Chapter-5

Bank Audit

• Imp. function of RBI :-

- R → Regulation of currency issue
- B → Bankers To,
  - CG/SG
  - commercial Bank inc. Term lending inst.
- I → Issue of currency.

• Peculiarities involved in Bank :-

- V → verify → Huge V.O.T.
- R → Range of P & Sr.
- T → Extensive use of Tech.
- G → wide geo. spread of Network.
- S → strict vigilance.

• Types of Bank Audit Report To be issue :-

Along with Main Report following shall be issue by SCAs :-

• GHOSH & JILANI :-

→ Status of compliance by Bank with regards To Implementation of Reco. of $\underbrace{\text{Ghosh comittee}}_{\text{fraud and malpractices.}}$ and $\underbrace{\text{Jilani comittee}}_{\text{ICS / credit system.}}$

• SAW :- SLR Requirement (Report on compliance)

• LONG :- LFAR (30th June Every year)

• irregularities :- if notice, whether attention require.

• in :- Adequate & Effective ICOFR for B.C. [Co. Act 2013]

• THE :- Report on Treasury operation. whether conducted as per RBI instruction.

• AIR :-

↓ ↳ Income Recognition. & provisioning

Asset classification. ⟶ As per RBI Guidelines.

• RATIO :- Report on ACDR in Rural Area.

• Reporting for Nationalised Bank & SBI :-

↳ To CA following, whether, ...

- F.S. provide T&FV
- Adequate info./Exp. given by Bank which satisfy Auditor.
- Transaction made within power of Bank.
- Adequate Return from Branch received.
- Any other viz. Necessary

Bank Audit Approach

A [Audit plan]

It should be drawn based on,

C : lvl. of compliance in Pre. Report.

A : Nature of Adverse feature

R : A.R. Based on Breach of ICS

O : Nature & lvl. of operation.

Advantage of E.T.D.

- I&A suceptibility of FS MMS {F, E} that enable Auditor (ET) To considere Appt. Response.
- Better Dele. of work.
- Helpful in determine procedure
- To be fwd if fraud identified.
- To Address the fraud, Assess Need to Appoint specialist.

C [Control Envirn.]

it includes,

- Effective seg. of Duties.
- Physical securities & contingencies planning.
- Accurate MSRment.
- Approval of Trans.
- Setting up limit.

E.T.D. Includes.

- ERROR
  - may occure
  - occure in P.Y.
- method by which fraud might be perpetruted by B. Plonu.
- Audit Response —> ER, PR, SR
- Need To maintain PS
- Alert for info. that indicate MMS.

E [E.T. Discussion].

- Personnel performing (+) Expert = Eng. Team.
- Done at planning stage.
- Should be Docs.
- Hold To gain understanding of Bank & IC

- Form and content of F.S:
  - Sec. 29(1) & (2) of BRA, 1949.
  - Applicable To → B.C + SBI + RBI + NB
  - SCH - III of BRA 1949 Form - A (B/S) and Form - B (P&L)

- Appointment and Remn. of Auditor:

Types of Bank.	Appointing Authority	Remn.
N.B.	BOD (Prior Appr. of RBI)	RBI [consult with CG]
other B.C.	SH @ AGM (Prior Appr. of RBI)	Sec. 142 of Co. Act, 2013.
RRBs: CG 50%, SG 15%, Sp. Bank 35%	concerned Bank. [Appr. of CG].	-

- Security over Advances:-

BANK —lending money→ B → Bank Have legal power To sell the c/s in case of Default in Repayt. within time.

B —collateral or securities→ BANK

MODES OF CREATION OF SECURITIES -

Mortgage
- Reg.
  - •MORT. Deed
  - •Signed By M'OR.
- Equitable:
  - •Mere Delivery of Title Deeds.

Pledge
- B'or → lending Bank.
- Delivery of goods
- involve Bailment
- Possesion : Bank
- legal owner : customer

Lien
- creation of legal charge with the consent of owner.

Hypothecation
- •Ownership, Possesion — TRF To Bank (xxx)
- •Physical possesion → customer.

Assignment
- •Transfer of
  - Existing or future Debt
  - Rights or property
- •Acceptable security By Bank,
- Actionable claim
  - ~> Book Debt
  - ~> LIP

Setoff
- •Stat. Right of creditor/Bank.
- •S/O — Dr. Bal. → Cr. Bal.
- •A/c should same {Name, Right.

SECURITIES
- IMP → Mortgage. [Property or P&M]
- MP
  - Hypo-thecation [car or stock]
  - Pledge. [gold]
- TRF. of Right. → Assignment or lien [Debtor or LIP]

Classification of ADVANCES
[AS per RBI prudential Norms]

- Std. loans/Asset
  - Standard Regular
  - SMAs
    - SMA-0 [A/c showing stress signal]
    - SMA-1 [O/D for 31 to 60 Days]
    - SMA-2 [O/D for 61 to 90 Days]
- NPA loans.
  - Substd. Asset @ 15%. [NPA ≤ 12 month]
  - Doubtful Asset.

		Sec.	Unsec.
D_1 =	< 1 year	25%	100%
D_2 =	1 - 2 yr.	40%	100%
D_3 =	> 3 yr.	100%	100%

  - Loss Asset @ 100% [loss has been identified but amt. not wholly w/o]

NPA

- When Asset cease to continue to generate income
- Classification as NPA based on,
  - Records & Recovery (✓✓✓)
  - Borrower wise, (✓✓✓) [N-1]
  - Facility wise (XXX)
  - Avl. sec. and N.W of Borrower. (XXX)

Bills pay./Disc.
&
1.] Term loan :- P/I O/D >90 days → NPA

ii.] Cash/credit or O.D. facility :-

An Account Treated As out of order when,

- O.S.B. > SL/DP {credit continue}
- O.S.B < SL/DP {No credit cont. for 90 days}
- Credit are there but Not Enough to cover interest Debited.

N-I :-

Mr.X has two loan
- Cash loan → Regular
- Home loan → Irregular

→ NPA on Borrower wise Not facility wise.

→ ∴ Both loan is NPA.

iii] GOVT. Guaranteed Advances:-

- CG.
  - Guarantee Not Invoke or Repudiate → Classify as std. Asset.
  - Income Recognition Purpose. → NPAs
- SG.
  - Overdue for >90 Days for P&IR Purpose → NPA

iv.] Agricultural Advances:-

Particular.	Treated as NPA if Installment of P/I OD ~~>90 Days.~~
• Short Duration Crop.	Two Crop season.
• Long Duration Crop	One Crop season.

v.] Credit Card Account (CCA):-

Bank gives option To user To pay Either TAD or MAD

↓

if not paid within 90 Days from Next Statement Date. (Gap B/W Two Stat ⇒ 1 month)

↓

NPA.

VI] Advances under Consortium :-

liable for D.P. computation and allocate the same to M.B.

Higher share :: lead Bank

A → $\boxed{\text{Axis}}$ = 3 L.

Members Bank (MB) {
SBI = 0.5 L.
BOB = 0.5 L.
ADC = 1 L.
}

5 L.

if Not Remit Their share then M.B. Treated Axis as NPA.

vii] Advances Against T.D. / IVPs / KVPs :- if Adequate margin N.A. then NPA.

- EROISON in value of securities :-

if R.V. < 50% of value assed by bank and Approv By RBI
↓
Doubtful Asset i.e. NPA.

R.V. < 10% of OSB in loan A/C
↓
loss Asset i.e. NPA
↓
it may either W/o or provided by Bank.

<u>NOTE</u> :- For Drawing Power Refer Text Book pg. 10.26.

Audit of Advances

→ The Auditor is primary concerned with obtaining Evidence about the following.

NOW: NO UnRecorded Advances

Picture: Provision made as per RBI NORMS, AS, GAAP

video: Basis of valuation of advances is Appt. and properly Applied

4D :-

D_1 - ADV. Represent Amt. Due To the bank.

D_2 - O/S at the Date of B/S. Date.

D_3 - Supported by loan Document & other Docs.

D_4 - ADV. are Disclosed, classified and Describe.

→ Auditor obtain SAAE about Advances by study of ICS and By,

Examining.

① validity of Recorded Amt
② loan Docs.
③ E, E, V of security

② Reviewing operation of Account

③ carrying out Appt. A.P (SA 520)

• Evaluation of ICs over Advances:-

→ IC over Advances includes,

- credit worthiness of borrower.
- Necessary docs. should be Executed.
- D.P. Register should be updated every month.
- A/C should within DP & SL.
- ↑ if not then brought to the Notice of controlling authority.
- each ADV. A/C operation should review at least once in a year. and more in case of large ADV.

NOTE: Detail elaboration on pg.10.29.(M_2)

• Audit of Revenue item:-

Auditor's concern Regarding Audit of Revenue item.

→ obtain Reasonable Assurance that income is,

- Recorded at Appt. Amt.
- No un-recorded Income
- Arose from Trans.
- Took place in C.Y.
- pertained to Bank.

Particular	Basis for Recognition
• Any Income > 1% of Total income → Gross Basis NPBT → Net Basis if income is Reckoned	Accrual Basis
• Immaterial income	cash basis
• int. fees, comission.	Accrual basis
• uncertain income	cash basis

• fees & comission as a result of Re-negotiation / sch. of o/s Debt	Accrual Basis.
• Int. on T.D./IVPs/KVPs/LIP Adv. against	on Due Date provided adequate margin is there.

• Reversal of Income :-

→ Any Adv. → NPA → Interest < Accrue / credited in income A/c > in past period. ↓ should be reversed or provided if same is not realised.

→ Bank wrongly recog. Income, if Recog. in.

- c.y. ↓ Reverse
- p.y. ↓ provision.

→ large debit in int. income A/c
↓
Not explain
↓
then inquiry by Auditor should be done

Take out Finance

- method of financing
- whereby loan procured later on used to replace the initial one.
- Objective.
  - Expand source of finance for Infra. project
  - Address A/L mis-match concern.
  - Boost Avl. of L.T. finance for project

→ if Account classified as NPA. → Not Recognise income unless Realised from borrower.

Audit of Expenses.

Interest Expense

- Auditor concerned with Reasonableness of interest
- Analyse ratio of int. paid on deposites. & Borrowing
- compare Avg. ROI with p.y. figure and Analyse Any material diff.
- Recalculation
- int. upto BSD. [ensure]
- Int. Rate According To RBI Norms / Internal Reg.

Operating Expense.

- Study and Evaluate IC and Autho. process.
- Examine Any Divergent trend.
- perform SAP
- verify EXP. with supporting DOCS.
- check calculation wherever required.

Provisioning & contingencies.

- ensure that provision made As required by Regulato
- verify loan classifi. on sample Basis for understand How Bank compute PRO. for Std. Asset & NPAs.
- check whether PRO. for Taxation Appt. calculated or not
- Examine other provision.

- Reason for c.c. limit interest variance is,
  - c.c.l. may Not fully utilised,
  - large Account sanctioned that Result in lower int. income,
- concurrent Auditor of Bank cannot Accept stat. audit of same Bank or Any of it's Branch i.e. Internal auditor cannot Accept stat. audit During same Year, of same Bank.