



Basics

Types of banks

1. Commercial: Accept deposits & grant advances
2. RRBs: Set in rural areas & cater to rural communities
3. Coop: Regd. Under coop societies Act + follow cooperative principles
4. Payment: New type of banks + accept restricted deposits + can't issue loans/cr. cards
5. Development: Funds for infra. facilities.
6. Small Finance: For unreserved & unserved sectors

Reserve Bank of India: Regulating Body

Responsibility → Develop. & supervision of constituents of Indian financial system (banks & NBFCs) + Deciding with CG, monetary & cr. policies + Regulating activities of banks

Important functions → Issuance & Regulation of currency + Acting as banker to central & state govts & commercial & other banks + Regulating activities of banks

Peculiarities: Huge volumes & complexity of transactions + Large no. of products & services + Extensive use of technology + Wide geographical spread of banks' network + Strict vigilance by regulator

Bank Audit Approach

Drawing audit plan based on: Nature & level of operations + Nature of adverse features + Level of compliance based on prev. reports + A/risk based on breach of ICs & familiarization exercise

Control environment at Bank → controls to mitigate the risk

1. Who Performs control + Have knowledge & authority?
2. What evidence is available to demonstrate /prove that control is performed?
3. When & with what frequency control performed? Is frequency enough to P/D/C RoMM?
4. Where is evidence of control retained? For how long retained? Is evidence accessible/ available?
5. How is control performed? Control activities? Can these activities be bypassed? Can bypass be detected? How are exceptions / deviations resolved? What is time frame for resolving?

Engg team discussions (Done at planning stage of audit)

1. Errors (likely to occur + identified in prior years)
2. Method by which fraud may occur within particular a/c balances &/or disclosures
3. Audit responses to Engg., Pervasive & Specific (EPS) Risks → 4. Maintain prof. skepticism
5. Need to alert for info. or other conditions that indicates a material misstatement

Advantages: 1. Specific emphasis to RoMM due to fraud, to respond to fraud risks, including EPS risks.

2. EP will delegate work to experienced ET members 3. EP may involve specialists to address fraud issues

General Provisions & Reporting

Form & Content of FS: Form A (3rd Schedule Banking Regulation Act, 1949) B.S. & Form B for P&L a/c.

Appointment of Auditor: Banking Co. → AGM by Shareholders & Nationalised bank → BOD (+RBI)

RRB → Bank with approval of CG

Remuneration of Auditor: Banking Co. → By Co. in GM or as Co. in GM may decide

Nationalised banks & SBI → RBI in consultation with CG

Auditor's Report (Nationalised bank/SBI → report to CG):

1. FS present a true & fair view? & info. or explanation, given & satisfactory?
2. Transactions of bank within powers of bank? 3. Returns recd from branches adequate for audit?
4. Any other matter

LFAR: Terms of appointment require + Matters specified by RBI + Submitted by 30th June + Proper planning for completion + format doesn't require executive summary, may share key observations

Reporting of FRAUD to RBI

1. RBI Circular for implementing recommendations of COLA of Bank Frauds applicable to all scheduled commercial banks (excluding RRBs).
If a/c professional, during audit finds anything susceptible to be fraud/fraudulent activity/smell any foul play → refer the matter to regulator (RBI). Deliberate failure → liable for action
2. SA 250 → Duty of confidentiality is over-ridden by statute, law or courts.
3. SA 240 → auditor is responsible for obtaining R.A. that FS are free from MM (F/E).

Types of Bank Audit Reports to be issued (generally) in addition to main audit report:

ICFR + LFAR+ SLR + Treasury operations + IRAC & provisioning + Any serious irregularity noticed? + Report on compliance w.r.t implementation of recommendations of Ghosh (frauds) & Jilani Committee (internal control) + Instances of adverse credit-deposit ratio in rural areas.

Conducting an Audit (Stages)

1. Initial consideration by statutory auditor:
Assessment of Engg Risk + Declaration of Indebtedness + Internal Assignments (eg. concurrent audit) in Banks by Stat. Auditors not allowed + Agree Terms of Audit Engg + Communication with Previous Auditor before accepting audit + Planning audit + Engg team (qualified & experienced) + Initial Audit engg (SA 510 → MM (Q/A opinion))
2. Identifying & Assessing RoMM
3. Understanding Bank & its env. including IC + 4. A/c process
5. Understanding the Risk Mgt Process
 - a. Oversight & involvement in control process by TCWG (Approve written risk mgt policies).
 - b. Identification, measurement & monitoring of risks
 - c. Control activities (to mitigate its risks including effective SODs (between front & back offices), approval of transactions, setting up limits, reporting & approval of exceptions etc)
 - d. Monitoring activities: May be conducted by independent risk mgt unit.
 - e. Reliable info. systems: To provide financial, operational & compliance info. on timely & consistently.
6. Engg Team Discussions 7. Establish Overall Audit Strategy + 8. Develop audit plan
9. Audit Planning Memorandum: To summarise audit plan:
Describe scope & extent of audit procedures + Highlight all significant issues & risks identified + Provide evidence that they have planned audit & responded to engg, pervasive, specific risks.
10. Determine Audit Materiality
11. Consider Going Concern
12. Assess Risk of Fraud including Money Laundering: As per SA 240 objective is to identify & assess RoMM in FS due to fraud, to respond appropriately. Attitude of professional skepticism maintained.
 - RBI guidelines on prevention of money laundering & KYC norms.
 - Banks to establish policies & procedures to recognise & report money laundering activities.
13. Assess Specific Risks + 14. Risk Associated with Outsourcing of Activities 15. Response to Assessed Risks
- Stress Testing: Software testing activity that check software speed beyond normal limits.

Eg. "mission critical", but used for all types of software. Board approved framework in risk mgt systems.

BASEL III framework: Proposed minimum set of instruments in new definition of regulatory capital.

Main focus on risks to banks & financial system.

Advances (Basics + Security)

Funded (actual transfer of funds) & Non-funded facilities (do not involve such transfer) Eg. BG/LOC
Sector wise: Lending to Priority Sector (ROI, receipt, sanction, rejection etc.) + RBI issues targets.
Nature of Security: Primary security (against which credit extended by bank i.e. principal security)
Collateral security is additional security (any form i.e. tangible/intangible, movable/immovable asset).

Mode of Creation of Security

1. Mortgage (Immovable prop.): Regd. (signed mortgage deed) OR Equitable (delivery of title deeds)
2. Pledge (Inventory): Bailment/delivery of goods + ownership ✗ + fixed charge
3. Hypothecation: Equitable charge with agreement + delivery ✗ ownership ✗ periodical returns ✓
4. Assignment: Trfr (existing/future debt) i.e. actionable claims → gives absolute right to assignee
5. Set off: Creditor can adjust dr. & cr. bal. of debtor + All branches (1 entity) + time barred debt ✓
6. Lien: Legal charge (borrower consent) → right to seize & sell asset

Classification & Provisioning

Std (SMA 0/1/2) → NPA (overdue > 90 days)

[Sub std (NPAs upto 12m) 15% →

Doubtful (D1 upto 1 y 25% /D2 1-3 yrs 40%/D3 >3y 100%) → Loss Assets 100%]

NPA: Term Loan (Installment) + Bills discounted → overdue > 90 days

Overdraft/Cash Credit → A/c remains 'Out Of Order' (o/s bal. > SL/DP or No cr for 90 days or cr < dr)

Spl. Cases

1. NPA Classification → Record of recovery (ignore → Net worth/security etc)
2. Asset classification would be borrower-wise and not facility-wise [One advance npa → all npa]
3. A/cs regularized near B.S. date: Deemed NPA (Inherent weakness → check trans before/after closing of FY + knowledge of objective of trans + reversal in 1st few days after closing to prevent NPA)
4. CG Guarantee (*invoked/revoked): Amt overdue > 90 days → Standard (Income: Realisation)
5. Advances under consortium: By 2/more banks + Highest share (leader) + classification based on recovery of individual banks + LB doesn't share → serviced (NPA) → Arrange/Consent of LB for sharing DP Allocation → By LB + rare case (borrower request for different allocation) [LB: Lead Bank]

A/cs (erosion in value of security) → Realisable value of security

- < 50 % of value assessed by Bank/RBI (last inspection) → Doubtful (make provision)
- < 10 % of o/s in borrower a/cs → Loss asset (Either w/off or fully provided)

Advances Against Term Deposits, NSCs, KVPs/ IVPs, etc. → Not treated NPAs + Income on accrual basis, if adequate margin available.

Agricultural Advances Affected by Natural Calamities: Master Circular by RBI + Banks provide relief measures, like ST to LT loan & fresh ST loan. NPA classification as per rescheduled terms.

Advances to Staff: As banker → Advances & As employer: 'Others' under schedule of Other Assets
NPA only on default of install. + Where intt payable after principal, intt not overdue from 1st qtr

Agricultural Advances: LDC (overdue > 1 crop season) & SDC (overdue > 2 crop seasons).

- Crop season (CS) → Decided by State Level Bankers' Committee in each State
- LDC (Long duration crop → C.S > 1 year) & SDC (Short duration crop → C.S ≤ 1 year)

Computation of Drawing Power (DP)

1. Meaning: CC facility i.e. limit upto which entity can withdraw from working capital limit sanctioned.
2. Sanctioned limit is total exposure whereas DP calculated based on primary security less margin.
3. Considerations: - All a/c to be kept within both DP & SL at all times.
A/cs with exposure > SL/DP OR against unapproved securities OR irregular → Notice of mgt/HO.
4. Bank's Duties: Ensure drawings covered by adequate current assets. DP arrived based on current stock statement (not older than 3 months). If older than 3 months → deemed as irregular.
5. Auditor's Concern: Scrutinise stock statements, qtr returns & other statements submitted by borrower + Audited Annual Report + Monthly stock statement (audited a/cs prepared & submitted)
6. Computation of DP based on Extant guidelines by BOD & agreed by stat. auditors. Focus on crs.
A. [Stocks (realizable value) - Crs. - Margin] + B. [Drs. - Ineligible drs - Margin] → Rest. to SL
7. Stock Audit: A/cs with funded exposure > 5 crores + other cases if situation requires.
 - Obtain stock A/R from lead bank where Bank is not leader.
 - Report reviewed & spl focus to comments on valuation of security and calculation of DP.

Audit of Advances

All large advances & others on sampling basis + problem a/cs examined in detail unless insignificant

Large advance: Excess of [₹10 Cr or 10% of agg. year-end advances of branch] whichever is less.

Auditor is primarily concerned with obtaining evidence about following: (E) Advances are outstanding at BS Date + Supported by loan documents. (R) Advances represent amount due to the bank. (C) No unrecorded advances. (V) Basis of valuation appropriate & recoverability recognized in valuation. + appt. provisions made as per RBI, AS & GAAP.

Obtain SAAE about advances by study & evaluation of ICs relating to advances & by:

Examining 1. validity of recorded amounts + 2. loan documentation 3. operation of a/c 4. Existence & Valuation of security 5. classification & provisioning 6. carrying out Analytical procedures

Internal Controls over Advances

Check Creditworthiness	Documentation executed	Compliance with terms & end use of funds
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Securities (Sufficient margin to cover decline in value + if shares, debentures, etc, ownership trfd in bank name + Goods in bank possession, test check contents of packages when recd. & Godowns inspected by branch/bank inspectors)

Drawing Power (DP Register updated every month + a/cs kept within both DP & SL + a/cs > SL/DP or irregular brought to notice of controlling authority + Operation of each advance a/c reviewed at least once a year & more frequently for large advances)

Income Recognition

Auditor's Concern: Relevant period + pertained to bank + no unrecorded income & recorded at appt. amt. RBI has advised any **income > 1%** of total income (gross basis) or PBT (income is reckoned net of costs) considered on accrual as per AS 9.

If any income not material → maybe recognised when recd & auditors not qualify report in such case.

Special Cases

Bills Purchased: For bills o/s at year end, discount recd properly **apportioned b/w 2 years**. [Unexpired discount/ rebate related to next year, recorded as "Other Liabilities"]. Intt (discount) paid on rediscount of bills, is **not netted off** from discount earned on bills discounted.

Bills for Collection: Customer's a/c credited only after bill collected by bank /agents. Commission of branch due only when bill collected.

Renegotiations: Fees & commissions recognized on accrual basis over renegotiated period.

Reversal of Income: For NPAs, entire **intt accrued & credited** to income a/c (not realized) [also for Govt. guaranteed a/cs] + **fees & commission** (uncollected) accrued should be reversed/provided + **Wrongly recognised income** → reversed or provided for.

Auditor enquire → if **large debits in Intt Income a/c** not explained + Any **communications from borrowers** pointing out differences in intt charged & whether appropriate action taken.

Leased assets: Finance income (as per AS 19) accrued & credited to income a/c before asset became NPA & remaining unrealised, should be reversed or provided for.

On Take-out finance: LT financing where loan procured later is used to replace initial loan. Lender promises to provide at particular date or when Criteria for Project Completion met. Commonly used in property development. Based on recovery, if a/c classified as NPA, recognize income on realisation basis.
Objectives of take-out finance: To expand sources of Finance for infra. projects + To boost availability of longer tenor debt finance + Address entity exposure issues & asset liability mismatch of tenders

Partial Recoveries in NPAs: If no agreement for appropriation of recoveries in NPAs, banks to adopt a/c policy & appropriate of recoveries in uniform & consistent manner.

- AS 9 → when certainty to realisation & amount reversed/not recognised in past should be accounted.
- Intt. partly/fully realised in NPAs can be taken to income.
- However, ensure that intt. recd not out of fresh/additional credit facilities sanctioned to borrowers.

Memorandum a/c: Banks may continue to accrue intt. in Memorandum a/c for control purposes.

For computing Gross Advances, intt. recorded in Memorandum a/c not considered.

Income from Investments

Intt. Income on Investments: Includes income from Govt securities, bonds & debentures of corporates by way of intt. & dividend, except dividends, etc., from subsidiaries & JVs abroad/in India.

Broken period intt. paid on securities purchased & amortisation of premium on SLR investments net off from intt. income on investments.

Profit on Sale of Investments: Net P&L on sale of investments taken to P&L account.

Profit/Loss on Revaluation of Investments: Depreciation or appreciation should be taken to P&L account.

Expenses

Interest Expense

- **Ratio Analysis:** Assessing overall reasonableness intt expense by analysing ratios of intt. paid on different types of deposits & borrowings to avg liabilities during year.
- **Weighted avg intt rate:** Obtain analysis of various types of deposits o/s at end of each quarter. Work out weighted avg intt rate. Then compare this rate with actual avg rate of intt. paid on relevant deposits as per annual a/cs & enquire if difference is material.
- **Compare with PY:** Compare avg rate of intt. paid on relevant deposits with PYs & analyse material differences.
- **MOM Analysis:** Analyse MOM (or QOQ) analysis & document reasons for variances as per benchmark stated.
- **Avg Balance:** Understand process of computation of avg balance & re-compute on sample basis.

Other Points:

Ensure: (Completeness) Intt provided on all deposits + Re-compute interest accrual

(Rates) As per bank's internal regulations, RBI & agreements with depositors + if any changes in intt rate on saving a/cs & FDs + Intt on inter-branch balances been provided at rates prescribed by HO/RBI.

Auditing Operating Expenses of a Bank

Internal Controls (to decide NTE of other audit pro)	Divergent Trends (for major expenses)
Substantive analytical Procedures (Ratio of exp to total expense & compare with PY)	Vouching & Verification (w.r.t supporting documents & check calculations)

Provisions & Contingencies

(Advances)	(Tax)	(Other expenses)
<ul style="list-style-type: none"> • Ensure compliances with circulares. • Obtain understanding of computation of provision on std assets & NPAs. Checking basis of classification into std, sub-std, doubtful, loss assets. Verify classification on sample basis. • Obtain detailed break up of std loans, NPA loans & agree with general ledger. 	Obtain tax provision computation & verify items dr. & cr. to p&l a/c to verify tax provision computation.	Other Provisions for expenses examined vis-a-vis circumstances warranting provisioning & adequacy of the same by discussing with mgt.