

Conducting Branch Audit in CBS Environment



Over the past few years, there has been a proliferation of many banks deploying a core banking solution. CBS, as it is popularly called, has changed the manner in which banking activity happens. The delivery channels have expanded from branch banking to net banking to mobile banking. The Electronic medium of transaction and communication has become the base of all banking activities. Coupled with this situation is the trend of banks to centralise operations either at one location or at regional hubs. These hubs handle significant back office operations and control activities. Some of them are housed in cities away from where the central or regional offices are located and rely heavily on the electronic transmission of data. There is also a proliferation of using outsourced agencies for support activities. RBI has guidelines on which activities can be outsourced. The common thread to all this outsourcing is once again the reliance on electronics – computers and data transmission equipments and the software that resides in each of them. As auditors, our challenge lies in executing our tasks in this new environment with the same high standards expected of our profession. Read on...



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Bank branch audits have been a significant segment of a chartered accountant's audit practice. The profession has kept pace with the changing business and technological practices across a spectrum of industries. Hence, the changes that have happened in the banking industry should not be a stumbling block to us auditors.

Considering the timelines that are given for a bank branch audit, it is necessary that we achieve what the auditing standards expect of us to achieve within the same timelines. To that extent, we can reinvent ourselves and use the technology to meet our audit objectives.

Normally, the appointment of a bank branch audit is received in the latter half of March. And the audit of the branch is expected to be completed

within the first week of April. Hence, in general, there are about ten to twelve working days available within which the auditor is required to familiarise himself with the control environment of the bank, comprehend the business processes, understand the technology deployed, do the substantive and compliance verification and then form an audit opinion.

However, all the above can be achieved without compromising on any of the requirements of professional standards and conducting procedures of “Auditing Through the Computer” and “Auditing Around the Computer”. In the ensuing paragraphs, it has been attempted to elaborate the key processes that an auditor can do once he is appointed to conduct the audit of a bank branch. The ICAI’s Guidance Notes on Audit of Banks gives detailed guidance of auditing in a computerised environment. There are certain checklists which are included in the Guidance Note. This article attempts not to repeat the aspects covered in the Guidance Note and the checklists. We as bank auditors need to be aware of the Guidance Note and follow the procedures mentioned therein.

First Few Steps

As soon as the audit is accepted and all due processes completed, schedule a meeting with the manager of the branch that is to be audited. Request that in this meeting the person in charge of systems at the branch is also present. It may be that there would not be a designated system executive; but there would most certainly be an official who will be responsible for the functioning of the information system facilities in the branch. As part of conducting processes in tune with the Standards on Auditing related to “Risk Assessment and Response to Assessed Risks” (SA 300, 315, 320, 330, 330, 402 and 450), we need to understand from him the way the system is designed and the manner in which it functions.

We need to ask him the following questions:-

- a) What is the CBS environment?
- b) Which software is implemented across the bank?
- c) Whether the software is bought out or customised?
- d) Whether any steps are necessary to be taken at the branch when the software is modified/updated centrally?
- e) Details of the hardware installed at the branch.
- f) How is the network managed? Does the branch have any role to play in the same?

- g) What are the other softwares in the branch?
- h) Does the CBS have any interface with these software?
- i) Whether the branch has been subjected to system audit during the year?
- j) What are the findings?

In case the branch has migrated into a CBS environment during the year or there has been a version change, then we need to get the following information:-

- a) Whether a migration/version change audit was done at the branch?
- b) If so, peruse the audit report and get satisfied that all the balances have been duly carried forward and there are no issues which would affect the database in the new environment.
- c) If not, ask whether the migration/version audit was done at an organisational level and whether the findings of that audit are available at the branch?
- d) If no audits were done, how has the bank/branch satisfied itself that all the data, balances etc. have seamlessly migrated into the CBS environment?

Having obtained the above information, we need to understand how the CBS behaves and what are the procedures and practices involved in the various nuances of the software *vis-à-vis* the banking operations. The following aspects need to be discussed with the system executive:-

- a) How are the EOD and SOD procedures handled?
 - o Every CBS environment requires an End of Day (EOD) & Start of Day (SOD) procedure to be done at the branch as well as at the data center. Typically, at the close of business hours the branch has to “handover” the system to the data center. At the data centre there are scheduled programmes/utilities which manage the data updated with the transactions for the day. These include (but not restricted to) updation of balance, application of interest, generation of exception reports etc. This EOD activity at the data centre can take upto several hours.
 - o An SOD procedure entails flushing into the branches' environment the various MIS and exception reports. The branches may or may not have to (depending

upon the manner of configuration of the CBS environment) give commands for accessing these reports and the updated database. The Branch Manager is required to give his sign-offs on the various reports that are generated, especially the exception reports.

- b) Whether implementation of CBS has changed the manner in the functioning of the branch. There would be branches in the midst of trading markets that would need extended business hours. We need to know whether the routine time targets of EOD processes have hampered the business behaviour of the branch adversely.
- c) Does the branch face significant downtime? There are occasions when the communication lines can be down and the branch may not be able to function. We, as auditors need to understand the business impact of such downtime, in particular the manner in which transactions that take place in the downtime period are recorded at the branch and ultimately uploaded onto the CBS.
- d) Peruse the Access Control Matrix of the branch. Compare the matrix with the actual users at the branch.
- e) Review the matrix, to be satisfied that conflicting duties are not given to any one or group of individuals.

The above steps will enable us as auditors to be satisfied that the cardinal principle of controls in a computerised environment is implemented. This is called the CIA principle wherein:-

C = Confidentiality

I = Integrity

A = Availability.

Once the above information is obtained and the auditor gets comfort that the system is designed

as implemented and there have been no incidents whereby the data is adversely affected *vis-à-vis* the CIA principle, then it would be reasonable to place reliance on the records produced from the CBS environment for audit.

In addition to all the above first steps, we need to peruse the internal audit, concurrent audit and system audit reports on the branch. We need to be satisfied that all matters that have arisen out of these reports are adequately addressed to by the bank by implementing suitable mitigating controls.

Next Steps

We should request for a read alone access to the CBS. This is akin to a request for the ledger in a non-computerised environment. The read alone access will enable us to peruse the transactions, accounts at our pace and style. To do this, there would, of course be a need for us to gain an orientation on how the CBS is configured. Since it is not possible for us to gain complete knowledge of how the CBS works and the various menus built into it, it will be necessary of us to request that the SE or some other knowledgeable person to accompany us while we navigate through the system. With the help of this designated bank official, we can run queries of various situations on the branch data. The queries could be of such nature that would help us accomplish our audit objectives. These include:-

- a) Identification of NPAs based on defaults in excess of 90 days
- b) Identification of potential NPAs by focusing on year end transactions as also transactions that happened at the beginning of next year
- c) Application of correct interest rates, both for advances & deposits
- d) Application of interest rate modifications
- e) Accuracy of interest computations
- f) Accuracy of mandates given by customers such as auto-sweep, recurring deposits etc.
- g) Accuracy of charges for non-funded facilities
- h) Accuracy of other service charges such as number of withdrawals, note counting etc.
- i) Existence of serial control over recording of transactions.

The output of these queries will reveal transactions of exceptional nature. From the information so generated, we can select our samples for further substantive verification dovetailing with the source documents, their authorisation and the appropriate

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capturing of the transaction in the books of account.

We need to test the adequacy of the interfaces by taking a sample of few cases where the data moves from CBS to the other software and *vice-versa*. There would be different softwares for uploading transactions into CBS from ATM, Net Banking, Mobile Banking etc.

If the CBS does not by itself apply IRAC norms and generate a NPA statement then there would be another software which does this analysis. It will be our task to be satisfied that the data that has flown into this other software is also accurate and from the CBS itself. This can be done by requesting the SE to run queries on both the software, (the transaction processing software CBS and the data analysis software) and matching the result so obtained. Over the past few years, public sector banks have been advised to configure the CBS in a manner that IRAC norms and NPA statements are generated without any manual interventions. Hence, it is necessary for us to obtain an understanding of this configuration of the CBS.

As auditors we have immense experience of banking transactions. We should use this experience for conceptualising various situations and then requesting the SE to run queries for them. The results of these queries will enable us to assess the performance of the branch *vis-à-vis* controls and adequacy of the CBS database. This will enhance our confidence in forming our audit opinion on the financial statements of the branch.

All our observations, findings, reservations arising out of the above steps will have to be discussed with the branch head. Based on his reactions and our audit findings, appropriate remarks will have to be given in the L FAR.

We do not need to be programmers or technical experts to understand the CBS but we need to harness our own audit techniques and processes and make use of the bank's technology to achieve the audit objective. We will also then be able to live upto the expectations of the former Governor of Reserve Bank of India, Mr. D. Subbarao, when he spoke to us members of the ICAI on "Challenges to the Accounting Profession – Some Reflections". The relevant extract of the inspiring speech is as under:-

Information Technology (IT)

16. Next on my list is the challenge of Information Technology. In the past, one of the main objectives of audit was ensuring the arithmetical accuracy of financial statements. With the advent of IT, this task has now been taken over by machines. This has both nudged and facilitated the profession to move up the value chain. The main task of the profession has now shifted to judgments of value, and to discharge this task, auditors have to demonstrate much higher levels of maturity, integrity, independence and balanced judgment. The development of these qualities will be a major challenge in the future.

17. Let me make a comment with regard to IT in banking. Over the past decade, most commercial banks have successfully implemented core banking solutions. This has created both opportunities and challenges for auditors. Challenges come by way of lack of visible evidence, risk of undetected system errors and bugs and frauds hidden in a labyrinth of data. Retrieving information in the computerised environment and assessing the implementation of computer related processes will also be critical to the audit process. Opportunities come by way of increasing use of Computer Assisted Audit Tools (CAATs) to access databases beneath the accounting software to create queries, write reports and develop audit trails. While the profession has risen to the challenge of auditing banks in an IT environment, we need to explore further on how audit can overcome the challenges and exploit the opportunities of the IT environment to make audit of banks more effective and meaningful.

All in all, with these slightly different but inherently same audit processes, I am sure that the audit of a branch in a CBS environment will be achieved within the given timelines as well as in conformity with the generally accepted auditing standards in India. ■