

Auditing in Core-Banking Environment - Some Special Considerations

Driven by the need for centralised access over branch operations, banks are integrating maximum number of their branches into Core Banking Solutions environment. This article is an attempt to probe some critical aspects of this environment and related controls that deserve special consideration by both auditors vis-a-vis internal as well as statutory.

In order to have centralised access over branch operations and for faster extraction of branch MIS information, trend amongst banks to integrate more and more branches into CBS (Core Banking Solutions) environment has been quite evident in past couple of years. Besides, to meet growing service expectations of customers as well as to optimally exploit the potential of technology, banks are ideating and resorting to newer and more effective service delivery channels e.g. ATM, Internet Banking, Tele Banking, Mobile Banking, SMS Banking etc. While it has led to tremendous benefits for the banks in terms of operational efficiencies, enhanced security and customer satisfaction etc, on the other hand, it also has several control implications deserving attention of Management as well as Auditors.

Basically, CBS is an environment based upon client-server architecture, having a remote server (called Data Centre) and client (called Service Outlets) branches. This environment has brought significant changes so far as workflow and housekeeping activities/accounting processes at branches are concerned. It also has had consequent impact upon relative controls. Now, user-actions and controls are elaborately menu-driven. User is prompted by the software to initiate an action and to apply a control. Various periodical runs/mass activities like Application of Interest & Service Charges,

Updation of Parameters globally, Balancing/ Reconciliation of Ledgers and TDS etc. are carried out centrally at the Data Centre, leaving various activities/control actions to be taken at the branch.

Needless to mention, the implications of such an environment on Audit & Compliance function have drawn the attention of the Banking Regulator. In its recent communication vide Cir. No. DBS.PP.BC1/11/01.005/2006-07 dated November 16, 2006 "Compliance Function in Banks", RBI has expressed its concerns. Para 6.3 of this circular states:

"Banks may consider software-based solutions provided by reputed vendors which make available all the regulatory instructions and also provide regular updates."

Para 6.9 of this circular states:

"Banks with fully operational core banking solutions should centralise the reporting at the Compliance Department. In other cases, Compliance Department shall monitor timely submission of regulatory returns by the controlling office through appropriate mechanism such as Monthly Returns Calendar, which may indicate the Return/Report to be submitted by each branch/controlling office and their dates of submission."

Further, in accordance with AAS (Auditing & Assurance Standard) -6 (Revised) of ICAI Risk Assessment and Internal Control, "the auditor should consider the CIS (Computer Information Systems) environment in designing audit procedures to reduce audit risk to an acceptably low level. He should make enquiries and particularly



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satisfy himself whether:

Adequate procedures exist to ensure that the data transmitted is correct and complete; and

Cross-verification of records, reconciliation statements and control systems between primary and subsidiary ledgers do exist and are operative and that accuracy of computer compiled records are not assumed."

Plain reading of this para of the Standard mandates to check whether adequate data validation procedures exist and to evaluate the existing systems of cross-verification and reconciliation between primary and subsidiary ledgers. It also mandates to check whether adequate system of verification of computer generated reports/statements for their correctness exists.

In a complex system with frequent updates in operating platforms/software functionalities, while it is the responsibility of the management to ensure adequate and effective control systems at the branches, the auditors need to continually stay current with this environment and with the relative impact on their audit function. Internal auditors have to evaluate and comment the existence, adequacy and effectiveness of controls, while statutory auditors have to express their opinion on the results generated by these systems.

Some critical aspects of this environment and related controls deserve special considerations by auditors both internal as well as statutory. These controls have been discussed in following sections:

I. General Administration & House-Keeping

S. No.	Controls	Suggested Audit Check-Point
i.	<p>Migration Controls</p> <p>If the branch has migrated from previous legacy package to CBS, then, in order to ensure consistency and integrity of data migrated, it is essential that adequate data validation procedures like Verification of Master-data, Mapping of Accounts (Linking of accounts with appropriate tables/scheme codes/GL Subheads), Confirmation of Accounts, Verification of arrears of loan instalments, etc. have been carried out at the Branch. Migration is a crucial exercise from the audit & control point of view as any lapse or inadequacy of procedures may not only lead to misleading results, but also result into several monetary and legal implications also. For instance: incorrect mapping of TDS rates table may result in non-compliance of tax laws attracting punitive actions.</p>	<p>i If migration process has been undertaken in the supervision of controlling office team, to check & comment whether Certificate of Verification of Integrity and Consistency of data migrated has been preserved on branch records.</p> <p>ii If branch has undergone an independent Migration Audit, to check whether all irregularities and recommendations have been duly attended/followed.</p> <p>iii To check from print copies of reports held on branch records whether migrated data has been verified by the branch for integrity and consistency and the procedures undertaken by the branch have been supervised and documented adequately. In case of inadequacy/ineffectiveness of procedures carried out, an independent Migration Audit may be recommended.</p>

<p>ii.</p>	<p>Control over Software Updates (New features). In order to comply with regulatory/other requirements, new updates/customisations in software functionalities are frequently introduced by the Banks. These updates mainly relate to various actions/accounting processes to be undertaken at branches and have control implications. Therefore, it becomes essential for the auditors to keep themselves updated with these and to assess their impact on their audit. For instance,</p> <ul style="list-style-type: none"> - Introducing feature of application of Processing Charges and Annual Review charges in loan accounts by the system at Data Centre instead of the branch. 	<p>To check whether list of such updates/customisations have been maintained in chronological order at the branch and to comment whether these have been complied with/actions prescribed for branches have been taken and controlled.</p>
<p>iii.</p>	<p>Day-End Controls In any computerised environment in general and in CBS environment in particular, day-end is a crucial process undertaken at branches in supervision of a designated official (System Administrator/Computer Officer). Various control reports are generated to ensure integrity of the transactions and also to ensure whether transactions are in conformity with the Bank's guidelines/system of authorisations (maker-checker). These reports reveal the exceptions and anomalies encountered during the day. Vital amongst these reports are:</p> <ul style="list-style-type: none"> a. Exceptional report b. List of users c. Access Log d. Rejected/Cancelled entries e. Over-limits/TOD Report f. GL affected Balances Report g. Report on large cash transactions/KYC & Anti Money Laundering etc. 	<ul style="list-style-type: none"> i. To obtain list of such reports generated by the system. ii. To check whether all the mandatory reports are taken daily including on Sundays and holidays, as ATM transactions are carried out on these days also, and are scrutinised adequately and to comment whether exceptions/anomalies, if encountered during the day, have been duly noted and disposed of.

<p>iv.</p>	<p>Control Over Periodical/Mass-Runs (System Generated Transactions) In CBS environment, various transactions relating to mass customers are run at the Data Centre, while the branches are expected to verify the reports on these runs/system generated transactions for their correctness. Examples of these runs are:</p> <ol style="list-style-type: none"> a. Application of Interest b. Application of service charges c. Updation of parameters globally d. Balancing & Reconciliations e. Classification of inoperative accounts etc. <p>Though these runs are controlled centrally at the Data Centre, yet there are several reasons of failure /incorrect output of such runs. For instance, interest application run might result in incorrect/non-application of interest owing to the following reasons:</p> <ol style="list-style-type: none"> a) Interest rate not mapped correctly: for example, interest rate of housing loan to staff linked to interest rate of vehicle loan to staff. b) Interest rate field kept as "Zero" c) Interest collection flag kept as "N" instead of "Y" d) Next interest demand date not changed and kept same as date of application of interest. e) Account remained unconfirmed. f) Account wrongly marked as Past-due/ "NPA" 	<ol style="list-style-type: none"> i. To obtain listing of such runs/system generated transactions, conveyed to the branch from time to time, which are being applied at the Data Centre. ii. To check whether print reports of such runs/system generated transactions are taken and scrutinised by the branch for correctness and comment whether discrepancies/inconsistencies encountered are duly noted and disposed of. iii. To check specifically & comment whether interest test-check has been carried out at the branch to verify the correctness and worksheets of such verification procedures have been preserved on branch records.
<p>v.</p>	<p>Control Over Inter-SOL Transactions In CBS environment, various transactions are initiated by the SOL for other SOLs and by other SOLs for the SOL. These transactions are reconciled centrally at The Data Centre as a part of EoD (End of day) process.</p>	<ol style="list-style-type: none"> i. To check whether report on such transactions and reconciliations are taken and scrutinised for correctness and to comment whether these transactions have been authorised by competent staff only. ii. To check whether applicable charges have been applied.

<p>vi.</p>	<p>Control over Proxy/Parking Transactions In normal course of business, some transactions might not be verified and may remain in entered (un-posted) status. But, since day end process could not be suspended for next day, hence, these transactions are posted in a pre-designated account called Proxy/Parking Account. These transactions, generally, are of two types:</p> <p>a) <u>System Generated</u>: Transactions which take place during various system runs. For instance: Execution of SI (Standing Instruction) by the Data Centre on last day of the month and SOL being closed on that day. This entry may not be posted and will remain in entered status and will be posted in Proxy Account.</p> <p>b) <u>User-Generated</u>: Transactions which are initiated by the user, but owing to certain reasons may not be posted/authorised and kept in proxy/parking transactions account. For instance: Depositing RD installment in excess of the cumulative installments. This entry may not be posted in RD Account and posted in Proxy/parking transactions account and reversed subsequently.</p>	<p>i. To check whether report on such transactions is taken as a part of day end process and scrutinised for prompt reversal.</p> <p>ii. To check and comment specifically on old outstanding entries and reasons for non-reversal of the same.</p>
<p>vii.</p>	<p>Control over Impersonal/Office Accounts Accounts which are opened by the Bank for their own operational purposes and are of impersonal nature. For instance: (a) sundry credit accounts, (b) sundry deposit accounts, (c) suspense (d) H.O Account etc. Adequate control over accounting and the adjustments of these accounts, considered as sensitive too, is to be ensured by the management.</p>	<p>i. To check whether these accounts have been mapped to correct GL Sub head and entries in the accounts have been done correctly. For instance:</p> <p>(a) Postings in sundry credit accounts and sundry deposit accounts have been duly verified by the branch.</p> <p>(b) Deposit from public and Deposit from Banks have been shown correctly in appropriate GL Subheads.</p> <p>(c) Credit balances in Loan accounts have not been shown in sundry deposit account.</p> <p>ii. To check whether these transactions are scrutinised by the branch for correctness and for prompt adjustment.</p>

II. Advances and Foreign Exchange

S. No.	Controls	Suggested Audit Check-Point
i.	<p>Securities Master Maintenance Generally, the credit limits are administered through security register maintenance. Value of various securities i.e. stocks, book-debts, plant and machineries and Land & Buildings etc. are updated at the branch and drawing powers are administered accordingly.</p>	<p>i. To check whether values of various securities are updated promptly and drawing powers are allowed on current value of such securities.</p> <p>ii. To check whether periodical reports on securities master are taken and scrutinised for verification of various fields i.e. value of securities, date of inspection, insurance, date of valuation, etc.</p>
ii.	<p>Linking of Credit-limits In CBS environment, in order to know the consolidated outstanding and value of assets of a customer under various credit-limits, all limits are linked to central/common node. Thus, drawing powers are administered under various limits. Besides, in order to comply with the prudential IRAC norms, this feature plays a vital role in CBS environment for effective asset classification for adhering to prudential IRAC norms.</p>	<p>To check whether this limit linking has been done and checked adequately for correctness and have been linked to a central/common node for arriving at drawing powers under various limits.</p>
iii.	<p>Income-Recognition & Asset-Classification by System In CBS environment, periodical runs relating to income-recognition and asset-classification are carried out by the system and branches are advised to verify the system classification.</p>	<p>i. To check whether asset classification done by the system has been verified by the branch for correctness.</p> <p>ii. To check whether any modifications in system classification have been duly authorised adhering to the IRAC Norms.</p> <p>iii. To check whether past-due status has been marked to all NPA accounts.</p> <p>iv. If provisioning has also been done by the system, to check whether it is in accordance with the provisioning norms of RBI.</p>
iv	<p>Control over Forex Business In CBS environment, various periodical statements/returns to be submitted to RBI/regulatory bodies are generated & extracted from the system. And, Banks are seeking these statements/returns verified from their Internal Audit function. Vital amongst these returns are:</p> <ol style="list-style-type: none"> R>Returns XOS (Outstanding export bills) State-5 (FCNR Accounts) Stat-8 (NRE Accounts) Stat-109 (RFC Accounts) BEF (Import transactions) TFD 1 (Turnover of Forex Business) 	<p>i. To check whether these statements are scrutinised by the branch for their correctness.</p> <p>ii. To check whether other controls have been exercised adequately, such as,</p> <ol style="list-style-type: none"> Application of Interest on different types of Non-Resident Accounts, etc has been verified for correctness. Classification of accounts into inoperative accounts as per norms.

III Deposits

S. No.	Controls	Suggested Audit Check-Point
i.	Mapping of Accounts It implies linking of accounts to various scheme code/tables/GL Subheads etc. For instance, linking of applicable interest rate table to SB (General), SB (Staff), SB (Pensioners). Incorrect mapping may lead not only to misleading results but may cause other consequences also.	To obtain print copies of verification sheets and check whether these have been verified by the branch adequately for correctness.
ii.	TDS	i. To check whether various TDS rates linked to different types of depositors/Other deductees have been verified for correctness in terms of TDS Rules. To check whether adequate care has been taken for mid-year amendment in the TDS rate, if any. ii. To check whether accounts of customers submitting Form 15G/15H have been linked to correct TDS Table. iii. To check whether all accounts of the customer have been linked to a customer-id for the purposes of TDS.
iii.	Auto-Renewal of Overdue Term Deposits	To check whether auto-renewal of overdue TDRs has been enabled and comment whether report on such effective renewals and failures and on application of interest have been taken and scrutinised by the branch for correctness.

IV. Legal Compliances And Other Controls

S. No.	Controls	Suggested Audit Check-Point
i.	Compliances of Tax Laws FBT, BCTT and Service Tax	To check whether eligible expenditures under FBT Laws have been debited in appropriate pre-designated account head under appropriate GL Subhead and reports generated have been verified. Similarly, to check whether adequate control over BCTT and service tax accounting has been exercised. For instance: Care has been taken for availing credit for Input service tax correctly.
ii.	ATM Transactions	i. To check whether ATM Cash has been verified periodically. ii. To check whether ATM transactions are reconciled periodically. iii. To check whether adequate control over physical inventories of ATM cards has been exercised.

iii	Internet Banking	To check & comment specifically whether adequate validation procedures such as verification of data relating to customer profile i.e. a) Identity and address proof b) Nature of constitution and c) mode of operations etc. fed into system have been carried out at Branch
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Conclusion

In this e-commerce era with frequent updates in legal/regulatory and technological environment, auditors need to take stock of recent developments and brush up their knowledge and skills. Undoubtedly, shift to CBS has brought considerable system efficiencies and service effectiveness besides enhancing security. Yet, there are several operational risks including compliance risks and risks of non-

adhering to control procedures at the floor level that have to be addressed by the Managements. Further, adequate user-training on operational as well as security aspects are concerns to be addressed by the Managements, as poorly controlled systems may not only vitiate the perceived objectives of such innovative shift but also jeopardise the Bank's interests by resulting in misleading results, loss of revenue, punitive actions and customer dissatisfaction. □

DID YOU KNOW?

Course in Management Accounting

Apart from the education and training for membership, the Council has also bestowed sufficient attention on keeping members of the Institute current in their knowledge. The Council has shown awareness that with passage of time, professional knowledge, and skill tend to undergo a process of obsolescence and therefore all facilities should be made available to rectify the situation.

The emphasis laid on practical experience gained in the office of a member in public practice as a condition for membership, has already been pointed out. However, with the phenomenal increase in the demand for accountants from the Industry both in the public and the private sectors; it had become necessary to provide membership with advanced

specialised knowledge of certain aspects of accounting in relation to management. Accountants in the industry are supposed to know much more about the functional areas of management, the economic and human aspects surrounding a business, the practical application of accounting analysis for business decisions etc. With a view to catering for the special needs of accountings in industry that are connected with management, the Council has introduced a separate Post Graduate Course in Management Accounting. In this field pioneering work was done by Mr. S.P. Chopra as the Vice President in 1955-56 and later on as the President of the Institute during 1956-57.

(Source: History of the Accountancy Profession in India –Volume I)