypothecation - Equitable charge-in favour of bank by execution of agreement-in case of movable security-neither possession nor ownership transfer to bank-borrower have to submit statement periodically.
Lien – Creation of legal charge with consent of owner-gives legal right to seize & dispose asset
Set-off- statutory right of creditor- to adjust full/part debit balance- against debtors balance-to combine 2 a/c of one person
Assignment- Transfer of existing/future debt/right/property-in favour of another person-only actionable claim is allowed-it gives absolute right to bank.

- Example of Common securities accepted by bank(Only for understanding)
  - Personal security of guarantor
  - Goods/stock/debtors/trade receivables
  - Gold/bullion/immovable property
  - Life insurance policy
  - Stock exchange securities

Q10) Criteria for classification of Advances as NPA

Advance is NPA-ceases to generate income

Interest &/or instalment of principal-out of order or overdue

- Out of order- Continuous outstanding in excess of drawing power or no credit for 90 Days as on BS date-or no enough credit to cover interest
- Overdue-Amt not paid on due date

Term Loans- Principal/interest – overdue for >90days

CC/DD – NPA if out of order for 90 days

Bills purchased & discounted – Remains unpaid for >90Days

Categories of NPA & Provisioning

- a. sub-std Asset (NPA </= 12m)
  - Up to 1Yr
    - Sec (25%)
    - unsec (100%)
- b. doubtful (NPA > 12m)
  - 1 to 3 Yrs.
    - Sec (40%)
    - Unsec (100%)
  - >3 yrs.
    - Total (100%)
- c. Loss (Identified by bank/IA/EA)
  - (100%)

(Sec= Secured Unsec= Unsecured IA=Internal Audit EA= External Auditor)

Q11) Advance under consortium (Like group of bank has given advance to one person- one bank will be leader)

- Record advance-based on recovery of respective individual member bank
- If remittances-pooled with one bank or bank receiving remittance not sharing with other bank-treat advance as NPA
- Bank should arrange- their share of recovery-from lead bank

Q12) Erosion in value of security/Fraud by borrowers

- Classify advance as- Doubtful or Loss asset straightaway.
- Value erosion>50% of value assessed by bank/accepted by RBI-case is significant-classify as doubtful
- Realisable value- assessed by bank/Approved by RBI <10% of outstanding in borrower's A/c-ignore existence of security- classify loss asset & write off fully.

Q13) Criteria of NPA in case of Agricultural Advances

- NPA if interest/Principal overdue for
  - ➢ Two crop season – if loan for short duration crop (other than long duration crop)
  - ➢ One crop season – If loan for long duration crop (crop season longer than one year)
- Crop Season – Period up to harvesting as determined
- NPA norms applicable – to all loans as per circular
- For other loans- follow normal norms of 90 Days
- In case of natural calamities – Bank may give own measures

Computation of Drawing power (Only for understanding)

- A/c which exceeds DP or against unapproved securities – bring to the notice of head office
- Working Cap A/c- Covered by adequate current asset- calculation to be done on basis of stock statement not older than 3months-if statement older than 3m- consider a/c as irregular
- Detail scrutiny – stock statement & quarterly returns to be done
- Detail scrutiny- Audited annual report & deviation in stock statement
- Stock Audit of Banks- for all A/c having funded exposure > 5crores
- Special care required – Companies in construction business

Q14) Obtain following evidence in respect of Advances (Perform Compliance & Substantive procedures)

- <u>Compliance Procedure (to check internal controls)</u>

➢ Loan Documentation, Validity of recorded amounts
➢ <u>Existence, enforceability & Valuation of security</u>
- Term of sanction
- End use of funds
- Loan policy & RBI Norms
- Review operation of A/c

- <u>Substantive Procedure (to check account balance)</u>

➢ Verify- outstanding amount in balance sheet as on BS date
➢ Advance- represent amount due to bank
➢ Outstanding amount – Supported by loan documents
➢ Ensure- No unrecorded advances
➢ Ensure – No unrecorded advances
➢ Verify- Appropriateness & valuation of advances
➢ Advances- are according to Policies + RBI norms + statutory requirements
➢ Provision on Advance- as per RBI Norms
➢ Recoverability of Advance- recognised in valuation of advance

Q15) Evaluation of Internal control over Advances (Examine efficacy of IC to determine NTE of substantive Procedure)

Shortcut – GOD Bole MORE Compliance

<u>Goods in possession of bank</u>-test check content of package at time of receipt – inspection of godowns by officers
<u>Operation of each of advances</u> – review at least once in a year
<u>Drawing Power</u>
➢ Register – Update and review by officer on monthly basis
➢ A/c – should be within DP limit
➢ A/c exceeds DP Limits – Bring notice to head office
<u>Borrower credit worthiness</u> – Make advance only after satisfying credit worthiness
<u>Margin</u> – To be kept against securities as per sanction letter- review at regular intervals to be done
<u>Ownership</u> – Securities ownership to be transfer in name of bank- effective control on documentation required
<u>Registration</u> – Either register on bank's name or sufficient title documents should be there
<u>Execution of documents</u> – to be done before advance made
<u>Compliance</u> – ensure with terms of Sanction & end of funds

Q16) Income recognition norms w.r.to Advances

- Any income exceeds: - follow AS9 recognise on accrual basis and other income on receipt(Cash) basis

✓1% of total income – if income reckoned (Calculated) on gross basis

✓OR 1% of NPBT –if income is reckoned (Calculated) on net of cost

- In case of NPA- recognise as and when received
- Interest on advance against – Term deposit, NSC, KVP, Life policies- recognise on due date if adequate margin is there
- Outstanding bill purchased & Discounted – Discount received to properly apportioned
- Fees & Commission from rescheduling of advances- recognise on accrual basis
- Obtain reasonable assurance- income arose from relevant transaction & relevant period
- No unrecorded income

Q17) Reversal of Income

- Advance or bill purchased & discounted – if becomes NPA at year end- reverse entire amount credited on accrual basis if not realised- applicable to government guarantee also
- NPA – Fees and commission – recorded on accrual basis- to be reversed if uncollected
- In case of banks – Wrongly recognised income – reverse interest if recognised as interest in CY or make provision if recognised as Income in PY
- Enquire – unexplained large debit in interest income
- Finance charge of lease asset- Finance income component accrued & credited to be reversed – if Asset becomes NPA
- Partial recoveries in NPA – appropriate recoveries towards interest & principal – follow AS9- interest realised in NPA can not be from fresh/ additional credit facilities by bank

Q18) Verification of Interest Expenditure

- Obtain- analysis of deposit outstanding at each quarter- compute weighted avg interest rate-compare with actual rate –enquire difference if material (compare actual rate with avg rate)
- Compare avg interest paid –with PY figures-analyse difference if material
- Verify interest calculation & ensure following

➢Interest provided on all deposit up to date of BS-analyse any excess or short credit
➢Interest rate – as per regulations, RBI directives
➢ Interest rate of FD- mentioned in system is as per FD certificate
➢Interest on Saving A/c – test based check – as per rules of bank
➢Interest on Inter-branch balance- Provided as per rate given by head office
➢Provide interest on overdue term
➢Ascertain any changes in rate of interest

Q19) Verification of provisions & Contingencies

- Understand-Compliance with regulatory requirement-& circulars
- calculation of provision on std asset & NPA – also classification of loans into std, sub std & doubtful
- Obtain detail break-up – secured & NPA loans- match balance with general ledger
- Examine- Provision on loans-and regulatory requirements
- Verify – tax provision calculation- verify items cr/dr to P&L
- Recompute provision of tax- apply tax rates as per Income Tax, Act
- Discuss and obtain- explanations for provision for expenditure

Q20) Verification of Operating Expenses

- Study & evaluate Internal control over expenditure
- Study authorization procedure – to determine NTE of audit procedure
- Examine- any major diversion trends in expenses
- Perform – Substantive analytical procedure (e.g. Compare total operating expense ratio to PY)
- Verify expense with – Supporting documents & calculations