

Conducting Branch Audit in CBS Environment

Core Banking System (CBS) Environment is a term that is more in the realm of Information Technology, which seems far away from field of financial audit. Yet, it has a tremendous influence on audit. CBS implies that instead of servers per branch containing software and data, they now reside at a central place called Data Centre (DC). The software, Operating system and data, all reside there and are managed by the staff of the data centre. Here is where the Branch Auditor feels undermined, because all interest processing, service charge, Dormant account conversion and many functions hitherto done by the branch, are now done by the staff at the Data Centre. Even the clearing and therefore the reconciliation, is also handled by the Central Clearing Cell. The CBS environment has changed some operational modalities, which can be used to enhance the quality of the Branch auditor without extension of time.

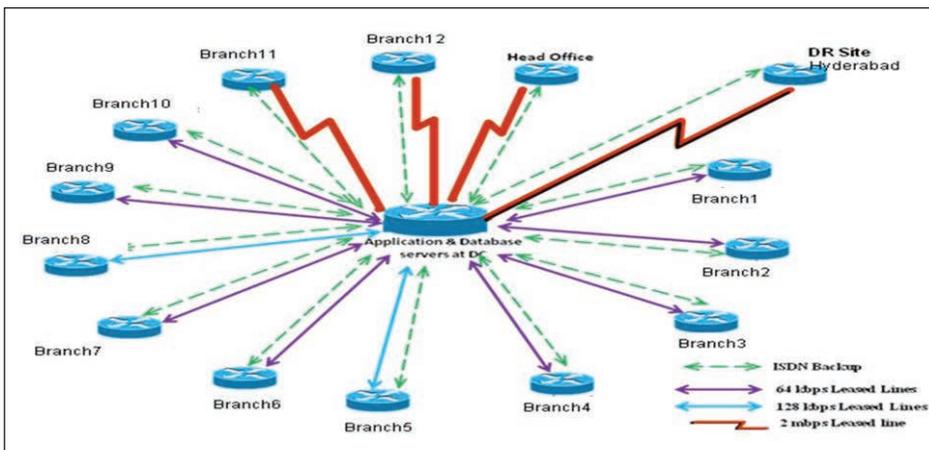


Figure 1: Representation of a CBS network (star Topography) assuming Hyderabad to be the Disaster Recovery site.



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If the Branch auditor restrains from the scope of the legacy system (Old TBM-Total Branch Mechanisation) at least in test check, then it will be done at the peril of his career, because the audit coverage of the Branch sometimes becomes 'nobody's baby'. The Branch auditor has no source of knowing what the auditor at the Data

Centre (if any) has covered, unless Audit report of the Data Centre is shared with the Branch Auditor. Furthermore, only if the DC auditor is a Chartered Accountant, can the Branch auditor rely on the work done by other Chartered Accountant. However, the basic scenario of sharing the DC audit report with the branch auditor is so rare that is almost non-existent. Therefore, the Branch Auditor has no option but to retain his scope of traditional Branch Audit. However, the CBS environment has changed some operational modalities, which can be used to enhance the quality of the Branch auditor without extension of time, which is the objective of this article.

Scope of Using the CBS Function for Bank Branch Audit

The Bank Branch auditor needs to focus on his primary duty and not convert himself into a system auditor.

The CBS features can be exploited by the Branch Auditor in the following sectors of work of the branch auditor.

- A. Calculations of revenue – Part of Long form audit report
- B. Outstandings/Non-Performing (NPA) – Part of certification and important Balance Sheet element
- C. Maker Checker control to ensure sanctity of data
- D. Perfection in balancing and departments not part of CBS
- E. System related features having dire impact on Bank Branch audit.

The acronym of the above works out to be short word of Computers i.e. COMPS. Each of these then, further leads to a larger coverage under that scheme.

Though every auditor would like the audit approach through the computer, this is not available to the Bank Branch Auditor. Therefore, the only aspect of ‘through’ the computer would be generation of reports available in the application system and rest of the actions would be a focused version of ‘around the computer’.

A. Calculations of revenue – Part of Long form audit report

To earn interest and give interest is the fundamental objective of a Bank. If you recall, it is the definition of a Bank. Other sources of income like commission, service charges and even underwriting commission follow. Therefore, in case this area is weak and there is no correct charge either as income or expenditure, the software application weakens the Bank. Though this point sounds theoretical and too farfetched to have any errors, there have been cases of wrong calculation due to either programming errors (especially February being a leap year) or even a bug, where all accounts are affected throughout the year. The Branch auditor needs to ensure that correct income and expense is calculated. However, the accounts are numerous. On the expense side, there are various schemes of deposits having thousands of accounts and the same is the case on the income side, with numerous loan accounts as well as cash credit overdraft accounts for interest. Add to this the service charges, chequebook charges and you just cannot finish in time, if you take the manual approach.

100% Manual check is not practical

Sr.	Element to check	Logic for audit
1	Parameter File of interest for both deposits and advances	<p>DEPOSITS: The Deposit interest parameter file will show you date of change, which should be compared with that of the interest change circular. The slabs will show whether the interpretation of the Management is correctly interpreted. Care needs to be taken when a NEW slab is envisaged by the management. Though this is all done at the Data Centre, it is crucial to ensure that there is no systematic error.</p> <p>ADVANCES: Similar approach needs to be taken for advances like, where the Bank has a policy of differential rate on limits of advance (Below Rs. 2 lakh and above Rs. 2 lakh). The accounts having interest defined in individual masters need individual attention. Advance against Bank's own fixed deposits need to be checked for three main reasons:</p> <ul style="list-style-type: none"> <input type="checkbox"/> Whether the advance rate is 2% higher than that of the deposits or as per Bank's policy (staff are given at just 1% higher rate). The new advances given in the year under audit should be accorded higher priority. <input type="checkbox"/> Older accounts whose deposits are renewed need to be also verified to ensure that if the deposit rates change, the advance rate also changes. Many systems do not have link of the security deposit rate and advance. <input type="checkbox"/> Where deposits of varying periods are offered as security, the weighted average calculation needs to be checked.
2	(Test) Check actual calculation	<p>Deposits: You can make templates on your laptop/notebook and test a few deposit accounts for their accuracy under any sampling technique or as follows:</p> <p>Normal deposit accounts of each scheme – few old and few new. The results should match and if not, then the management of the Bank needs to take responsibility of accepting calculation made by the application system. Some applications do not give the same result for cumulative scheme deposits and rely more on the accuracy of the computer processor. The factors given by Banker's Association have a three month multiplier with only four digits after decimal. So, when the Bank had just purchased an application software, this aspect MUST be checked, as the fourteen floating point decimal of the Chip is bound to give different answers for high value deposits.</p>

Sr.	Element to check	Logic for audit
		<p>Deposits paid before maturity is likely to be defined in the 'scheme parameter file', where parameter file per scheme is available. Ensure that the 'penalty' rate is properly defined and implemented.</p> <p>All advance accounts need to be also checked to ensure implementation of parameter and master file.</p> <p>NPA Accounts: You are aware that the interest on such accounts should not be credited to the Profit and Loss account. However, many systems calculate the interest and post it to either a memorandum or any account other than P&L. See the rate and track the posting.</p>
3	Charges	<p>Some charges are periodical, while some are triggered by specific transaction like issue of cheque book. In such cases, parameter file defining leaves free per year and charges for over this free limit should be checked. Postage and commission on Bills are triggered at the time of collection or discount. The parameter file will assure compliance of rates and test check will assure operational accuracy.</p>

B. Outstandings/Non-Performing (NPA) – Part of certification and important Balance sheet element

The application system can be used extensively to verify the NPA position on very important provisions. Many Banks announce the existence of 'software' to accurately calculate NPA accounts. This should be taken at face value, only after determining how deep is the software. A typical situation is shown in figure 2.

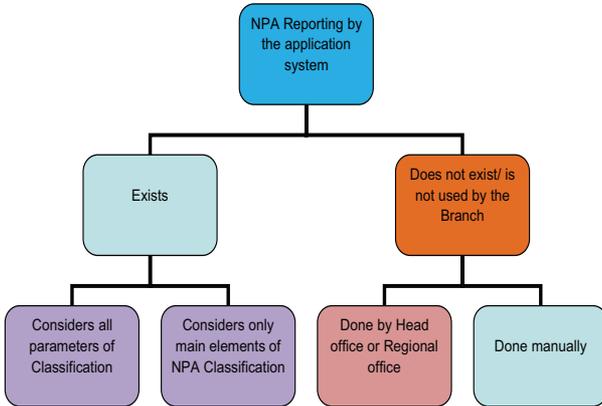


Figure 2: Possible situations on software feature for NPA classification

If the Branch does not have the software then the classification is done either manually or at the Head Office. Only if the HO provides you the NPA account list then it can be verified, otherwise a disclaimer on this point from you will hold you in good stead. Whenever the software exists either as part of the application or as an external addition, all parameter considerations may be possible but only in the rarest of cases. For example, the early software considered only the outstanding balance and Drawing power (Remember it is not sanctioned limit). It ignored non-submission of

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stock statements for over three months. Also, some did not consider departments of Bills of Exchange either Purchased or discounted or even letters of Credit. You need to know which areas the software does not cover and then approach the uncovered departments. Even assuming there is no such software, the MIS reports of the application software can help you a great deal. The names of the reports listed below may vary a bit but will give you the same information. Demand these and then work on these. A soft copy normally in TXT format is easily given.

Report title	The aspect of NPA covered by such a report
Overdue loan accounts	<p>Amount and number of installments are normal part of such reports. As per the prevailing rule, you can compare the number of installments in arrears and verify with the NPA List. TIP: If you can get a soft copy of both NPA list as well as this account, you can convert both to Excel and sort accounts alphabetically. Now, you can put them side by side and compare easily, no matter how many accounts are there in the branch.</p>

Report title	The aspect of NPA covered by such a report
Over-limit Overdraft and Cash Credit accounts	This report will give you the date from which the accounts are overdue. You can easily calculate which are over three months overdue and thus NPA. Just ensure that the 'over-limit' is with reference to Drawing power determined by the stock or Debtors value and not just the sanctioned limit.
Non submitted stock/Debtors statements	These lists of accounts where stock/Debtors statements need to be submitted normally at monthly intervals. The last submitted date is available, so here again, the outstandings of three months can be visually seen. For some accounts, the stock statement is needed to be submitted only annually, so ensure you are not misled by the standard period of three months. Such accounts are normally of small finance, like upto ₹1 lakh for retail trade like chemist/ grocer etc.
Overdue Bills purchased / Discounted	Since a single account of finance classified as NPA deems all accounts to be NPA, this funded facility should not be ignored. The overdue report shows list of all bills overdue of the borrower. If you get a soft copy (TXT is readily given in many Banks) converted to Excel, you can sort borrower-wise and within that by date, you can examine the oldest bill and determine whether the account and thus the borrower is NPA.

C. Maker Checker control to ensure sanctity of data

Internal Control is the bone of control in any organisation and more so in a Bank where cash is the element in all transactions. In a Bank using computers, this is termed as 'Maker Checker', to imply that for all transactions entered by a person, another person checks it. This is important because the implications of a wrong entry go deep either in terms of time or number of accounts affected depending on the type of wrong entry. For example, a wrong address and cell number will mean statements of account will not reach



the account holder and he may complain only after a few months. Wrong cell number would mean that the withdrawal alerts are not delivered and in case of a fraud, the Bank may be held for negligence by the court.

Maker-checker for parameter files of Interest etc.

In a CBS environment, these are created and edited at the Data Centre, so the Branch auditor need not look at these for this aspect.

Maker checker for account opening: When the accounts are opened by the branch it needs to be checked by the branch auditor for this aspect. This can be done in two ways. (1) The account master of any account will show two account IDs, One under the head 'Opened by' and the other 'Authorised by'. The exception will be regarding conversion of old data, where a conversion issue may not capture both or either of these IDs. Another exception will be in case of small branches of two or three persons, where such a restriction may hamper operations and thus, the maker-checker control is turned off. The Branch auditor will have to take a call on the conclusion of lifting of such controls.

Maker-checker for operations: Cash, Transfer and clearing operations also are normally under this control. Scroll sheet of the period under audit can show you the account ID of both the maker as well as checker. These scroll sheets need to be printed and stored for audit trail. cursory glance of the IDs will show you that both should not be the same and that the one authorising the entries needs to be superior in rank over the one making the entries. ■