

Bank Branch Audit in CBS Environment



Core Banking System (CBS) is widespread today. As an auditor, it will be rare for you to not find your unit of bank branch not to be under CBS. Such a situation is a blessing if you embrace this fact and exploit it. The notorious difficulty of the bank branch auditor is that his audit is restrained to "smallest timeframe". Exploitation of the CBS system for audit, thus, is no longer an option to the bank branch auditor, but is a necessity. This article talks about various areas that require special consideration by the auditor in an audit of computerised bank branch. Read on...

CBS Environment

Instead of a server at each branch, there is one high end server for all the branches. The server is kept in a place called the data centre (DC). In case of failure of this server/site, there is a backup site and if the site is in another location (another city) preferably in a different seismic zone, it is called the disaster recovery centre (DRC). It is not uncommon to see the DRC to be located in a different continent in case of multinational banks. A lot of care is therefore taken at

the data centre but that not being in the scope of the branch auditor, it is not a subject matter of discussion here. Traditionally, the networking was done by way of leased lines as the primary network. In case this network failed, the other back-up network was dial up integrated services digital network (ISDN) where the connection was automatically dialed up. Later, other modes such as wireless (radio frequency), very small aperture terminal (VSAT) and virtual private network (VPN) (over the internet), cloud, *etc.* came into popularity.

You will note the progress from the previous years to be the addition of channel of service. ATM is old news just like debit and credit cards, e-transfer, mobile banking, *etc.* Each channel has an impact on the working of the bank as well as recorded and unrecorded liability, if any. Auditors should especially concern themselves with the newer opened channels of service as teething problems are normal.



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Branch Auditor or Systems Auditor

It is accepted that the branch auditor today, is not expected to evaluate the technical issues of computerisation at the branch other than that required to be reported under the Jilani Committee recommendations. Yet the fact remains that almost all the work is done through computers. Even sanctions are first sent by email followed by the hardcopy. All admit that though the interest is levied by the computer system, the auditor needs to at least test check it. This responsibility of interest verification is still retained in the LFAR and not removed just because computers are involved. Similarly, aspects impacting the work of the auditor need to be recognised and not excluded from the scope of audit.

Computerisation of Banks-Targets

The computerisation of the bank can be used to cover the following:

- Assurance of accuracy and continuity of the bank branch.
- Support the statutory duty of the auditor.
- Fraud issues.

'Computers are accurate' is the oft quoted axiom. This is true as well as untrue. The fact is that the computer or more precisely, the software application is *as accurate as it is programmed* to be. Then again, even if programmed with correct logic, some software bugs may tilt the scale of accuracy. Such issues are not marginal but sometimes very serious, as often seen.

1. **Books may not be balanced:** Amazingly, such errors are not expected from an 'accurate' machine. But logical errors or extreme situations which were not foreseen in programming stage may upset the cart. The branch auditor will be more secure if he lists 'jottings' from the system to compare with the trial balance or the general ledger balance and note discrepancy, if any. You have to remember that the banks are on triple entry system and software applications have aped the manual system. So even though

in non-banking corporate, such errors are unfathomable, they are very much possible in the banking system. Such errors may be either carry forward of errors of conversion of data from legacy system or errors in posting where the GL voucher is posted but the subsidiary is not, in situations of power failure or such.

2. **Applications not available in (main) core banking system:** We have yet to see an all pervasive banking application taking care of all aspects of administration. Some applications like salary, foreign exchange transaction management, or even treasury management are some which are external to the core, which may or may not be provided by the same vendor. If it is not supplied by the same vendor, then the link to the core data base is the weak link. Core database is considered rightly sacrosanct and thus, ringed. Similarly, the applications not provided by the core software vendor are kept at bay with transactions uploaded at 'arm's length'. This is the weak link. The procedure of 'arm's length' is sometimes very crude, like transactions of the smaller applications generated in a text file which has to be uploaded in a small procedure to update the core database. In such cases, even if the upload is done twice or not at all, will not be logged/warned. Admittedly, some procedures are intelligently designed. Such applications beg to be audited strictly for inclusion in the core database. Otherwise, the bank will be faced with a situation of a transaction committed to a customer but no back end procedure done. The auditor can at least cover the last week of the year end as well as the days on which the critical staff doing such work was on leave in the year. If the transactions exist in the core database, then at least there is no error of exclusion.
3. **New channels of delivery:** Whenever there are new channels of delivery, the auditor needs to ensure that all accounting aspects have been impacted on the correct day for the correct amount. Foreign exchange is one such minefield of an area made more complex, if it is not supplied by the same vendor. Even when the new delivery

Bank Audit

channel software is supplied by the same vendor, there might be complications which an auditor can easily comprehend. The accounting impact for the precise amount needs to be checked for the dates and amount. Take the simple any branch banking (ABB) service where customers can withdraw from any branch. This is not a new service yet you need to check if there is any change in logic made in maintenance during the year. This should be checked especially if there are branches which are closed on any day when the other branches are working. Multi-state banks will experience this when there are State holidays unique to that State only. If a customer having account in a branch which is closed on a particular day, withdraws from other branch open on that day then the impact in his account should be on the same day of transaction. This may be an ABB transaction or through ATM. Normally, the postings are smooth as the branches are 'open' in database though closed physically. But there are some situations where the closed branches also do not permit entries on closed dates. Such an entry is made on the next working day. This would mean a loss of one working day having revenue and liability impacts as well as cash tally. This is also circumvented by the concept of 'as of date' or accounting date for interest where though the posting is done on a later date, the correct date will be taken for interest. Auditor needs to check whether this is so. System audits have hitherto revealed this is not so always. There is an impacted delay of one day or two days which is monumental for the summation of transactions. Again, impact on year end


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clearly means the final accounts are not representative of the correct position of the bank as on the end of the year. New channels to check will illustratively include:

- ATM (Automated teller machine including cash collection machine)
- ABB (Any branch banking)
- Credit Card transactions

4. **Anti-money laundering (AML) application and its accurate representation:** The branch auditor is the last sentinel to protect the bank from abuse of this aspect. As the governing body, the Reserve Bank of India has amply reminded, by issuance of various circulars, the statutory auditor needs to cover this aspect. Most CBS banks have resorted to software application for AML reporting. This software application may be from the CBS application provider or a third party software. Whatever be the case, the common feature of concern is that this module or application is an 'afterthought' as the AML guidelines came in force more than two decades after CBS. The fundamental feature of this module/application is that it 'reads' data from CBS and processes it for its report. This feature of 'reading' is important because many banks boast NIL cases. This is usually because of 'mapping' error. This module looks at the wrong places and comes back with no cases to report which is misconstrued as NIL returns. The auditor can also scrutinise the 'white listing' of cases where the branch is better suited to remove the cases of suspicious transactions based on some rules of deposit and withdrawal which are also specified by The Reserve Bank of India. The reasons for not considering the transaction to be suspicious is within the realm of the branch, by identifying retail cash business of account holder like petrol service station or grocery shop, *etc.* The classification rules are set normally at the data centre which the branch auditor need not concern with. But the reasons and replies definitely are of his concern to ensure that these are logical and do not undermine the objectives of AML. Low AML training of bank staff emphasises the intervention of the branch auditor for AML audit.

5. NPA (Non-Performing Asset)

classification: Rules of classification of assets are set by The Reserve Bank of India. Due to the number of accounts and rules of classification, it is preferable to have a system driven classification. Some banks prefer to have a manual override. What action your branch is executing is to be verified. If classification is systems driven, borderline cases need to be confirmed along with the definite cases. In particular, the following issues should be well covered:

- a. Inclusion of all accounts: If the auto NPA system or manually determined, then the rule that all accounts of the borrower should be classified as NPA need to be ensured by the auditor. The bank's system can now be exploited by the auditor. Most systems have a name search or customer number-search (if unique customer ID procedure is implemented by the bank) either for the branch or the bank as a whole. All you need to do is use this option to search for the accounts by the same name. If so, the NPA exposure list can be compared to ensure all accounts are classified as NPA.
 - b. MIS (Management Information System) reports should not mismatch the NPA classification report without reconciliation or explanation without doubt. Auditor needs to take care that all accounts evident from MIS reports as NPA are finally classified as NPA. Thus, a loan installment in arrears exceeding three installments or overdraft/cash credit overdrawn from the date shown in the report is exceeding three months, should be in the NPA list of the branch. Otherwise, explanation will be difficult later on when MIS evidence is stark clear.
 - c. Another MIS report which should be readily available is report of accounts not renewed/reviewed for more than a year. This is one of the statements to be submitted in LFAR. This MIS report helps confirm whether these accounts are included in the NPA list.
- 6. ATM Cash:** This is like cash of the ATM is clubbed with that of the branch. If it is shown in the balance sheet of the branch then the

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branch auditor needs to verify this. Auditor should not rely only on the general balance shown in the books since this reflects the sum total of vouchers passed automatically of the ATM transactions. Most ATMs have a user friendly activated report on cash balance in ATM. Sometimes, update in the branch reports from ATM is not on real time basis but at the end of the day. Branch auditor needs to take cognizance of such feature.

7. **Basel II compliance:** This is one of the comments expected from the branch auditor. If you notice, the compliance of BASEL II requires assets to be risk weighted. Based on this, the banks are to make provision. Data from the branches flows to the higher offices, either Regional or straight to the Head Office, who depend on the risk weight allocated by the branch and thus make the provision. This regulatory compliance is heavily dependent on the marking for each account made by the branch. Given the high volume, accuracy will be assured only if made in the main database. The auditor needs to study the policy and process of allocation of risk weights and check a few. Only if computer driven and entered periodically other than at the time of account opening will this aspect be correctly reflected.

To Conclude

Computer aided audit techniques (CAATs) are ideal tools to enable the branch auditor to cover full year's transactions in a handful of days. With CAATs, 100% population gets covered but it depends on the auditor's talent in setting up the tool. Currently, tools are not permitted at the branch level by most banks. Therefore, via media, using output of text files in excel should be used as much as possible. If this is done, the coverage of transactions is much larger than what it would have been manually. ■