

Approach to Audit of Bank Branches

Auditors begin the financial year with the most rewarding work of performing the statutory audit of bank branches. Most of us are generally allotted two or three branches of the bank. Therefore, it is imperative that we plan and schedule the work to ensure timely and effective completion of audit. The following action points would help the auditors to plan better and perform the task within the allotted time span.

reported in LFAR, Tax audit and other certifications.

The auditor shall open a separate file for each branch allotted to him and docket these correspondence.

2. Planning for Audit

The next step would be to carefully and thoroughly go through the appointment letter and list out the various documents like Audit report, Trial Balance— before and after closing, Balance Sheet and

Carry with you the letter of authority, branch file (infra), checklist of documents to be certified and recent RBI circulars while commencing the audit.

4. Audit program

A comprehensive audit program should be prepared in such a manner that all the aspects relating to the statutory audit, LFAR, Tax audit and other certification work are covered in it.

5. Conduct of Audit

Begin the work by seeking the following documents/books of accounts

- i. Trial Balance – Before and after closing.
- ii. Balance Sheet and Profit & Loss Account (if these are required to be certified)
- iii. Statement of NPA accounts
- iv. Account closing circulars issued by Head office.
- v. Branch Audit report of last year, Concurrent Audit Reports, Internal/ Inspection Audit Report and RBI inspection Reports.

5.1. Cash and Bank Balances

If possible, verify the Cash Balance as on March 31, 2006. If the verification is done on any later date, reconcile the cash balance from the date of verification to March 31, 2006. Obtain a certificate of balance from the branch on the date of verification.

- Verify confirmation of balance received from

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In the present era of Corporate Governance, SOX and Peer Review et al, a greater degree of responsibility is cast on the auditors of the bank. Moreover, the banks require that the branch audits commence latest by first week of April and the related reports be submitted by mid-April. This short deadline demands great deal of planning and preparation on the part of auditors to render quality service. This article highlights the salient features and audit steps governing the audit of bank branches.

1. Appointment

Upon receipt of appointment letter, the auditor shall communicate with the previous auditor and later send his acceptance. Simultaneously, the branch head should be contacted to ascertain the quantum of business at the branch. This would help to plan the audit. The branch can be informed in writing as to when the audit would commence and a request should be made to keep the statements ready for audit. The auditor can ideally send a questionnaire containing the details and information he wants from the branch for early completion of audit and also the various other information that need to be

Profit & Loss account, LFAR, Tax audit, etc. that need to be certified. Prepare a checklist of documents to be certified and the number of copies to be despatched to each office.

3. Updation of Knowledge

Browse through RBI website www.rbi.org.in and download relevant Master Circulars which shall act as the basic guide for conducting the audit. Also, the audit team should also attend the seminar/ workshop on Bank audit conducted by the regional councils/local branches/chapters/study circles. The guidance note issued by the ICAI on audit of banks will be very handy for a good performance of the audit.

other banks with books and check reconciliation statement.

5.2. Advances

- Review the appraisal system and the internal controls in place and the adequacy thereof.
- check all files of large (accounts with a outstanding of 5% of the total advances of the branch are Rs. 2.00 crore which ever is less) as well as critical borrowers, sanctions, disbursement, renewals, documentation, systems, securities, etc.
- In the case of other advances check at random the sanctions, disbursement, renewals, documentation, systems, securities, etc. (note down the account Numbers, Name of Borrowers etc... of those accounts which were checked)
- Extent of compliance of terms and conditions detailed in the sanction ticket and whether the borrower is regular in submission of stock statements, book debt statements, financial statements, QIS reports, etc. and whether penal interest is charged in case of default in submission of such documents.
- Whether the branch has classified the advances in accordance with prudential norms prescribed by RBI.
- Check whether classification and reporting is made properly such as secured loans, unsecured loans, priority, non-priority etc.
- Check whether unrealised interest on NPA accounts are reversed and not charged to such non performing Advance Accounts
- For detailed classification please refer to Table 1.

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5.3 Fixed Assets

- To verify whether the Fixed Asset Register is maintained and also ascertain whether physical verification has been done around the Balance Sheet date. Verify the bills in case of additions and also confirm whether proper authorization is available for such additions.
- Verify the depreciation charged— rates and calculations thereof.
- If the branch premises is owned, verify the title deeds. If the title deeds are not available with the branch, report accordingly.

5.4. Deposits

The transactions during the year shall be verified in respect of —

- New Accounts opened and large sums of deposits placed (compliance with KYC norms—Concurrent audit reports generally contain these details)
- In-operative accounts
- Random checking of provisioning for accrued interest (note down the relevant account numbers checked by you)
- Compliance with RBI directive on maintenance of NRI accounts.

5.5 Profit & Loss Items

To verify the correctness of —

- Random check of Charging of interest and levy of processing fee on advances accounts (Note down the relevant account numbers checked by you.)
- Random check of Interest paid on deposit accounts (Note down the relevant account numbers checked by you.)
- Whether adequate provisioning for expenses has been made for interest accrued and not due,

other recurring costs like Rent, Electricity, Annual maintenance etc.

- Whether the branch has followed strictly the norms prescribed by the reserve bank of India regarding income recognition on Non Performing Advances

5.6 Contingent Liabilities

Letter of credit issued on behalf of its constituents: Verify the Register maintained with the copies of the LC and the margin held. Obtain a certificate from the branch management that all letter of credits issued are recorded in the relevant register.

Bills drawn by the customers and accepted by the bank: Verify outstanding bills accepted by the banks with the register maintained

Guarantees issued: Verify the register of guarantees and look for any claims made. Whether the branch has reversed expired guarantees. Obtain a certificate from the branch management that all guarantees issued are recorded in the relevant register.

Claims against the bank not acknowledged as debts: To seek from the bank pending cases against the branch for claims made by third parties or constituents.

5.7 Long Form Audit Report – Salient Points

- First action point would be to collect the information required to be provided in the LFAR from the Branch Manager duly certified including the Annexure to LFAR where the particulars of large borrowers are given in detail.
- Where branch maintains balance with other banks, verify confirmation of balance received from other banks with books and check reconciliation statement.

- While checking for Investments held at the branch on behalf of Head office, physical verification of scrips shall be made. Together with the LFAR report, attach a photocopy of the scrip and state in the LFAR that the scrips have been duly verified. Also, check whether income and related Tax deduction certificate received at the branch is accounted for accordingly. In case you are informed that there are no investments held at the branch, obtain a certificate from the branch management to that effect.
- In respect of advances,
 - Look for deviation in compliance by the borrower in submitting stock/book debt statements,
 - Whether lending is made for inventory held for more than 90 days or book debts exceeding 90 days
 - In respect of corporate borrowers, ascertain whether the Branch Manager has read through the Auditors report and Notes to account thoroughly before putting up the proposal for sanction/renewal, since these contain valuable information impacting the company's future plans.
 - Ascertain and quantify the extent of deficiency in documentation and report the same.
- Pay special attention to Bank Guarantees and Letters of credit.
- Ascertain and report on long pending (> 3 years) Suspense account items and Sundry assets. Also, check for entries made in Suspense account and Sundry deposit account. Special attention is needed for non-operative accounts. Any debits to the account shall be examined.
- Matured/overdue term deposits to be reported separately.
- To check whether any window dressing has been done. It would be worth reviewing the deposit and advances through the period mid March'06 to the completion of audit and check for significant variance.
- In respect of Inter branch accounts; verify head office communication to branch to ascertain the date up to which statements about inter-branch



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reconciliation have been sent. Report reversal of any old or unexplained entries, which had remained outstanding in IBR

- Any other relevant point that one may come across during audit shall be reported in LFAR
- Obtain a management representation letter for various relevant aspects reported in the LFAR for e.g.: occurrences of fraud at the branch.
- Discuss with the Branch Manager on the observations made in LFAR and obtain a certificate confirming that the same was discussed.

5.8 TAX AUDIT – Relevant Aspects

- It would be more appropriate to mention “Prudential Accounting norms enunciated by RBI in respect of Income recognition and asset classification” under method of accounting employed instead of “Accrual basis/Mercantile method”
- In places where the term MODVAT credit appears in the Tax Audit report, this can be interpreted as CENVAT credit as well and can be reported accordingly. For example, CENVAT credits availed against Service tax dues or in respect of accounting for Fixed Assets and charging of depreciation, etc, wherever applicable shall be commented upon.
- Payments made to clubs.
- Details of revenue expenses, if any capitalised.
- Whether Tax deducted at Source has been deducted at applicable rates and remitted within the due date. Generally, the concurrent audit reports

An account should be treated as ‘out of order’ if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

may contain the relevant information. Special care should be taken while reporting on inadmissible under section 40(a) since the same shall also contain all instances where failure to deduct or remit TDS deducted as prescribed by the section 40 (a) (ia) has occurred.

- Obtain management representation letter for various relevant aspects reported in the tax audit report.

5.9 Other special purpose certificates

The auditors shall give equal importance in certifying the following statements /certificates since these are consolidated at Head Office and reported under Notes to Accounts.

(A) Statement of Standard Assets and Sub-Standard Assets and sub-classification thereof:

An asset including a leased asset becomes non-performing when it ceases to generate income for the bank. A non-performing asset is a loan or an advance where;

- Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.
- The account remains ‘Out of order’ for a period of more than 90 days, in respect of an Overdraft/ Cash Credit (OD/CC).
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- A loan Granted for short duration crops will be treated as NPA, is the installment of principal or interest thereon remains overdue for two crop seasons.
- A loan granted for long duration crops will be treated as NPA, if the In-

stallment of principal or interest thereon remains overdue for one crop season.

- Banks should, classify an account as NPA only if the interest charged during any quarter is not serviced fully within 90 days from the end of the quarter.

“An account should be treated as ‘out of order’ if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as ‘out of order’”.

Other aspects to be borne in mind

- Once an account has been classified as NPA, all the facilities granted to the borrower will be treated as NPA.
- Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and Life policies need not be treated as NPAs. Advances against gold ornaments, government securities and all other securities would not be covered by this exemption.
- The Asset classification of borrowal account where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as NPA. In other genuine

TABLE 1: ASSET CLASSIFICATION

Asset Category	Basic Consideration	Provisioning Requirement
Standard Assets	Standard Asset is one, which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset should not be an NPA.	General Provision of a minimum of 0.40% for advances other than Banks' direct advances to agricultural and SME sectors. 0.25% for Banks' direct advances to agricultural and SME sectors.
Sub-Standard Assets	With effect from 31.03.2005, the sub-standard asset is one which has remained as NPA for a period not exceeding 12 months.	A general provision of 10 per cent on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available. The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10 percent ,i.e., a total of 20 per cent on the outstanding balance. The provisioning requirement for unsecured 'doubtful' assets is 100 per cent. Unsecured exposure is defined as an exposure where the realizable value of the security, as assessed by the bank /approved value/ Reserve Bank's inspecting officers, is not more than 10 percent, abinitio, of the outstanding exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly discharged to the bank and will not include intangible securities like guarantees, comfort letters etc.
Doubtful Assets	With effect from 31 March 2005, an asset would be classified as doubtful if it remained in the sub-standard category for 12 months. Banks have been permitted to phase the consequent additional provisioning over a four-year period commencing from the year ended 31 March 2005, with a minimum of 20 per cent each year	100 per cent of the extent to which the advance is not covered by the realisable value of the security. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 20 per cent to 100 per cent of the secured portion depending upon the period for which the asset has remained doubtful Up to 1 year - 20% 1 to 3 years - 30% Over 3 years – (i) outstanding stock of NPAs as on March 31,2004 – 60 % with effect from March 31, 2005. - 75 % with effect from March 31, 2006 - 100 % with effect from March 31, 2007 (ii) advances classified as 'doubtful more than three years' on or after April 1, 2004 – 100 % with effect from March 31,2005.
Loss Assets	A loss asset is one where loss has been identified by the bank or internal or external auditors or by the Co-operation Department or by the Reserve Bank of India inspection but the amount has not been written off, wholly or partly.	100% of the outstanding should be provided for/ written off

cases, the banks must furnish satisfactory evidence to the statutory Auditors/ inspecting officers about the manner of regularization of the account to

- eliminate doubts on their performing status.
- Advances under consortium arrangements. Asset classification under Consortium should

- be based on the records of individual member banks.
- Accounts with temporary deficiencies. The classification of asset as NPA

should be based on the record of recovery. Banks should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of the stock statements and non-renewal of the limit on the due date etc...

- In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment the asset should be straightaway classified as doubtful (50% erosion in the value of the security) or loss asset (if the realizable of the security is only 10% of the outstanding).
- As regards advances where moratorium for repayment, restructuring, under CDR scheme, Government guaranteed classification shall be done as prescribed by the Reserve Bank of India in their master circular dated 1st July 2005.

(B) Maturity Profile of Loans & Advances and Deposits

In respect of branches covered under full computerization/ Core Bank-

ing Solution, the software may automatically generate the maturity profile of the loans and advances and the Term deposits. The auditor shall verify on selective basis the report generated by the system. In respect of other branches, the auditor shall check on test basis the tenure of the loan/deposit and working sheets of the branch for the preparation of maturity profile sheets.

(C) Movement in NPA accounts

Check whether the Opening Balance as on 1st April 2005 is the same as certified by the prior year auditors as at 31st March 2005. Movements in NPA accounts such as recoveries, upgradation, write-offs, additions to NPA, closing balances could be readily verified from branch records.

(D) Lending to Sensitive Sector

- Advances to Capital Market sector
- Advances to Real Estate sector
- Advances to Commodities sector

The data sheet given by the branch shall be verified with advances profile of the branch.

(E) DICGC certificate

Where there is recovery from constituent, it has to be checked as to whether proportionate sum has been returned to the DICG Corporation. If the bank has opted out of the DICGS scheme, the auditor shall mention "The bank has opted out of the scheme and hence not applicable. However, if there is recovery in respect of earlier claims the details shall be furnished by the auditors.

(F) Statement of Risk Weighted Assets

This statement is required for ascertaining the capital adequacy of the bank. The auditor shall verify the cash or equivalent margins, value of security, etc. for advances given since the same determines the risk value.

(G) Details of Loans Subjected to Restructuring/ CDR

The auditor is expected to provide total amount of loan assets subjected to restructuring and rescheduling. The auditor shall also state the amount of standard assets, sub-standard assets and doubtful assets subjected to restructuring, rescheduling, renegotiation and the CDR portion in each of them.

Conclusion

It would be appropriate for the auditors to dispatch the reports to Zonal office/ Head office/Central Statutory auditor immediately after the completion of audit, preferably before leaving the branch. Auditors should ensure to obtain copies of all statements attested duly signed by the branch management.

Preparation of working paper shall have to be done concurrently at the time of audit. The working paper are very essential since the same shall serve as reference material when any clarification is sought. Moreover, with peer review covering branch auditors as well, the onus is on us to maintain the working papers as required. They should serially number all the working papers, index them and docket it in such a manner that the same would be easily accessible. □