

Necessity of statutory branch audit in public sector banks

It has come to the notice of the Institute of Chartered Accountants of India (ICAI) that some of the public sector banks (PSBs) have requested to RBI and Department of Financial Services, Ministry of Finance to consider the representation on partial/full exemption from statutory bank branch audit, for the year ended March 31, 2020, in view of the delay in starting the bank audits on account of lockdown due to COVID-19 pandemic. Accordingly, the ICAI has approached the Central Statutory Auditors (CSA) about their opinion on challenges in completion of central audits without the statutory bank branch audit in the present format.

The ICAI considered the issue, along with CSAs, and is of the opinion that there will be several serious problems in dispensing with the statutory bank branch audit for the year ended March 31, 2020 in the current format of doing 100% coverage of branches having advances above rupees 20 crores, and such a move would not be in the interest of the banks, auditors, and stakeholders.

The Professional Development Committee (PDC) has issued the advisory to all the audit firms and individuals expected to do bank branch audit for F.Y. 2019-20, and has urged them to get the required data for branch audit from respective bank through internet, and start the process of audit as early as possible. **The advisory issued to 34,722 eligible auditors is enclosed.**

The specific issues that may arise by dispensing with statutory bank branch audits in the current format in PSBs are as follows:

- i) Audit – Auditor:
 - a) **CSAs have done the entire audit planning during the year 2019-20 based on the assumption that they do not have to audit more than 20 branches during the year.** If they are required to complete the audit without statutory bank branch audit of branches having advances above rupees 20 crores, their entire planning process would need a change, which is not possible at this juncture.
 - b) CSAs have not planned to cover zones, regions in their audit plan. Many specialized branches like MSME, housing loan, staff loan etc. would go unchecked.
 - c) **If the number of branches audited are reduced, with the increased workload the time required by CSAs would be multifold** and thus would nullify the time saved.
 - d) **Percentage of advances that should be covered in audit are stated by RBI as 75% of each category. In the F.Y. 2018-19, more than 60% of the advances of various categories were checked by**

branch auditors. That means less than 40% of the advances were checked by the central auditors.

- e) We wish to point out that **the number of central auditors has been reduced** over the period by PSBs under RBI guidelines. This will make it even more difficult for central auditors to cover the increased work in the given timeline.
- f) **The audit of PSBs is a bottom-up approach. The system is not conducive to top-down approach.**
- g) Using a centralized approach this year as against decentralized approach would make the whole culture totally different. Decentralized to centralized and again decentralized approach would have serious implications on quality of audits and has inherent risk of losing controls.

In view of the above, we wish to point out to you the provision of Clause 6(b) of Standard on Auditing (SA) 705 (Revised), which states “the circumstances in which a modification to the auditor’s opinion is required is when the auditor is unable to obtain sufficient, appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements.”

Clause 9 of SA 705 (Revised) states “the auditor shall disclaim an opinion when the auditor is unable to obtain sufficient, appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.”

The additional considerations relating to audit and auditors are as follows:

- 1) Several banks have been amalgamated as on 1/4/2020. In the next year, when the audit of branches is undertaken, the auditors would find the opening balances unaudited and they would be forced to disclose the same in other information of their audit report as per provisions of SA- 706.
- 2) Every year, as the branch audits are started on April 1, there is a delay by banks in providing various returns including Non-Performing Assets (NPA) statements to the branch auditor. **In the current scenario, when banks are working in spite of overall lockdown of the country, they are expected to be ready with all statements before start of audit after lockdown period. This as well as PDCs advisory of starting branch audit through internet, will make the task of branch auditors easy and the branch audits can be completed speedily.**
- 3) The statutory bank branch auditors are generally appointed considering the availability in the area where branches are situated, with minimum travel requirement. If central auditors need to travel to audit such branches, it would involve enormous amounts of costs and time. In the current situation under COVID-19, having a local auditor would be an immense advantage rather than requiring a central auditor to risk its staff travelling extensively.

II) Control

- a) RBI inspections have stopped and risk assessment is done by RBI team by calling for information. The banks have an internal inspection system, but the statutory bank branch audits are still required as several control deficiencies are pointed out by auditors and recommendations are given in their long form audit report (LFAR). This advantage would be lost if no branch audit is conducted. **In fact, the CSAs compile their LFAR based on the reports received from various branch auditors.** In absence of the branch audits, RBI would lose the benefit of comprehensive LFAR as a control on system deficiencies.
- b) Several frauds are found by branch auditors especially where audit is done once in five years. **A number of branches which are not covered in concurrent/internal audit are covered in statutory bank branch audit.**
- c) The materiality level at branches is different than that used by central auditors, which would mean that smaller loans are also well covered.
- d) **Documentation of PSBs is not centralized. Scanning is not intelligent so as to enable navigation through it.** Several documentations for various types of loans such as agriculture, Mudra, gold, NSC, LIC, vehicle loan, housing loan, etc. is maintained only at the branch. The documentation on non-fund advances, the most fraud-prone area, is available only at the branch. By dispensing with statutory bank branch audit in the present format, the whole of this documentation will go unchecked.
- e) Specialised branches like foreign exchange branches need extensive checking. **Several branches are allowed to deal in foreign exchange, where statutory bank branch audit is a must,** considering that in several cases the public sector banks are using the services of their own retired staff to do the work of concurrent audit.

III) Advances and NPA

- a) **The NPA statement is required to be system-driven. But in several cases it has been found in the past that manual intervention is either required or has been inadvertently done.** The example of such requirement is evident regarding RBI circular dated March 27, 2020 and a circular dated July 7, 2019 on restructuring. **We understand that thousands of accounts have been restructured by PSBs under current RBI guidelines and it will not be possible for central auditors to cover them.**
- b) **Operation of accounts need to be scrutinized only at branches.** This is needed for all advance accounts for working capital finance.
- c) Majority individual borrowers' accounts are maintained at branch level itself.
- d) Several Memorandums of Changes (MOCs) are given by branch auditors requiring substantial reclassification of advances and provision

for NPAs. These **MOCs run into thousands for every PSB. This indicates complete lack of controls at ground level , which makes branch audits even more necessary.**

- e) The accounts regularised near balance sheet date and inherent weaknesses in accounts can be noticed at branch level. **Central auditors would not be able to perform extensive scrutiny** of individual accounts as normally done by statutory branch auditors. Several small loan accounts of agriculture, Mudra loans, MSME, etc. would escape NPA due to this.

IV) Work at branch

- a) Apart from documentation stated above, **several certifications are required to be given by statutory branch auditors. This is taken as a base by central auditors** while giving their certificates to bank for sending them to RBI. The examples are Ghosh Jilani, BASEL-III, advance classification, interest subsidy, government subsidies, priority sector classification, etc.
- b) **The focus of the branch auditors is also on the deposit side. This will be completely left undone**, especially for deposit-oriented branches which would not be covered at all.
- c) **Fraud-prone accounts such as parking accounts, sundry and suspense need to be checked in detail at branch level.** Clearing of entries in such accounts and substantial amounts transacted through these accounts need to be reported in LFAR. Unusual items also need to be reported. This cannot be done without the branch auditors.
- d) **Checking of depreciation, verification of assets, stock verification, insurance, and stock statements based on which drawing power is calculated are all checked by branch auditors.**
- e) **The window dressing in accounts cannot be found at central level** as it is done through the account operations at branch level.
- f) **Major issues identified in concurrent audit need solutions at branch level itself**, which can be checked by statutory branch auditors.
- g) Income generation activities need checking with physical documents available with the branch. **There is no control centrally for correct booking of income.**
- h) **Tax audit** data need to be checked at branch level.
- i) Contingent liabilities are required to be listed appropriately, which is checked by branch auditors.
- j) Substantial authority is available at branch/zone for passing **expense vouchers which need checking** at appropriate levels only.
- k) As per RBI guidelines, early warning signals (EWS) and Know Your Customer (KYC) is required to be checked at branch level only.

Consequences of changes in statutory bank branch audit in its present format

- 1) Due to serious limitations in scope for audit coverage, all the auditors of PSBs would have to qualify their reports. They will not be able to express any opinion on the accounts of the banks. In such a case, audits done at central level would be meaningless as almost all deposits and a substantial percentage of advances and almost all deposits would not be covered in audit.
- 2) The conduct of bank branch audits in the present format would require only 15 days from lifting of lockdown. There are enormous advantages of conducting it as stated above. Any change in the process therein would create enormous disturbance and it will also make the whole exercise of audit meaningless.
- 3) The auditee cannot decide how the audit should be done. The auditee cannot dilute the audit procedures required to be carried out as per the auditing standards applicable in India. It is not the banks but the stakeholders who need to decide whether branch audits are required, as public money is involved with heavy government stakes in PSBs.

In view of the above, it is imperative that it is not in the interest of the country to discontinue statutory bank branch audit in PSBs in the present format.

Communication Sent to Statutory Branch Auditors(SBAs) of PSBs

My dear Professional Colleagues,

I hope this communique will find you safe and healthy. I am sure that by now most of us must have received appointment letters for statutory bank branch audits indicating branches to be audited barring few cases wherein the allotment of branches is in progress. As all of us face tough unprecedented challenges arising out of COVID-19 pandemic, we as professionals need to brace up ourselves to undertake the bank branch audits, within the restrictions imposed by the government authorities. The various state government have extended the lockdown period for various intervals and the same is likely to affect the physical moment of the professionals for conducting the bank branch statutory audits, thus, the **need of the hour is to initiate the process of bank branch audit remotely by seeking certain information through net** and also asking the **bank to keep balance requisite data / documents ready** to ensure that the audit process is effectively initiated and concluded as and when the physical access to the branches is permitted as per government regulatory guidelines in coming days.

I am appending herewith an **Annexure containing an illustrative communication** which may be initiated from your end to the **respective branches (banks) with or without any additions / deletions / amendments** thereto, which will ensure that the branches which provide you the requisite data can be used by yourselves to initiate the process of audit remotely and in other cases, the communique will enable the respective branches to keep the records ready for the audit, thereby reducing the time and manpower required for conducting the audit.

I would further like to inform that the Professional Development Committee (PDC) of ICAI will be **conducting couple of seminars** to discuss and resolve the various challenges which the statutory branch auditors are likely to face and the practical resolutions thereto. Further, similar to earlier years, an **expert panel** has been formulated by AASB of ICAI to address the queries related to statutory bank audit raised by the members, which will be announced shortly.

I will once again like to assure you all that the **forum of ICAI would be always available** to each of its members to address any practical / professional queries arising while performing the function of statutory bank branch auditors.

Best wishes, stay safe and healthy!

Chairman, PDC

Mumbai, April 12, 2020

Annexure

Illustrative format of the communication from statutory bank branch auditors to the branch

Ref. No.: 2020-21/XXX

Date: April XX, 2020

To

The Branch Manager

ABC Bank

Branch: XYZ (Branch Code: NNNN)

Address of the branch

Sir / Madam

Subject: Statutory Branch Auditors of XYZ Branch (Branch Code: NNNN) of ABC Bank for the F.Y.: 2019-20

As you are aware, we have been appointed as statutory branch auditors of your bank for the financial year 2019-20. The government has ordered lockdown whereby the physical moment has been restricted and as a law abiding professional, our firm is in complete compliance of the same. Thus, we hereby request you to kindly let us know as and when the lockdown is lifted by government authorities at your branch location, so as to enable us to visit the branch accordingly. In the meanwhile, we wish to go through certain exceptional and other system generated reports and data compilations, so as to enable us to do data analysis of the same and keep our observations based on the same ready for conducting the statutory branch audit. This will enable us to reduce the audit time substantially and to start the process of bank branch statutory audit as and when the lockdown is lifted by concerned government authorities.

As per the terms of appointment letter, the said statutory audit is required to be concluded in time. In order to ensure that the said timelines as specified by the bank are adhered to, we hereby request you to kindly make the following preliminary records available for our verification, which can be shared with us either by way of email or remote access to cloud data, whichever is convenient to you:

- a) GL / PL / Trial Balance as on 31.03.2019, 30.06.2019, 30.09.2019, 31.12.2019 and 31.03.2020;
- b) Advances and Deposits as on 31.03.2019, 30.06.2019, 30.09.2019, 31.12.2019 and 31.03.2020;
- c) Status of the web-based (and manual) returns and certifications which are compiled and ready for audit at your end and copies of the same, including annexures LFAR, Tax Audit Report, etc.;
- d) Broad composition of Advances (C & I, Personal segment in terms of no. of accounts and amount outstanding);
- e) Details of the accounts above Rs. 2 crores of exposure;
- f) No. of new accounts sanctioned during the financial year 2019-20 (data required is no. of accounts and amount sanctioned and details of new accounts sanctioned / renewed or enhancement in limits for accounts. The data should be provided separately for accounts with exposures below Rs. 2 crores and with exposures above Rs. 2 crores);
- g) Jotting of new advances accounts sanctioned, renewed, enhanced during the financial year 2019-20;
- h) Details of all the exceptional reports generated through CBS system;
- i) NPA report of 2018-19 and 2019-20;
- j) Advances report 2018-19 & 2019-20
- k) List of accounts wherein the deferment of installments / Interest is availed by the borrowers as per COVID-19 Regulatory package declared by RBI vide its circular dated March 27, 2020
- l) List of accounts wherein the MSME Relief was granted vide RBI circular dated January 01, 2019 and February 11, 2020
- m) SMA reporting all quarter end and as per specific requested period by auditor
- n) Last year statutory audit report and LFAR
- o) Concurrent audit reports 2 months along with pending compliances as at March-end
- p) Internal audit report (last 2) along with pending compliances as at March-end
- q) Forex and other audit reports
- r) BG balancing report
- s) LC Balancing Report
- t) Bill Balancing Report
- u) Balance Sheet and P & L / Trial Balance generated from system
- v) GL report from 23rd March till 4th April (for the purpose of review of unusual transactions)
- w) Status of contingent liabilities as per last financials as well as current year contingent liabilities
- x) Details of suits and current status
- y) Details of fraud if any detected and reported
- z) AML report

- aa) RBI AFI Observation w.r.t.that branch
- bb) In case of forex:
 - 1. Export bills outstanding more than one-year report
 - 2. Export Advance outstanding more than one year
 - 3. Import Advance outstanding more than one year
 - 4. Outstanding merchant trading transactions and it's status
 - 5. Outstanding BOE more than one year

We will require following basic documents ready when our audit team visits the branch:

- a) Last two Statutory Audit reports (FY: 2017-18 and 2018-19) along with all annexure, certificates, Tax Audit Report and LFAR along with compliance report thereof
- b) Following reports for the audits conducted during the FY: 2019-20:
 - a. Concurrent Audit Reports
 - b. Internal Inspection Report
 - c. Credit Audit Reports
 - d. Stock Audit Reports
 - e. RBI Inspection Reports
 - f. Revenue Audit Reports
 - g. IS / IT / EDP / System Audit Reports
 - h. Special Audit / Inspection Reports

In case if any of the above audit / inspection is not conducted during the FY: 2019-20, kindly make the last report w.r.t. the same available;
- c) Files (includes document file) of new loans (Above Rs. 2 crores) and enhancements in old loan accounts with total exposure above Rs. 2 crores
- d) CIS Data of Feb'20 and Mar'20
- e) Statement of Income and Expenditure, Balance Sheet as at March 31, 2020
- f) Statement of Depreciation along with vouchers related to additions / deletions including transfer of assets, if any
- g) Movement of NPA and NPA Statement along with the documents supporting security value of the NPA Accounts
- h) Capital Adequacy Returns along with the supporting related to ratings of accounts

- i) Details of Letters of Comforts which are outstanding as on March 31, 2020 and details of Letters of Comforts issued and settled during the financial year along with relevant documents executed by the customer with bank and details of payment of principal and interest component on Buyer's Credit
- j) Details of Accounts restructured during the financial year 2019-20 along with working of sacrifice
- k) List of Accounts, if any, wherein the bank is holding any security issued by the borrower in Treasury Department of the bank and status of the said security (PA / NPA)
- l) System generated Overdue Report of borrowers as at 31.03.2019, 30.06.2019, 30.09.2019, 31.12.2019 and 31.03.2020 duly authenticated
- m) Details of Adjusting Entries passed for yearly closing of 31.03.2020
- n) System generated NPA marking report (specifying the accounts which are considered as NPA by the automated NPA marking mechanism) as at 31.03.2019, 30.06.2019, 30.09.2019, 31.12.2019 and 31.03.2020
- o) System-generated CIS related Audit Trail related only to (i) revocation of NPA status, (ii) changes made in limit master, (iii) changes made in date of expiry of loan for the period 01.03.2019 to 31.03.2020
- p) Details of Overdue Time Deposits, if any
- q) Details of inoperative (dormant) accounts with details of date from which the account is marked as dormant
- r) If the branch has been designated for gold demonetization scheme, the details of the gold demonetized

We hereby also request you to kindly let us know the name of the officer of the bank nominated by the branch for compiling the above-mentioned requirements related to annual audit, so as to enable us to co-ordinate with the said officer and maintain the time schedules prescribed by the bank. We will be continuously doing the statutory audit of your branch once the lockdown is lifted by the appropriate government authorities till completion of the audit.

Kindly let us know the branch opening timings, so as to enable us to plan our time schedules accordingly.

Further, we hereby request you to kindly provide us Read Only login to the CBS system, so as to enable us to carry out the audit function effectively.

Kindly let us know in case if you require any clarifications in the above matters.

Thanking you,

Yours sincerely

For PQR & Co.
Chartered Accountants
Firm Registration No.: NNNNNNW

LMN

Partner
M. No.: NNNNNN