

# Concurrent Audit — A Real Time Audit Machinery for Banks



Many Commercial Banks including Primary Urban Co-operative Banks (PUCB) nowadays appoint concurrent auditors in spite of having their own separate inspection departments. This is due to the fact that it has been observed quite often that own inspection departments of many banks have failed to highlight and pinpoint the existence of major and serious irregularities. The failure of inspection machinery is mainly attributable to the incompetence, casual manner and familiarity (as they also belong to the same banks) of the inspection personnel. It has also been observed that the personnel who can't otherwise be deployed in other sensitive areas are more often appointed in the inspection departments. The several instances of failure of inspection machinery directly insisted the Reserve Bank of India (RBI) to constitute a high level committee at the instance of Government of India under the Chairmanship of the then Deputy Governor of RBI Sri A. Ghosh to enquire into various aspects of fraud and malpractices in banks. The Committee submitted its recommendation in June 1992. It recommended introduction of a system of Concurrent Audit in specified branches and areas of banks, mainly to arrest *Kite Flying Transactions*, malpractices and also to ensure *real time detection and prevention of frauds/errors* and their concurrent rectification. Read on to know more...



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## Concurrent Bank Audit

Concurrent bank audit is the verification or examination of transactions or activities of a bank which go contemporaneously with the occurrence of transactions/activities. In other words, concurrent bank audit is an independent examination of the activities or transactions at the same time when they take place.

Selection of Branch/ Division for Concurrent Audit  
RBI Guidelines require that concurrent audit should be conducted in the Departments/ Divisions of Head

Office (H.O), which deal in foreign exchange, treasury functions, bill re-discounting etc. While selecting branches, divisions etc, banks should ensure that such audit covers the branches on the basis of following norms:

<b>Credit &amp; Other Risk Exposures and Deposits</b>		<b>Inspection Ratings</b>
Whose total credit and other risk exposures in aggregate are not less than 50 % of the total credit and other risk exposures of the bank.	Whose aggregate deposits are not less than 50 % of the aggregate deposits of the banks.	Which are continuously getting poor or very poor rating in their Annual Inspection or Audit and where the house keeping is extremely poor.

Moreover, it may be conducted in any other branch, department etc, where in Bank’s opinion, it is desirable.

### Appointment of Concurrent Bank Auditors

Each bank is at liberty in taking the decision whether Concurrent Audit should be conducted by its own staff or external auditors. Therefore, the following persons may be appointed as the concurrent auditors:

**Banks’ Own Staff-** Senior officials of the Inspection Department, who are not engaged in the operational activities of the Banks, may be appointed as the concurrent auditors. They should be experienced, well trained and independent.

**External Chartered Accountants/Firms of Chartered Accountants-** A firm of chartered accountants may be appointed as concurrent bank auditors. In this case, the appointment is initially for one year and can be extended up to a period of three years based upon the review of performance.

### Specific Guidelines with regard to the Scope of Concurrent Audit

Concurrent Auditor should cover every transaction and decision of the branch in which he is engaged. There is an emphasis on substantive checking in the key areas rather than test checking.

The concurrent auditor may broadly cover the following areas:

#### 1. Cash Management:

- Verify the daily cash transactions with special attention to abnormal nature of receipts and payments, if any. Verify high value receipts and payments with special care. The amount of high

value cash transactions is generally fixed by the Central Office (CO) and it varies across the Banks.

- The cash balance in hand including Foreign Currency Notes and cash in ATM should be checked on a surprise basis, at least once in a month. Generally, a designated bank official verifies cash balance in hand and signs in the *Cash Balance Register*, wherein the total amount of cash together with their denomination is recorded after the *end of day (EOD)* process. Date of checking should be different from that of the surprise check done by the branch head or manager. He should tally the cash balances with the respective *General Ledger (GL)* balances and report on any excess or shortage. There are various reasons for excess or short cash balance. The reasons may be the mistake committed by the cashier while paying/receiving cash, passing the entry or it may so happen that depositor erroneously or by mistake deposited excess money instead of what he intended to deposit. Excess or shortage in ATM cash balance arises because of technical problems in ATM machine, carelessness of the customers to pull the cash within the time limit stipulated in the ATM machine as precautionary measure. However, all the cases should carefully be probed into, so as to prevent any fraud crept in the cash department.
- Verify and comment on the following:
  - (a) Whether excess cash beyond the *Retention Limit* is held and how many days in a month it has exceeded that limit and comment on its adequacy.
  - (b) Whether *Token Register* has been maintained and effective control exercised thereon. He should observe whether number of missing token recorded in the register and displayed at the paying counter. If not, he should report it immediately.
  - (c) Whether the branch has accumulated huge amount of soiled/cut/mutilated notes and what step the branch has taken for their timely disposal.
  - (d) Examine the coverage of insurance, safety and security arrangements in cash department and report immediately if any deficiency is observed.
  - (e) In case of suspicious transaction, whether the branch has submitted *Suspicious Transaction Report (STR)* to RBI in time and its Central Office gave the full details of the transactions.

## 2. Deposit Accounts:

While verifying deposits, examine and report the following:

### *In case of new accounts*

- Whether deposit accounts are opened as per RBI's Know Your Customer (KYC) norms and Anti Money Laundering (AML) measures. KYC norms require that account opening form should be accompanied by duly attested proper address and identity proof of the customers. As income proof photocopy of PAN card or duly signed *Form 60/61* may be taken by the Bank.
- In case of opening of Current Deposit (CD), documents relating to Partnership Deed, Trust Deed, Trade License, Memorandum and Articles of Association, Resolution of the meeting of Board of Directors etc. should be checked very carefully.
- Observe whether latest photograph of the depositor has been affixed with the Form and the depositor is properly introduced and where extra interest is paid because of senior citizenship of depositor, verify the age of the depositor with reference to the age proof obtained.

### *In case of existing accounts*

- Transactions in inoperative Savings Bank (SB), Current Deposits (CD) accounts should be verified and to report whether all debits in the inoperative accounts are passed by the branch manager or designated officer.

### *In case of accounts closed:*

- Verify the accounts closed during the month with reference to Letter of Closure request, copy of resolution of meeting passing the closure etc.

## 3. Advances:

It is the most crucial area for the auditors. Before verifying the specific advances, examine the following:

### ♣ *Verification of Effectiveness of Internal Control:*

- Although a system of Internal Control always exists due to the very nature of banking operations. However, the auditor is required to evaluate its effectiveness in relation to advances in order to determine the nature, timing and extent of substantive procedures as required by the Standards issued by ICAI.
- Various reports viz. CO Inspection Report, previous Concurrent Audit Report, Statutory Audit Report etc. are to be studied for identifying any adverse comment on any specific borrower and to know the action taken by the branch in this respect.

### ♣ **Audit of Documentation:**

Evaluate the adequacy, completeness and legality of loan documents by examining them. Documentation includes (a) Loan Application form, (b) documents evidencing creation like Partnership Deed, Trust Deed, Certificate of incorporation, Articles, Memorandum etc. (c) Review/ Processing Notes, (d) Letter of sanction, (e) Demand Promissory Note (DPN), etc. In case of advance to limited company, verify whether charge has been created and registered with ROC in the name of the company.

### ♣ **Period of Documents:**

- Since each document has specific validity period according to Laws of Limitation, Advances whose documents are older than 36 months are to be reported promptly. In case of expiry of documents, duly filled up and signed *Revival Letters (RL)* are required to be obtained to revalidate them.
- Report the advances for which RLs are required to be obtained in case of documents nearing expiry date.
- Verify that *Documents Due Date Register* has been maintained and kept up to date.

### ♣ **Verification of securities:**

- Examine that the securities are in effective control of the branch, legally enforceable, complete in all respect and assigned in bank's favour.
- Verify that the value of securities, assessed realistically, cover the amount outstanding as on a specific date.

### ♣ **Renewal/ Review of Advances:**

- All advance accounts should be renewed/ reviewed at least once in a year, generally within a period of three months from the date of their expiry. Report the advances whose credit limits already expired and not renewed as on the last date of month.

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**Concurrent Auditor should cover every transaction and decision of the branch in which he is engaged. There is an emphasis on substantive checking in the key areas rather than test checking. The concurrent auditor may broadly cover the areas like Cash Management, Deposit Accounts, Advances, House Keeping, Clearing Transactions, Submission Of Returns/ Statements, Government Transactions and Revenue Audit.**

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- Observe critically that renewal of limit is based on latest audited Balance Sheet and other documents. Comment on Short Review, if any, conducted for any account because of non receipt of Balance Sheet, other documents etc.
- Because of inconveniences, if Short Review is conducted for any account, ensure that final review/renewal of limit is completed within the specific period. Otherwise, the account might be compulsorily categorised as NPA.

♣ **Review of Some Specific Advances:**

**(A) Fund Based Advances**

**(1) Cash Credit (CC)/Advance against stock/Book Debts:**

- **Submission of Statements** - Verify whether the borrower has submitted monthly Stock Statement within 10<sup>th</sup> of the next month as per the RBI guidelines.
- **Drawing Power (DP)** - It is to be verified that the branch has arrived at Drawing Power (DP) based on the figures of monthly Stock Statement and ensure that DP of particular advance account is properly recorded in Drawing Power Register.
- **Godown Inspection** - Ascertain whether the godowns of the Borrowers are periodically visited by the bank officials. While conducting such inspection, safety of stocks, scrap, low moving stocks etc. are to be noticed carefully.
- **Insurance-** Critically examine the Insurance Policies (Fire, Burglary etc.) to verify their validity, adequacy. Observe the Bank's Clause in Insurance Certificate to be ensured that the policy is assigned in Bank's favour.
- **Month End adjustments** - Verify that account is not window dressed by paying off excess drawings at month end and drawing further advances again in the next period.
- **Stock Audit** - Review the Stock Audit and Book Debts Audit Reports in case the Bank has ordered such audit in respect of such advances and identify adverse comments, if any.

**(2) Advances against Branch's Deposits, LIC Policy/ KVP/ IVP/NSC, etc:**

- Ensure that the Deposits are properly discharged; Bank's lien is marked on them and recorded in proper Register.
- In case of advance against LIC policy, NSC, KVP, IVP etc, verify that they are in Bank's custody and assigned in Bank's favour.
- In case of advance against LIC, Certificate of Surrender Value issued by the insurer is to be

checked so as to ensure the amount of advance is within the surrender value of the policy.

**(3) Advances against Immovable Property:**

- **Valuation Reports** - Valuation Reports of authorised valuers are to be reviewed to ascertain whether property value covers the advance amount.
- **Legal Opinion** – Title Deed, Legal Opinion Report, Plan Approval Statement, Nil Encumbrance Certificate etc. are to be reviewed to ensure that borrower has a clear and unencumbered title to the property.
- **Insurance Coverage** - In case of advance against building, verify whether the building is covered by Earthquake Insurance and the insurance is in force. Observe specifically that the policy is assigned in Bank's favour.

**(4) Term Loans:**

- Confirm that the amount disbursed has been utilised for the intended purpose.
- Go through the relevant *Advance Ledger* to examine that all repayments are as per the Repayment Schedule/ Equalised Monthly Installment (EMI) as specified in Sanction Letter.

♣ **Vigilance on special Mention Accounts:**

According to RBI Guidelines, high value advances which are likely to slip into NPA should be categorised as *Special Mention Accounts*. These accounts require close monitoring and auditor should critically examine the transactions of these accounts.

**(B) Non Fund Based Advances:**

**(1) Letter of Guarantees (LGs):**

- Report that all expired guarantees have been reversed and eliminated. Also report the expired/ invoked LCs etc.
- Observe that unexpired portion of commission is kept in *Unexpired Commission Account* and not credited in P&L Account.
- Ensure that stipulated Margin as required has been maintained.

**(2) Letter of Credits (LCs):**

- Verify that LCs are opened as per internal/ RBI Guidelines and are in conformity with the provisions of Foreign Exchange Management Act (FEMA) and commitments under LCs are promptly met on due date.
- LCs expired but not eliminated/ reversed should be reported.

♣ **Non Performing Assets (NPAs):**

- **Time Limits-** The auditor should ensure that bank is proper in classifying the advances as NPA after

having followed the specific time limits. CC/ Overdraft accounts become NPA if they remained out of order for a period exceeding 90 days. In case of Term Loans, Bills Purchased & Discounted etc. the account becomes NPA if interest and/ principal has remained overdue for a period exceeding 90 days.

- **Recovery Initiatives** - Ensure whether any recovery initiative is taken by the Bank to recover cash from the NPA accounts.
- **Interest** - Confirm that no interest is debited in advance accounts that have been classified as NPA. If recoverability of interest is certain or interest is received in cash, then interest may be debited in NPA accounts.

#### 4. House Keeping:

- Verify that all GL heads have been tallied upto date and if not, probe into the matters and report them.
- Verify the genuineness of transactions recorded in Suspense, Sundry Creditors, Banker's Cheque Accounts etc. and report outstanding entries in the above GL heads for a period exceeding three months.

#### 5. Clearing Transactions:

- Ensure that *Clearing Account* through Central Clearing Office (CCO)/main office is brought to 'Nil' at fixed interval.
- Report clearing differences remaining unreconciled, giving special attention to entries older than 6 months.

#### 6. Submission Of Returns/Statements:

- Comment on submission of Returns to CO, RO, RBI, IT Department etc. as per the *Calendar of Returns*.

#### 7. Government Transactions:

Verify that-

- Branch is maintaining proper Registers/Records for Provident fund, Pension etc.
- For all Pension accounts, Life Certificate, Non Marriage Certificate etc. are obtained every year at specific time.

#### 8. Revenue Audit:

Branches that are subjected to concurrent audit should not normally be included for Revenue Audit. Therefore, it is to be ensured that relevant Guidelines of RBI, CO and requirements of AS 9 issued by ICAI have been complied with in respect of income recognition. Moreover, as a part of routine checking, the following should be verified:

- **Interest on Loans & Advances, Deposits** - In case of CBS connected branch, if proper rate of interest is fed into *Advance Master, Deposit Master* interest

calculation must be correct. Therefore, *Advance Master* and *Deposit Masters* are to be checked so as to ensure that prescribed interest rates have been fed. For branch not connected with CBS, check whether the extraction of product for the number of days is done correctly. Review the interest computation and its debits/credits to accounts.

- **Processing Charges** - Examine that Processing Fees at the prescribed rate has been recovered both at the time of initial processing and at each renewal, upto the period of belated renewal.
- **Penal Interest & Incidental Charges** - Verify whether Penal Interest and Other Incidental Charges have been recovered from the CC/ Overdrafts, Inoperative SB Accounts etc.
- **Commission on LGs & LCs** - Examine that commission has been charged at the prescribed rate at the time of issue/ renewal of LGs upto the period of claim. In case of LCs, examine whether Opening, Re- instatement, Amendment and Commitment Charges etc have been properly charged.
- **Interest on Deposits** - Verify correct interest rate has been applied on Deposits. In case of closure of premature TD, verify whether interest has been recalculated and excess payment has been recovered.
- Here, it is to be mentioned that charges discussed above are only illustrative, not exhaustive. Auditor should ensure that recovered charges are as per Service Charge Circular issued by CO. Non recovery of charges as per the Service Charge Circular requires mentioning.

#### Concurrent Audit Report

On the basis of periodicity, reports may be monthly, quarterly and half yearly report. Time limit of submission of report varies across the banks. Report should specifically mention *Major, Minor Irregularities* and *Persisting Irregularities* (i.e. irregularities which were reported earlier but not corrected by Bank).

#### Conclusion

Concurrent audit has become important real time inspection machinery of banks. One of the drawbacks hitherto observed has been the non integration of it with the other systems of audit/inspections, which are already in co-existence and lack of response towards audit qualifications. Banks should take proper initiative to integrate the entire systems of audit/inspection and should ensure that performance of the integrated audit system is reviewed from time to time. ■