

# APPROACH TO BANK BRANCH AUDIT

The banking system in India is perhaps, one of the largest in the world as far as its extensive branch network is concerned. The dynamic banking sector in the country has been constantly undergoing a change. With the rapid advancement in information technology and communication more and more branches have not only been completely computerised, but have also been networked to provide services comparable to those prevalent in the most advanced global economies.

The rapid changes in this sector has placed an additional responsibility on members of the auditing fraternity auditing the Indian banks and their numerous branches. The 'race' between the banks to publish the audited accounts resulting in very little time available to complete the audit of the branches has added to the onerous responsibility of the auditors. Our cup of woe will be full if we also take into consideration the considerable time required from our end for documenting the audit process to satisfy the **Peer Review Process**.

A process statement for the audit of a bank branch will essentially comprise the following:

- > Appointment and acceptance
- > Plan for the audit
- > Programme
- > Refresher course for the audit team
- > Organise the limited time available effectively
- > Apply the appropriate audit techniques and conduct the

audit.

- > Compiling the report
- > House keeping with reference to working papers

## 1. Appointment & Acceptance



—S Ramesh

- 1.1 On receipt of the appointment letter, go through the same in detail and ensure that your firm does not suffer from any of the



disqualifications like

- ✎ Change in the constitution of the firm since your application to the ICAI
- ✎ Being indebted to the bank for a sum exceeding Rs 1000/-
- ✎ Holding any security of the bank carrying voting rights.

In case of a change in the constitution of the firm since the date of application to ICAI, you need to inform the bank regarding the change and wait for their confirmation before accepting the appointment.

- 1.2 Ensure that the acceptance letter is sent in the specified format along with the required declaration of secrecy & fidelity to the concerned authority within the specified time.

- 1.3 Communicate with the previous auditor as a matter of good ethical practice.

## 2. Plan for the Audit

- 2.1 Create a master file containing the original appointment letter and instructions received from the bank.
- 2.2 Prepare a file for each branch to be audited containing photocopies of the appointment letter, circulars and instructions received, formats of various certificates, audit report, LFAR and tax audit report.
- 2.3 Ensure that each audit team has copies of the latest ICAI guidance note on bank audit, recent RBI master circular and an audit programme.
- 2.4 Prepare a letter of authority for each team setting out the names, qualification and specimen signature of the team members.
- 2.5 Send a questionnaire to the branch calling for specific details, which will help, in timely completion of audit. (A specimen questionnaire is set out in Annexure 1)

## 3. Programme

- 3.1 Chalk out an audit programme taking into consideration the volume of work and the level of computerisation at the branch.
- 3.2 Do a compliance test of the internal controls to identify areas of weaknesses.
- 3.3 Based on the results of the compliance testing prepare a programme for substantive testing

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3.4 The following areas require full checking irrespective of the level of internal controls.

- Verification of Balance Sheet and Profit & Loss account with the main and subsidiary ledgers
- Verification of all closing returns with the ledgers and registers
- Verification of all large advances granted during the year with specific reference to terms of sanction and documents
- Verification of all large NPA advances & the provisioning thereof
- Balancing of books
- Inter branch items and clearing differences.
- PMRY loans granted during the year

3.5 It may be advisable to draw up a programme separately for verification of advances with specific reference to the following:

- Credit appraisal
- Sanction & disbursement
- Documentation
- Review & supervision
- House keeping

3.6 In order to verify the above, one needs to peruse the following:

- Delegated powers
- Banks advance manual, circulars, guidelines etc
- RBI Guidelines on lending
- Borrowers proposal and respective credit file
- RBI inspection report, concurrent audit report and inspection report
- Watch list

3.7 Design a format for noting down the particulars of each advance to ensure that none of the significant information is missed out. The format will also help at the time of compilation of the audit report and LFAR. A specimen format is set out in Annexure 2.

#### 4. Refresher course for the audit team

4.1 Unlike the audit of other entities a bank branch audit is done by most firms only during the month of April and the chances of remembering the various circulars and applicable accounting and auditing standards is not very bright.

4.2 Even in the case of firms engaged in the concurrent audit of banks it is usually one or two of the audit assistants who are involved in the audit and as such the other members of the team may not be well versed in conducting a bank branch audit.

4.3 In the light of the above it may be worthwhile to have a half day



workshop to familiarise the team members with the following:

- i. RBI circulars relating to income recognition, asset classification and provisioning norms. The latest master circular covering all these aspects is available in the RBI site ([www.rbi.org.in](http://www.rbi.org.in)).
- ii. Guidelines issued to the auditors by the banks with reference to certificates to be issued by them.
- iii. Accounts closing instructions issued to the branches by the central office.
- iv. The accounting system of the bank and the related internal controls

v. Salient features of the LFAR

vi. Audit procedure to be adopted in a computerised environment.

#### 5. Organising the limited resource – TIME - effectively

5.1 With most of the banks specifying April 15, 2005 as the '*deadline*' for completing the branch audit, time available has become a scarce resource.

5.2 As per the information available at present most of the banks have instructed their branches to allow the audit to be taken up before the close of the financial year.

5.3 The audit needs to be done in two stages – pre-closure and post-closure of books.

5.4 In the first leg of audit one may take up the following areas for scrutiny:

- i. Review the file of major borrowers
- ii. Peruse the sanction/renewal letter to ensure compliance with the terms and conditions of sanction
- iii. Review the status of the accounts already identified as NPA during the year.
- iv. Peruse the stock statements and insurance cover
- v. Review the quality of credit appraisal of loans granted during the year
- vi. Ensure that the documentation has been completed in all respects as set out in the terms of sanction
- vii. Study all accounts which are featured in the 'watch list'
- viii. Study problem accounts that have since become good
- xi. Visits of select borrowers if necessary can also be completed prior to March 31.
- x. Test checking of interest

received, interest paid and other major heads of income & expenditure can also be carried out.

## 6. Appropriate Audit Techniques

- 6.1 Almost all the large and medium branches have been computerised. In fact in major cities almost 100% of the branches have been computerised.
- 6.2 It must be clearly understood that while computerisation of any process does not change the scope and objectives of audit, it certainly changes the methodology of audit.
- 6.3 It is imperative that auditing methodology and tools used must be modified to suit the IT environment. For example if one of the audit objectives is to check whether an account was in excess of the sanctioned limit or drawing power during a particular period, the manual method would be to review all the accounts and list out those accounts which have been in excess for all the specified days. In a computerised environment the audit procedure to be performed should include generation of an exceptional report of all accounts in excess of the DP\ sanctioned limits during a specified period.
- 6.4 One needs to obtain an overall understanding of the computer system in operation at the branch. A discussion with the systems manager or officer in charge will be of immense help
- 6.5 One can ask the branch to give the account statements that are required for review in the form of *.sdf, .txt, .xml or .html* files which can then be opened using MS Excel and various analysis can be done with the data. This will be particularly useful in branches where there is a short-

age of systems and will also help in major accounts to be analysed offsite.

- 6.6 Structured Query Language (SQL) is a computer language for communication with databases. The communicating parties are typically a “front end” which sends a SQL Statement across a connection to a “back end” that holds the data
- 6.7 We can use SQL to obtain various reports or listings by querying the database. It is not necessary for us to know programming but we need to be clear about the conditions, the data to be analysed and the output format. The systems manager in the branch should be able to write a SQL provided we clearly specify the parameters.

## 7. Compiling the Report

- 7.1 Every branch auditor needs to prepare two audit reports – one the short form wherein he expresses his opinion on the financial statements of the branch and the other a Long Form Audit Report (LFAR)
- 7.2 Both the reports are to be submitted to the Central Statutory Auditors and the management for their consideration and consolidation.
- 7.3 Ensure that the audit team has carried out the audit as per the guidelines and in strict conformity with the audit programme and that no area has been left out before compiling the report.
- 7.4 Ensure that all the audit queries and observations have been discussed with the branch management and their replies obtained. It is suggested that the queries be discussed with the officers and branch manager on a daily basis.
- 7.5 Issue written memos and obtain written representations/clarifications wherever

considered necessary.

- 7.6 Discuss the draft report in detail with the manger preferably in the presence of the officer in charge of advances and ensure that they fully understand your views.
- 7.7 It has been remarked by several Central Statutory Auditors in various forums that many branch auditors just state **YES, NO or NA** for most of the points in LFAR. It should be ensured that all points are answered setting out the full facts clearly.
- 7.8 Vague and general comments should be avoided.
- 7.9 Ensure that adequate attention is given to all the certificates to be issued.
- 7.10 Ensure that the required number of copies of your reports are taken and sent to the various controlling authorities as mentioned in the appointment letter.

## 8. Housekeeping with reference to working papers

- 8.1 The need for organising and preserving the working papers assumes greater significance in the light of the recently introduced Peer Review Process. It is best expressed in the Statement of Auditing Practices (ICAI) as **“It is necessary to prepare and keep adequate working papers to show precisely;**
  - (a) **What work was done and by whom**
  - (b) **What explanations and information was given and by whom; and**
  - (c) **What decision on the various points was taken and by whom.”**

The details of what would come under the ambit of working papers has been detailed in the statement as follows:

**“ The auditor is expected to maintain evidence of the work done by him and his staff. This**

is best achieved by a well-designed file for audit working papers, which should contain inter alia the following:

- (a) An audit programme duly completed, showing the nature of work, the extent of checking and the initials of the person who have done the work
- (b) Details of important queries raised in the course of audit and the explanations obtained.
- (c) Detailed schedules in respect of important items
- (d) Important confirmation received from third parties
- (e) Certificates obtained from management.”

#### 8.3 Working papers

- Aid in the planning and performance of the audit
- Aid in the supervision and review of the audit work

- Provide evidence of the audit work performed to support the auditors' opinion
- Become the basis for drafting the auditors report.

#### 8.4 Working papers should include

- Nature of engagement
- The audit plan
- Papers and records which would provide the basis for relying on the internal controls
- The basis for deciding on the 'sample selection' for scrutiny
- All confirmations and certificates wherever necessary
- In areas where difference of opinion exists, the views of the organisation should be obtained in writing or minuted
- Significant ratio and trend analysis
- Significant audit observations culled out from other

audit reports

- Copies of expert opinion where the auditor has placed reliance on the opinion of the expert
- Directive from Government/Regulatory authority, etc. which have a bearing on the audit.

8.5 Working papers are the property of the auditors and should be retained for a reasonable period to satisfy the professional and possible legal requirements.

8.6 Lack of proper/inadequate working papers have landed many professionals in trouble with the Disciplinary Committee of the ICAI.

8.7 With the Peer Review process already in place the working papers assume greater relevance and can be neglected only at ones own peril. ■

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