

4 to
8
Marks

CA IPCC Inter.
Bank Audits (Notes).
Summary of ICAI Module.

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Chapter Overview Chart

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- Q2 → Principal Enactments Governing Bank Audit
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- Q4 → Matters to be discussed with Engagement Team
- Q5 Audit Report in case of Nationalised Bank
- Q6 → Long Form Audit Report
- Q7 → Reporting of Fraud to RBI - MTP18
- Q8 Requirement of Risk management process - M19, MTP18
- Q9 → modes of creating security - M18
- Q10 criteria for classification of Advance as NPA - PEG
- Q11 Advance under consortium
- Q12 → A/c where Emission in value of security / Fraud - N18
- Q13 → NPA → Agricultural Advances
- Q14 → Evidence in case of Advances - RTP18
- Q15 → Evaluation of Internal Control in case of Advance - RTP19
- Q16 Income recognition in case of advances.
- Q17 Reversal of Income
- Q18 → verification of Interest Expenditure
- Q19 → Audit procedure for provisions & contingencies
- Q20 → Audit procedure for operating expenses

MTP - Mock Test Paper

RTP - Revision Test Paper

PEG - Past Examination Que.

Highlighted - Expected Que.

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* AR - Audit Report
* IFCOFR - Internal Controls over financial Reporting.

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Q-1

RBI - acts as central Bank of our country - {PEQ}

- 1- RBI is responsible for development & supervision of (Banks + NB financial institution) i.e. Indian financial system
2. Determining and regulation of credit policies.
3. Issuance & regulation of currency
4. acting as Banker to CG & SG & other Banks.
5. Regulation of activities of Commercial & other Banks.
6. RBI has power to inspect any Bank.

Q-2

Principal Enactments Governing Bank Audit {PEQ}

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,

(BR CR SS PI)

Q-3

Types of Audit Reports to be issued

- Statutory central Auditor → furnish → maintain other AR
- a. Adequacy & operating effectiveness of IFCOFR - 143(3) (i)
- b. Long form Audit report - LFAR
- c. SLR Compliance requirement
- d. Report on Treasury operations.
- e. Report → income recognition. Asset classification & provision
- f. Report → any serious irregularity noticed.
- g. implementation of recommendations of Ghosh & Julani Committee
- h. Instances of adverse credit-deposit relation in rural areas.

Bank Audit Approach. (Only for understanding)

Audit to be conducted Based on

- Level of operations, Compliances, level of features, Inadequacy or breach of Internal Control

Bank → Controls required to mitigate risk

- ↳ Effective segregation of duty
- ↳ Reporting of positions.
- ↳ Verification & Approval of transactions.
- ↳ Setting up limits
- ↳ Physical security.

Q4 Matters to be discussed with Engagement Team (PEQ)

Purpose: (Everything to be documented)

1. Gain better understanding of Bank & its Environment
2. understand Internal Control
3. Assess potential for material misstatement of Ps.

↳ Chances of Big Errors in P&L, Bs, Notes etc)

Benefits of discussion:

1. Opportunity for Team to share insight Based on knowledge.
2. opportunity → Exchange information about Bank's risk
3. make understanding among Team → Effect of results of risk assessment procedure
4. NTE (Nature, Timing, Extent) of further Audit procedure.

Matters to be discussed:

1. Errors → more likely to occur
2. Errors → Identified in prior years. → Commit/carry out
3. Method → fraud might be perpetrated by Bank/others within A/c Bal disclosure.
4. Audit response → 3 Risk (Engagement, Pervasive, Specific).
5. Maintain professional Skepticism during audit (Alert mind)
6. Alert for information [conclusions → indicates material misstatement.

- * T&F - True & fair view.
- * FS = Balance sheet, Profit & Loss, Notes to A/c.

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Q5

Auditor's Report in case of Nationalised Bank (PEQ)

Report to CG → in case of nationalised Bank

- Opinion on financial statement of Bank, i.e. whether its giving T&F view or not
- Information or Explanation called by him are satisfactory
- whether or not Transaction of Bank → within power of that bank
- Returns from branches/office are adequate
- Any other matter he finds necessary

Q6

Long Form Audit Report (PEQ)

- LFAR to be furnished by A* in addition to Audit report as per statutory requirement
- Matters require A* of bank to deal with are specified by RBI
- LFAR to be submitted before 30th June Every year
- To submit on time proper planning is required
- Members may provide summary to bring key observations

Q7

Reporting of Fraud to RBI (PEQ)

(SA 240 + SA 250 + Companies Act, 2013)

RBI circular provide → "If an accounting professional whether in the course of Internal or External audit or in the process of institutional audit finds anything susceptible to be fraud or fraudulent activity or act of Excess power or smell any foul play in any transaction, he should refer matter to the regulator. Any deliberate failure on part of A* should render himself liable for Action"

* MM: material misstatement

* Romms: Risk of material misstatement.

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- circular Applicable → All Scheduled Commercial bank
Excluding Regional rural bank
- Auditor is not Expected to look into each Transaction but evaluate the system as a whole.
- Consider SA 200 "Consideration of laws & Regulations in an Audit of FS" → Explain duty of confidentiality.
- consider SA 240 "Responsibilities Relating to Fraud in an Audit of FS"
↳ states that A* is responsible for reasonable assurance that FS are free from MM by Fraud/Error.
- Consider 143(12) of Companies Act, 2013 → if A* has reason to believe that an offence of fraud as prescribed has been committed by co./officers/Employee
⇒ report matter to Central Govt.

Conducting - An Audit (only for understanding).

- ① Initial consideration by statutory Auditor
- ② Identifying & Assessing Romms
- ③ Understanding → Bank + Environment + Internal Control
- ④ understanding Banks Accounting process.
- ⑤ understanding the Risk management process **PEQ-08**
- ⑥ Engagement Team Discussions
- ⑦ Establish overall Audit strategy
- ⑧ Develop the Audit plan
- ⑨ Audit planning memorandum
- ⑩ Determine materiality
- ⑪ Consider Going Concern
- ⑫ Assess the Risk of fraud + Money laundering.
- ⑬ Assess specific Risks
- ⑭ Risk Associated with outsourcing of Activities
- ⑮ Response to Assessed risk
- ⑯ Stress Testing
- ⑰

* TCG - Those charged with Governance (eg. BOD, CFO, etc).

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(17) BASEL III Framework.

(18) Reliance on other reports.

Q8 Requirements of Risk management process - PEO
Understanding the risk management process:

(1) TCG Involvement:

- Risk management policies → Approved by TCG
- TCG should ensure → policies consistent with Bank business objective & strategies, capital strength, management expertise, regulatory req & acceptable risk.

(M) (R) (O) (S) (C) (R)
Mgmt Expert Regulatory Req Objective Strategy Capital Risk.

(2) Identification, measurement & monitoring of risks:

- Identify risk which significantly affect → Bank's goal & objectives.
- measure & monitor risk against pre-approved limits & criteria.

(3) Control activities: Appropriate control for risks.

- Segregation of duties (SOD)
- verification + Approval of transactions.
- setting of limits.
- Reporting & Approval of exceptions.

(4) Reliable information systems.

- Bank must have system → provide adequate financial, operational, ~~compliance~~ compliance info. on timely & consistent basis → Mgmt + TCG

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⑤ Monitoring Activities.

set up independent risk management unit → which assess risk models, methodologies & assumption → to measure & manage risk.

(I Take Care Risk Management)

Shortcut - **I T C R M**

Ident, meas + monitor risk Take control activities Reliable IFS monitoring activities.

Advances (only for understanding)

Advances : core business of bank is accepting deposit for lending. Advances constitute largest item of Asset.

Advances comprises:

Term loan, cash credit, OD, demand loans, Bill discounted & purchased, Bal. in Deposit A/c, participation on Risk sharing basis, interest bearing staff loan.

* Balance sheet Disclosure *

A. (i) Bill purchased & discounted.

(ii) cash credit, op & loans repayable on demand.

(iii) Term loans.

B. (i) Secured by tangible Assets

(ii) Covered by Bank / Government Guarantee.

(iii) unsecured.

C. I. Advances in India

(i) priority Sectors

(ii) Public Sectors

(iii) Banks

(iv) other.

C. II. Advances outside India

(i) Due from Banks

(ii) Due from others

(a) Bills purchased & discounted

(b) Syndicated loans

(c) other.

Nature of security (only for understanding)

Primary collateral.
 offered by Additional security
 Borrower (ie. tangible / intangible
 Principal security) Asset).

Eg of Common Securities accepted by Bank

- personal security of Guarantor
- Goods / Stock / Debts / Trade receivable
- Gold / Bullion
- Immovable property
- Agricultural Advances
- Third party Guarantee
- Banks General Lien
- life insurance policies
- stock exchange securities.

Remember
5 to 6

Examples.

Q9 Modes of creating security (4 modes).

① Mortgage → Registered.
 Equitable.

Registered: Mortgage deed → signed by mortgagor.
 eg: in case of home loan → charge is created on property by Bank.

Equitable: its mere delivery of title deeds or other documents.

eg: possession of only original title documents.

② pledge: Delivery of Goods by borrower to lending bank with intention of creating a charge, as security, legal ownership remains with pledger, & lending Bank gets defined interest in goods.
 eg: lending of goods with bank & taking loan

- ③ Hypothecation: creation of Equitable charge → created in favour of lending Bank by execution of Agreement in respect of movable securities of borrower → Borrower will hold physical possession of Goods.
eg. In vehicle loan, vehicle remains with borrower, but hypothecated to bank.
Neither ownership nor possession are transferred to bank.
Borrower periodically submits statements of quantity & value of Asset to bank based on which drawing power is fixed.
- ④ Lien: creation of legal charge with Consent of owner → Gives lender a legal right to seize & dispose Asset.
- ⑤ Assignment: It represents Transfer of existing/future debt right/Property → in favour of another person. → Only actionable claim (other Free claim) is accepted by bank.
→ Gives absolute right over debt assigned.
eg. Money receivable from 'A' & payable to bank By "Ram"
Now Ram will Assign 'A' i.e. debtor to bank.
- ⑥ Set-off: It is a statutory right of creditor → adjust full/partial debt balance in debtor's A/c against any credit balance lying in another A/c of Debtor → Enables Bank to combine 2 A/c → only if both A/c are of same person (Name + right)
eg: set off of deposit & loan A/c.

* Write 4 modes if que is of 4 marks. or any specific modes also, can be asked as separate question

- * BS - Balance sheet
- * IA - Internal Auditor
- * EA - External Auditor

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Q10

Criteria for classification of Advance as NPA

Advances will be classified as NPA if:

- ceases to generate income for bank
- Interest &/or instalment of principal in respect of Advance remain overdue or out of order for specified period of time:

↳ overdue: Not paid on due date fixed by bank

↳ out of order: Outstanding Amt remains continuously in excess of drawing power or No credits continuously for 90 days as on BS date or credit are not enough to cover interest debited during same period.

NPA classification w.r.t specified advances:

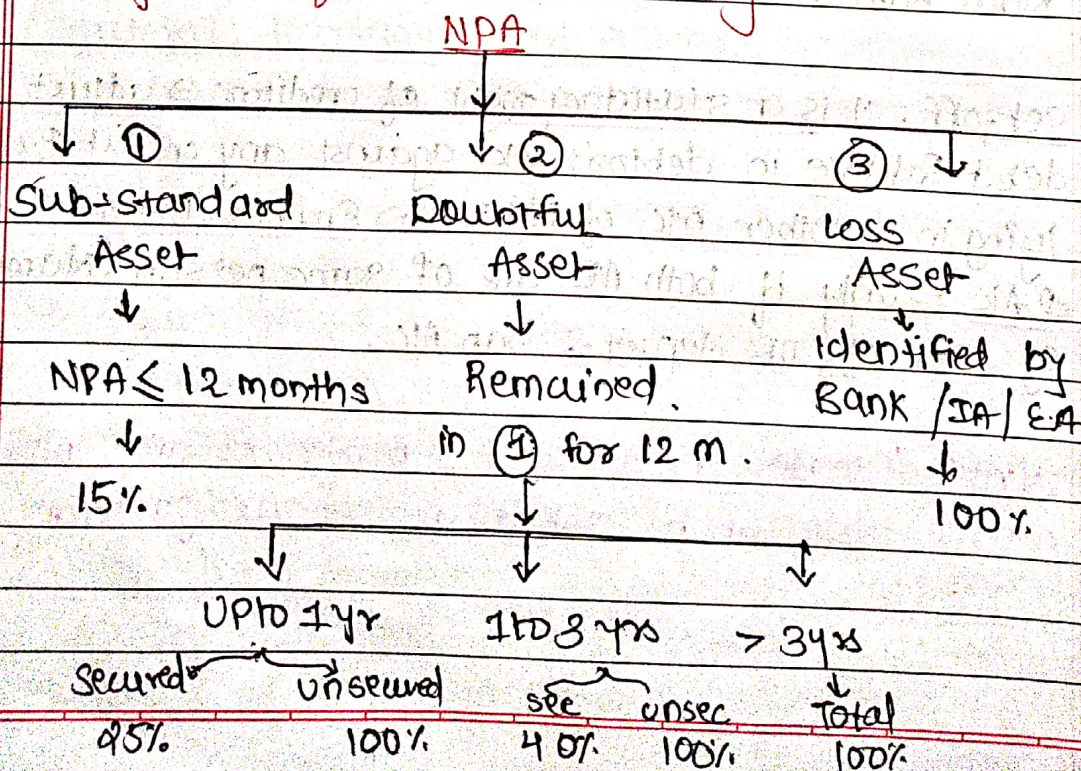
Term loans: NPA if principal/interest remain overdue for exceeding 90 days.

CC/OD: NPA if remain out of order for 90 days.

Bills purchased & Discounted: when bill remains overdue & Unpaid for exceeding 90 days.

Q11

Categories of NPA & Provisioning



* BS - Balance sheet.
OFO: only for understanding

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Classification as NPA (only for understanding)

- classification is based on recovery & not on security or net-worth
- classification would be borrower wise & not facility wise
- Accounts regularised near the BS Date (OFO)
A/c where solitary or few credits are recorded before BS
→ shows inherent weakness → should be deemed as NPA

S11 Advances under Consortium:

- Record advances based on recovery of respective individual member banks & other aspects of recoverability
- if remittances by borrower are pooled with one bank or bank receiving remittance not sharing with other banks
→ the A/c should be Treated as NPA
- therefore, bank need to arrange their share of recovery from lead bank.

S12 Accounts where there is erosion in value of security / Frauds committed by Borrowers (PES)

- when there is erosion in value or fraud by borrower
→ classify Advance Doubtful Asset or Loss Asset irrespective of the period of NPA
 - ↳ if value erosion > 50% of value assessed by bank / accepted by RBI Team as time of last inspection
→ case to be considered as "significant" → classify doubtful straightaway.
 - ↳ if 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 → Agricultural Advances (P&Q)

- Agricultural Advance is NPA if int/principal overdue
- Two crop seasons - if loan for short duration crop
- one crop season - if loan for long duration (> 1yr)
- long duration crop - crop season longer than one year
- short duration crop - Other than long duration crops
- crop season → period upto harvesting as determined by state level Bankers Committee.
- Norm applicable to all direct agricultural advance listed in circular.
- For other agricultural loan follow normal norms i.e. 90 days
- In case of natural calamities → Bank may decide their own relief measure for concession & repayment terms & period.

Computation of Drawing Power

- ALC which exceed sanctioned limit / drawing power or are against unapproved securities → bring to notice of head office
- Drawings in x/c ALC → covered by adequacy of current Assets → calculation to be done based on current stock statement or statement not older than 3 months → if statement is > 3m ALC is considered as irregular.
- Detail scrutiny of stock statement & quarterly returns to be done
- Audited annual report & deviation in stock statements - to be scrutinized in detail
- stock Audit of Bank for All ALC having funded exposure > 5 crores.
- Special care required for co. in construction business

NTE - Nature, Timing & Extent
IC - Internal Control!

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Q14

Obtain following Evidence in respect of Advances. {PEQ}

- Evidence may be collected by performing compliance & substantive procedures.

Compliance procedures

Examine:

1. loan documentation
 2. validity of recorded amounts
 3. Existence, Enforceability & valuation of security
- Ensure compliance with:
1. Term of sanction
 2. End use of funds
 3. loan policy + RBI Norms → classification & provisioning
 4. review operation of A/c

Substantive procedure

1. Verify amount in Balance sheet → are outstanding at date of BS.
2. Advances represent amount due to bank
3. Ensure outstanding amt is supported by loan document
4. Ensure that there are No unrecorded advance
5. Verify appropriateness of valuation of advances
6. recoverability of Advance is recognised in valuation
7. Advances → disclosed, classified, described accordance with A/c policies + regulatory & statutory requirements
8. provision on advances is as RBI Norms

Q15

Evaluation of Internal controls over advances. {PEQ}

Auditor should Examine Efficacy of IC over advance to determine NTE of Substantive procedures.

Shortcut → G O D3 @ - Bole M O R E
Compliance so that IC will be effective.

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- ① Goods in possession of bank → Content of packages to be Test check at time of receipt → Inspection of Godown to be done by officers.
- ② Operation of Each adv → reviewed at least once in a year → and more for large advances.
- ③ Drawing Power
 - a. Register should be updated monthly and check by officers
 - b. ALC should be kept in limit of DP & sanctioned limit
 - c. ALC which exceed DP limit → bring notice to Controlling authority.
- ④ Borrowers credit worthiness should satisfy → only after satisfying bank should make advances.
- ⑤ Margin to be kept against securities as per Sanction letter → check margin at regular intervals.
- ⑥ Ownership of securities (Share, Deb) should be transferred in the name of bank → Ensure effective control over documentation
- ⑦ Registration of securities → Either registered on Bank's name or sufficient document to give title to bank
- ⑧ Execution of documents to be done before advance made
- ⑨ Compliance with terms of sanction & end use of funds should be ensured

→ Income (only for understanding)

- ① Interest earned → Adv, investment, other
- ② Other income → Commission → Bfe, NEFT, RTGS, LC, LOC, loan processing, → credit/debit card fee
→ Rent of lockers, Agency business, Brokerage, Banking charges, Profit on sale of investment, Revaluation profit

* Cy - current year
* Py - Previous year

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Q16

Income recognition norms w.r to Advances - (PEQ)

- ① Any income which exceeds:
 - ↳ 1% of total income. → if income recognised on Gross basis.
 - ↳ 1% of Net profit before taxes → if income is reckoned net of costs.
- ② should be considered on accruals aspect As per AS-9 & other income as & when received.
- ③ In case of NPA → recognise as and when received.
- ④ Interest on advances against → Term Deposits, NSCs, IVPs, KVPs, life policies → provide on due date if adequate security margin is available.
- ⑤ Outstanding bill purchased & discounted → discount received should be properly apportioned.
- ⑥ Fees & Commission → from rescheduling of advances → recognised on accrual basis.
- ⑦ Obtain reasonable assurance → income arose from relevant transaction, relevant period.
- ⑧ There is no unrecorded income.

Q167 - Reversal of income

- Advance or bill purchased & discounted → NPA at close of any year → Entire accrued interest credited to income A/c → to be reversed if not realised → same applies to Government guaranteed A/c also.
- NPA → fees, commission → that have accrued should be reversed → if uncollected.
- In case of banks → wrongly recognised income → reverse the interest if recognised as interest in cy → or make a provision if it was recognised as income in py.
- Auditor should enquire → large debit in Interest Income if its unexplained.

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- Finance charge of lease asset → finance income component EA accrued & credited to income A/c → If asset become NPA → should be reversed.
- on partial recoveries in NPA → Appropriate recoveries towards interest & principal → follow Assn policy → interest realised in NPA cannot be from fresh/additional credit facilities sanctioned to borrowers.

Q18: Verification of Interest Expenditure - (RTP)

- obtain from bank → analysis of deposit outstanding at each quarter → compute weighted avg int rate → compare that with actual avg rate → and Enquire difference if material.
- compare avg rate of int paid with py figures and analyse difference if material.
- verify interest calculation & ensure following:
 - ↳ interest provided on all deposit upto to date of BS → determine any excess or short credit
 - ↳ interest rates → according with regulations, RBI directives & Agreements
 - ↳ fixed deposit → interest mentioned in A/c system is as per rate on FD certificate
 - ↳ interest on saving A/c → do test based checking check → as per rules of bank
 - ↳ interest on inter-branch balance → provided as per rate prescribed by Head Office
 - ↳ provide interest on overdue term.
- Ascertain any changes in rate of interest

- * IT Act = Income tax Act, 1961
- * NTE - Nature, Timing & Extent
- * AP - Audit procedure

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Q19 Audit procedure for verification of provisions & contingencies.

- Ascertain compliance with regulatory requirement as per circulars
- Understand → how bank computes provision on standard asset & NPA → also classification of loans into std, substd, doubtful
- obtain detail breakup → secured loan, NPA loans → Agree (match) Balance with General ledger
- Examine → provision of standard loan & NPA → regulatory req
- verify tax provision computation → verify nature of item debited / credited to P&L
- Re-compute provision for tax → applying tax rates → & IT Act, 1961
- Discuss and obtain Explanations → from bank's management for provision for Expenditure.

Q20 Audit procedure for verification of operating Expenses.

- study & evaluate system of internal control over Exp.
- study authorization procedure → to determine NTE of AP
- examine any major diversion trends in Expenses.
- perform substantive analytical procedure.
eg. Total operating Expense ratio, as compared to Py.
- verify Exp with reference to supporting documents & calculations.

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