

# **ADVANCES & PRUDENTIAL NORMS**

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**Pimpri Chinchwad Branch of WIRC**  
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# ADVANCES

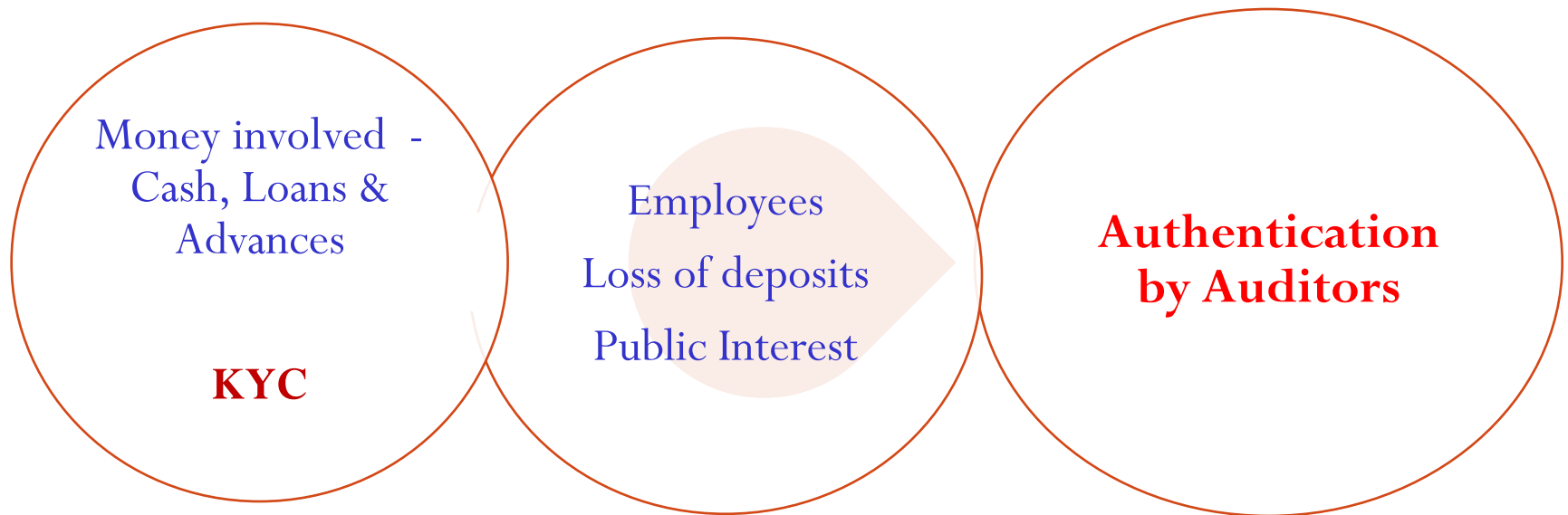
**PART I : Advances**

**PART II : Prudential Norms(IRAC & Prov.)**

**PART III : LFAR**

- Definitions, Procedures, Verification, Prudential Norms and Income Recognition

# Issues



# ADVANCES...Basics

## *Preliminary Work*

⇒ Aware of :

- ⇒ RBI Circulars, Circulars of Banks (interest & Service charges), Credit Policy
- ⇒ Delegation of Authority & Financial powers
- ⇒ Latest Internal Inspection, Concurrent Audit Reports, Stock Audit Reports in case of advances
- ⇒ *Status and level of compliance by the branch, on adverse features pointed out in earlier reports*

# Basics

- ⇒ Audit Working Papers – Guidance Note
- ⇒ Detailed Check list on audit
- ⇒ **Identify the staff -**
  - ⇒ Experienced/Train the staff (CBS system)
  - ⇒ *Allocate the work* – Advances

# Coverage

- **Advances – Largest revenue earner –**
  - **Major Activity of Bank & Largest item in ASSETS**
  - **Major Source of INCOME & Most FOCUSED Audit Area**
  - **Can SUBSTANTIALY CHANGE the financial results**

# Types of Advances – Funded...

- Cash Credit - secured against stock, BD, etc
- Overdrafts - Secured/unsecured – FD, Property, etc
- Term Loans - on Fixed Assets, House, etc.
  - Fixed period
  - Demand Loans/Term Loans (criteria of 36 months)
- WCDL – Non operable a/c, for a fixed period, renewable basis
- Bills Purchased / Discounted/ Foreign Bills for Collected -
  - Purchase of bills
  - Discounting of bills
  - Advance against bills under collection

# Types of Advances – Funded...

## Export Credit:

- Pre Shipment:
  - Packing Credit - in Rupees/FC
  - Advance against cheques/draft, etc
- Post Shipment:
  - Export Bills purchased/Discounted
  - Advance against export bills(collection)



# Types of Advances...non funded

## A. Guarantees —

- To guarantee the performance of contractual obligations.
- Types — Financial or Performance
- Specific or Multiple transactions

## B. Letter of Credit —

- Undertaking by the bank to payee
- Types - Documentary, Clean, Inland or Foreign

# Audit Process in Advances

- **Credit Appraisal**

- Prescribed form, KYC, Board Resolution, Evaluation of FS, Project Report, IT Returns
- Credit appraisal, CIBIL Report, NOC from existing banker

- **Sanction & Disbursement**

- Proposal to go through proper auth levels / recommendations to be taken on record, discretionary powers / appropriate authority

- **Documentation**

- Sanction letter, as per loan policy, execution of loan documents

- **Review / Monitoring / Supervision**

- Review / renewal, stock inspection, QIS, Operation of account, Insurance, end use of the funds

# Application

- Prescribed Application Form from the borrower for fresh or renewal proposal (deed, M/A)
- SSI registration, NOC, Credit Report, Valuation Report(list of Assets), Stock & Debtors Statement,
- *KYC Compliance as per RBI Requirements*
- Latest audited financial statements
- *Project Report*, Projected P&L, Balance Sheet & Cash Flow
- Board Resolution for the availment of the facility obtained
- Latest Income Tax Records/Declaration of Assets & Liabilities of Borrower and guarantor

# Credit Appraisals...

- Prospects of business sources and periodicity of repayments, evaluation of financial statements
- Report of Dun & Brad street for Export finance or while opening Letter of Credit is obtained
- *Credit worthiness of borrower & Guarantor - Networth*
- Verify whether Exposure limit (including derivative instruments) is within the limits fixed by Bank-group wise, Industry wise & policy of Bank
- *Nayak Committee Recommendations (Turnover Method)*
- *Previous Adverse comments of the auditors, inspectors, etc.*

# Credit Appraisals.....

- *Verify Appraisal note of Bank is proper and done by competent person*
- Review Projections whether realistic or not
- *Confidential report and NOC from the existing banker*
- *Adequacy of security cover, Title clearance report and Valuation report*
- Nature of securities (prime/ collateral) offered and to confirm the adequacy of security cover
- Credit Rating – to be done as per last Audited Balance sheet(not available + ROI)
- Verify that important Financial ratios are satisfactory such as
  - Debt Equity ratio, DSCR , Current Ratio and other ratios

# Appraisals ...

- ⇒ *Fresh Loans & Renewals : Whether appraised properly?*
- ⇒ *Whether adverse remarks of field officer are over ruled by seniors?*
- ⇒ Sensitive Areas identified by RBI: Real Estate/ Securities
- ⇒ Housing Loans, Gold Loans, Real Estate Loans, etc.

# Appraisals...

- ⇒ Sanctioning
- ⇒ *Non-corporate borrowers - Limits over Rs. 20.00 Lakhs*
- ⇒ *Inadequate Insurance, Over drawings, Fall in DP and security*
- ⇒ DICGC/ECGC claims lodged or not
- ⇒ *Devolvment/ Invocations*
- ⇒ Sanctioning huge non-fund based limits without proper margins
- ⇒ Timely renewal of advances

# Sanctioning

- Proposal has been routed through appropriate authorization levels and **recommendations** are properly documented and noted
- Limits sanctioned - **discretionary powers** of the sanctioning authority
- Sanctions are beyond the discretionary powers - reported to appropriate authorities and ratified within specified period
- *Any change in the terms of sanction is ratified by appropriate authority*
- Pre disbursements unit inspection has been carried out & report held on record
- *Limits sanctioned, Interest, Margin, Security... Properly entered in CBS*



# Documentation

- *Limits conveyed to the party should be the same as sanctioned by the authorities with the terms & conditions.*
- *Sanction letter to be accepted by the borrower and guarantors*
- All loan documents, as required by the sanction letter and loan policy have been executed (eg. DP Note, loan Agreement, Letter of guarantee, hypothecation Agreement, etc)
- Loan documents – vetted by legal expert, if required
- *Compliance certificate issued by the concurrent auditors / Legal Experts*

# Documentation...

- *Fresh loan documents are obtained on change in limit, change in the constitution of the borrower*
- Original documents, share certificate, title deeds, title clearance certificate, valuation report are held on record
- Stamping : As per the Stamp Act.
- Insurance : All securities charged to the Bank –Insured adequately /Policy to **have Bank Clause.**

# Documentation...Security

- **Original documents are kept in safe custody**
- Charge on securities offered have been registered with registrar of companies / appropriate authority within stipulated time.
- **Lien marking – FD, NOC & Lien confirmation**
- Special Documentation for Consortium/ Multiple Banking advances
- No Blank /Partly filled documents to be kept.

# Interchangeability

- The sanction ticket in some cases invariably provides a main limit with sub – limits
- Documentation
- Interchangeability can be between two sub limits within the same facility or two different facilities.

# Disbursement

- Verify that Disbursement done only after compliance of all terms and conditions of Sanction
- *Verify all **Ad hoc** sanction limits given*
- Home Loans/term loans to be disbursed directly to the Builder / Owner/supplier
- ***Post Disbursement Inspection***

# Review/Monitoring...

- Review / Renewal of facilities carried out as per the policy of the bank
- Verify Follow up of accounts pending renewal
- Stock Inspection reports
- Regular submission of stocks / book debts statements and calculation of correct D.P.
- *Stock / debts statements and other periodic operational data and financial statements etc received regularly from borrowers and duly scrutinized*
- *Important registers – Discretionary power, insurance, limitation, security verification*

# Review/ Monitoring...

- Scrutiny of **Exceptional Transactions**
- End use of Funds - Fund disbursement has been utilized for which limit was sanctioned i.e. Not diverted to group companies / associates or used to pay of existing overdues. WC not to be used for buying fixed assets
- Penal interest to be charged if,
  - DP limits breached
  - Statements not submitted
  - Limit not renewed
- *Credit Discipline - Timely adjustment of adhoc limits / Serving of Interest.*
- *Monthly turnover to commensurate with Annual Projection.*
- *Credit Turnover in the account to match with sales(stock statement)*

# Review & Monitoring...

- Consortium meetings: Read Minutes & exchange of Information between the Banks
- Management explanation of unusual items / large transactions
- Over limit - TOD
- Any comment by inspectors/auditors
- Insufficient security
- *Correct feeding of interest rates in the system*
- Scrutiny of QIS-
  - Regularity in submission.
  - Achievement of performance vis-à-vis Projection.
  - Reasons for Variance.



# Drawing Power Calc.(DP)

- Based on Stocks, Debtors and Share value- Critical review of stock / Book Debts statements (Old debtors more than 90/180 days not to be considered).
- *Stock & Debtors pertaining to sister/ associate concern not to be included.*
- DP limits to be set as per latest statements. If stock statements is older than 3 months accounts to be classified as “irregular”
- Verify banks guidelines for DP calculation specially for unpaid stocks
- Inventory & equity shares valuation important in the current scenario
- Verify Stock audit report for NPA’s more than Rs. 5.00 Crore

# Scrutiny of Stock & Book Debts

## Inspection

- Regularity in submission of statements.
- Slow/non moving/ obsolete stock to be deducted for D.P.
- Unpaid Stock / Stock under Usance L/C to be declared separately and deducted for D.P. calculation.
- Age of the book debts. Certification from a C.A.
- *Value of stock / Book Debts as on 31<sup>st</sup> March – compared Audited Balance sheet.*

### Physical Inspection of Securities...

- Periodic Inspections of Stocks - Deficiencies/Irregularities
- Consortium Account - inspection reports exchanged

# Term Loan

- End-use of funds, disbursement by way of DD/PO/Cheques directly in favour of Suppliers
- *Disbursement by way of reimbursement only if permitted by sanction and after meeting all sanction terms.*
- Disbursement strictly as per project implementation.
- Repayment schedule to be as per the sanction and verify record of repayment
- *Stipulated installments / **interests** are being paid regularly*

# Pre-shipment - PC

- Pre-shipment credit all the advances required to finance the production cycle advance is given on the basis of individual order obtained which is to *repaid out of export proceeds*
- The post shipment credit relates to financing of bills raised on the overseas buyer upon shipment of goods pending
- *Verify proceeds received from export as these accounts have concessional interest (normal interest)*

# Post-shipment-Bills

- Tenor as per sanctioned terms
- Export bills, if remain o/s. for more than 30 days after due date to be crystallized
- *Party wise limit to be checked as per sanction - register*
- Audit team should fully be aware of various regulations & Exchange Control formalities
- Branch follow up of **overdue bills**
- Report to RBI about bills beyond 180 days
- *Ensure that the premium to ECGC is paid promptly unless specific waiver was given by the competent authority*

# Bank Guarantees

- Verify sanction terms/ margin/ commission, validity and action period
- Register of guarantee issued to be maintained.
- Reversal of expired guarantee - notice sent to the beneficiary
- Un reversed Expired guarantees will attract Capital Adequacy

# Letter of Credit

- Examine sanction to verify L/Cs as per terms.
- Compliance of Import Policy guidelines
- L/C should be signed by authorized officials (Two)
- Proper sanction for Extensions/Modifications and relevant charges to be recovered.
- *On devolvement, no fresh L/C is to be issued without special sanction from competent authority*
- Discrepancies in documents promptly reported to negotiating banker/shipper.
- On non payment liability is crystallized and reported.

# Advances...Issues/Risks

- Documentation and compliance
- Sanction without proper applications and credit appraisal
- Sanction made beyond discretionary power and non-reporting of the same to the appropriate authority
- Unauthorised release of securities
- Charging of same security to different Banks and for different facilities
- Diversion of funds - to other concerns



# Issues ...related to risks

- Continuous accommodation of excess to a few customers.
- Frequent/ unauthorized overdrawing beyond limits
- Bouncing of cheques due to insufficient funds
- Frequent issue of stop payment instructions.
- Cheques deposited and not honored.
- TOD for major part of the month, gets adjusted just on 29<sup>th</sup> / 30<sup>th</sup>
- Non submission of Balance Sheet in time resulting in non renewal.
- Existence of overdue bills, devolved L\C etc...
- Delay / Non Submission of Stock / Book debts statement.
- Understatement of Sundry Creditors in stock statement so as to inflate D.P
- **POTENTIAL NPA'S(Early Alert /Special Mention A/cs)**

# System Reports- Availability

- Facility wise reports/Party wise
- Renewals/adhoc facilities
- Stock/Book debts statements not recd. – Penal Interest
- Insurance expired - Underinsurance
- List of accounts overdrawn
- Turnover in accounts – Monthwise - CC/OD
- Outstanding bills statement
- Expired guarantee statements
- Overdue term loan accounts

# Test check in CBS...

- *Whether frequent changes in the rate of interest & other changes are correctly parameterized?*
- *Are changes being authorized?*
- *Compute interest manually & compare the same with system*
- Interest is computed on daily or monthly basis?
- Ensure that the rate of int. EMI and month entered is as per sanction
- Inquire about period end process, which can be monthly/quarterly/half yearly.
- Deposits:
  - Ensure regular update of deposits scheme & interest thereon.
  - *Interest on loan against FD*
  - Review pre-mandated transactions.

# Auditing in CBS Environment

- ⇒ No visible audit trail
- ⇒ Walk thru of the transactions – from start to end and document
- ⇒ Inadequate segregation of duties and risk to integrity of data
- ⇒ Check rights of access – to staff members & its level
- ⇒ Computer generated “Error Reports” to verify accuracy of interest rates, date of NPA, etc, if available
- ⇒ System suspense entries
- ⇒ Exceptional reports
- ⇒ Check whether the recurrence of such discrepancies is general or in respect of some specific clients
- ⇒ Auditor to go to root cause of the problems

# PRUDENTIAL NORMS & INCOME RECOGNITION

# Present Position

- With a view to moving towards international best practices and to ensure greater transparency, “90 days” overdue’ norms for identification of NPAs have been made applicable from the year ended March 31, 2004

# Prudential Norms & NPA Classification

- A non – performing asset (NPA) is a loan or an advance where
- An asset (including a leased asset) which ceases to generate income
  - ❑ Term Loan – *interest and/ or installment* remains overdue for a period more than 90 days.
  - ❑ Cash Credit and Overdraft – the account remains out of order – i.e.
    - o/s balance remains continuously in excess of the sanctioned limit/ drawing power OR
    - o/s balance is less than the sanctioned limit/ drawing power, but there have been no credits continuously for 90 days/ the credits are not enough to cover the interest debited during the same period.
    - *Stock statement more than 3 months old for a continuous period of 90 days*

# Prudential Norms & NPA Classification

- Bills Purchased/ discounted – bills remain overdue for more than 90 days
- **Agriculture Loans:**
  - Crop Loan – principal or interest remains overdue for 2 crop and 1 crop seasons for short duration crops and long term duration crops respectively.
  - Re-schedulement: Current Due - As per revised terms – NPA
  - Indira Awas Yojana, Golden Jubilee Rural Housing Fin Scheme – Linked to crop cycles.
- Derivative transactions – the overdue receivables representing positive mark to market value of derivative remain unpaid for a period of more than 90 days.



# Prudential Norms & NPA Classification

- Government Guaranteed Advances:
  - State government guaranteed advances have to be classified as NPA if remains overdue for more than 90 days
  - Central government advances to be considered as NPA only if guarantee invoked and repudiated by the government
- ❑ Securitization transaction – amount of liquidity facility remains overdue for more than 90 days.

# Prudential Norms & NPA Classification

- NPAs - Borrower – wise and not Facility-wise
- Verify errors in classification, provisioning/ Value of security, interest reversal
- Verify audit trail for changes to critical dates eg. date of NPA, etc
- *Identification of assets as NPAs should be done on an ongoing basis by the branch & internal systems*

# Prudential Norms & NPA Classification

- ❑ *Make a Detailed Note on observation and facts especially where you are recommending a change of classification*
- ❑ In respect of NPAs over Rs. 5.00 Crore
  - Stock audit – Annually
  - Inspection of immovable properties – once in 3 years
- ❑ Do not go by BANKS circular (Interpretation mistakes could be there)
- ❑ Verify that Repayment is from genuine sources

# Prudential Norms & NPA Classification

- ❑ NPA accounts can be upgraded to performing after all overdues are adjusted or at least reduced to a period of less than 90 days
- ❑ Suit filed accounts to be classified as Doubtful unless there is strong justification against it

# Prudential Norms & NPA Classification

- NPA classification:
- Sub Standard Asset – NPA for a period of less than or equal to 12 months.
- Doubtful Asset – remained sub-standard for a period of 12 months
- Loss Asset – identified as such, but has not been written off wholly. Is considered uncollectible and of such little value that's its continuance as a bankable asset is not warranted.

# Prudential Norms & NPA Classification

- ❑ Advances against Term deposits, NSC, KVP, IVP and Life policy not to be treated as NPA provided adequate margins are available
  - Note – Advances against Gold ornaments and government security and all other securities are not covered in the aforesaid exception
- ❑ Regular/ ad-hoc limits need to be reviewed / regularized not later than 3 months from due date/ date of adhoc sanction if not done within 180 days then NPA
- ❑ Erosion in value of security : where erosion is to the extent 50% / 10% of o/s NPAs straightaway doubtful/ loss

## Other important points

- In respect of a borrower having more than one credit facility, all the facilities granted by the bank will be treated as NPA and not the particular facility or part thereof which has become irregular.

# Restructuring

- ❑ Only loans with viability and with reasonable certainty of repayment to be Restructured
- ❑ Reschedulement of recovery cannot upgrade the classification from the previous classification
- ❑ Upgrading to standard category only after satisfactory performance during the specified period

Specified period-period of one year from the date when the 1<sup>st</sup> payment of interest or installment of principal falls due under the terms of restructuring



# Restructuring...

- Additional finance to be treated as standard Asset, upto one year after date of first principal / interest payment under approved restructuring package.
- ❑ Restructuring not to be retrospective
- ❑ Asset classification norms applicable till restructuring is finalised
- ❑ Provisions to be made for the diminution in the fair value of the advance

# Restructuring...

- Documentation standards – Acceptance – poor & inadequate
- Adherence to CUT OFF date
- Infusion of Promoters contribution – not factored
- FITL & Sundry Liability Account
- Up gradation of Accounts – Satisfactory Performance
- Restructuring accounts – slipping to NP – Ignore the restructuring process and classify as per regular course

# MSME Borrowers

- GST registered as on 31.01.2018
- Aggregate Exposure < Rs. 25.00 Crores
- Standard Account as on 31.01.2017
- Amount overdue on 01.09.2017 till 31.01.2018 paid on time and not later than 180 days
- 5% if not classified as NPA
- Interest is overdue for > 90 days – No accrual basis

# What to check...for NPA

- Potential NPAs report of concurrent auditors - – **SMA ACCOUNTS**
- Handover report and Internal Inspection report of Banks
- Stock audit report
- Exception report
- Accounts not classified though the installment are pending more than 3 months
- Accounts not renewed for more than 6 months
- Stock statement not submitted for more than 3 months
- Temporary adhoc limits given
- No turnover in the account
- Inadequate DP
- Continuous overdrawings
- Debit balance in the SB and current accounts
- Debit balances in Sundry accounts

## Common Irregularities

- Appraisal/ Sanction on the basis of inadequate documents
- Disbursement without execution of all documents.
- Over drawings beyond sanctioned limit/drawing
- Non receipt of monthly /quarterly data/information.
- Inspection of unit/ security not done periodically as per terms of sanction
- Insurance coverage over security not taken/ inadequate
- Copy of minutes of Consortium banks meeting not available
- Incorrect interest rate application
- Incorrect classification either in terms of security or in terms of prudential guidelines
- Incorrect provisioning

# Income Recognition

- Once the account has been classified as NPA, all accrued interest, fees, commission etc. which has been credited to income account, but has not been realized has to be reversed.
- Thereafter, all interest, income etc. has to be accounted on receipt basis and not accrual basis. The interest on such accounts is updated in the Dummy Register.
- However, interest on advances against TD, NSCs, IVPS, KVPs (check for fraudulent documents) and Life policies may be taken to Income account on the due date, provided adequate margin is available in the accounts
- If Government guaranteed advances become NPA, interest on such advances should not be taken to income account unless the interest has been realised

# Income recognition

- Interest income to be recognised only on cash basis for Assets which were NPAs at time of restructuring
- Fees and commissions earned by the bank as a result of re – negotiation or rescheduling of outstanding debts to be recognised on an accrual basis over re-negotiated period
- Verify whether Interest calculations are correct or not – Sample basis and Check Systems also

## Booking of Income on Investments in Shares & Bonds

- Income on units of UTI and equity of All India Financial Institutions should be booked on cash basis and not on accrual basis.
- Income from Government securities / bonds of public sector undertakings and All India Financial Institutions, where interest rates on the instruments are predetermined, income may be booked on accrual basis, provided interest is serviced regularly and is not in arrears.



# Provisioning Norms

- *Doubtful : Provisioning*
  - *Unsecured Portion - 100%*
  - *Secured Portion - D1-25%, D2-40%, D3-100%*
- *Does the accounts indicate possible window dressing? —  
Year end deposit & advances*

## FAQ's

**Whether a working capital account will become an NPA if the stock statements are not submitted regularly? What should be the period for which the stock statements can be in arrears before the account is treated as an NPA?**

- Stock statements should not be older than three months.
- The outstanding in the account based on drawing power calculated from stock statements older than three months would be deemed as irregular.
- A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days

**Whether an account will become an NPA if the review / renewal of regular/adhoc credit limits are not done when due? What should be periodicity of review /renewal to decide the present status of an account?**

- Regular and ad-hoc credit limits need to be reviewed / regularised not later than three months from the due date / date of ad-hoc sanction.
- Any delay beyond 90 days is not considered desirable as a general discipline.
- Hence, an account where the regular / ad-hoc credit limits have not been reviewed / renewed within 90 days from the due date / date of ad-hoc sanction will be treated as NPA.

**Appropriation of recoveries- What is the practice to be adopted by banks regarding appropriation of recoveries in NPA accounts?**

In the absence of a clear agreement between the bank and the borrower for the purpose, banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

**There are instances where banks park the dues from a borrower in respect of devolved letters of credit and invoked guarantees in a separate account, irrespective of whether the borrower's credit facilities are regular or not. How to determine when the account in which such dues are parked has become an NPA?**

- A number of banks adopt the practice of parking the dues of the borrower in respect of devolved letters of credit and invoked guarantees in a separate account which is not a regular sanctioned facility.
- As a result these are not reflected in the principal operating account of the borrower. This renders application of the prudential norms for identification of NPAs difficult.
- It is, therefore, desirable that if the debts arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, and the balance outstanding in that account also treated as a part of the borrower's principal operating account for the purpose of application of prudential IRAC norms.

# RBI Circulars on Advances

- Master Circular – Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
- Circular No. 129 dated 07.02.2018



# **LONG FORM AUDIT REPORT**

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# INPUTS

- ⇒ Obtaining knowledge of business of bank/branch - Advances, Deposits, Large borrowers, NPA, CBS, etc.
- ⇒ Review of reports, viz:
  - ⇒ Circulars (interest & Service charges), Credit Policy
  - ⇒ Delegation of Authority & Financial powers
  - ⇒ Branch Audit Report/ LFAR of previous year
  - ⇒ Latest Internal Inspection, Concurrent Audit report, Revenue Audit Report, Stock Audit Reports in case of large advances, System Audit Report, etc.
  - ⇒ RBI Inspection Report, if any
  - ⇒ *Status and level of compliance by the branch, on adverse features pointed out in reports*



# LFAR - Background

- ⇒ LFAR is a detailed questionnaire prepared by RBI.
- ⇒ LFAR has been in use since 1985. Introduced by RBI to overcome the shortfall in Stat. Audit Report to communicate lacunae in operations and internal control system.
- ⇒ Current format is applicable from the year ending **31.3.2003**
- ⇒ To be submitted by the Auditors of Public sector banks, Private sector banks & foreign banks (including their branches)
- ⇒ Management letter /Questionnaire by RBI –Internal Controls Rectification/ Modification and improvement in functioning of bank and branches
- ⇒ LFAR questionnaire is a useful tool for planning the audit

# Major Categories

• Assets	-	46 Questions
• Liabilities	-	6 Questions
• Profit & Loss account	-	5 Questions
• General	-	15 Questions
Total	-	72 Questions

# Basics

- ⇒ **It covers all the areas of branch and end result of efforts**
- ⇒ Study & Plan the work & Professional competence – Thorough understanding
- ⇒ **Shortcomings & Failures** - Give Detailed shortcomings/ weakness areas of the branch. It shall be sufficiently detailed and **quantified**
- ⇒ Acts as **whistleblower** for the irregularities
- ⇒ **Management Report** - Used by the Management, SCA & RBI
- ⇒ Responses to be sorted out before completion
- ⇒ Complete & Submit together – **Main report & LFAR**
- ⇒ Standard on Auditing – Documentation/Internal Controls/Terms of engagement/Relying work on others, etc.

# Basics.....

- ⇒ Not a substitute for the main report
- ⇒ Clarity while replying the LFAR
- ⇒ **Be specific with facts while replying LFAR – Yes/No/NA**
- ⇒ **No vague / general comments & No replica of Last year**
- ⇒ **Answers to LFAR should be specific, clear and unambiguous.**
- ⇒ ***Authentication from Bank Branches***
- ⇒ **Management representation letter -**
  - ⇒ Individual or collective letter
  - ⇒ Primary responsibility of compilation of statements
  - ⇒ Cannot be a substitute for audit evidence
  - ⇒ Does not skips or slips – responsibility
  - ⇒ ***Non receipt of letter***

# Basics...

- ⇒ Main Audit Report and LFAR are two separate reports - no contradictory to each other & Unrelated....
- ⇒ LFAR is not a substitution of the Statutory Report, neither a part of the said report
- ⇒ ***Include audit qualifications in Main Audit Report and not in LFAR***
- ⇒ Every adverse comment would not result in qualification in Main Audit Report
- ⇒ It can be elaborated where ever necessary
- ⇒ Comments in ***LFAR should not be qualificatory in nature.***

# Basics..

- ⇒ Complete LFAR simultaneously alongwith the main audit report
- ⇒ LFAR should be sufficiently ***detailed and quantified*** for expeditious consolidation and rectification by Bank
- ⇒ Main Report should be a self contained document and should ***contain no reference of any point made in the LFAR***
  - ⇒ Audit Qualifications in the Main Report only and not in LFAR

# Basics....Internal control

- ⇒ Evaluate the strength/ effectiveness of internal control systems-
  - ⇒ segregation of duties, roles & responsibilities of staff, exception reports, awareness of circulars and systems.
  - ⇒ Areas of Deficiencies/weakness **identified earlier** - Test Actual transactions
  - ⇒ Checks should be extended in areas of weaknesses - identified **during the course of audit**
  - ⇒ Sampling - Test Check or substantive checking
  - ⇒ Document 'Evaluation of Internal Control Systems' and its effectiveness
- ⇒ Testing Internal Control would also include:
  - ⇒ Accounting Controls - Financial Statements, financial powers,
  - ⇒ Administrative Controls – Policies & procedures

# Documentation

- ⇒ Obtain ***copies of documents*** which have been relied upon, like internal/ concurrent, branch's RBI inspection report, etc.
- ⇒ Document the ***Extent of check*** applied in all the areas and the names of persons who covered these areas of audit
- ⇒ *Proper minutes should be made of important discussions held with the bank/branch management on critical issues and how it was concluded.*
- ⇒ ***Well- documented*** queries and responses should be also placed on record.



# I. Assets

- ⇒ Cash
- ⇒ Balance with RBI, SBI and other banks
- ⇒ Money at call and short notice
- ⇒ Investments
- ⇒ Advances
- ⇒ Other Assets

# 1. Cash

- ⇒ Branches carry cash depending upon the limit fixed by controlling authority
  - Cash balance retention limit as per internal guidelines v. general level of cash balance
  - Reporting of excess cash holding
- ⇒ Adequate insurance cover of the cash in hand & cash in transit
- ⇒ Effective Joint Custody - Some small branches maintain cash in custody of a single official
- ⇒ Cash balance checked at proper intervals
- ⇒ ATM Cash, disposal of soiled notes, etc
- ⇒ Currency Chest/Hand cash
- ⇒ Any transactions of Rs. 10.00 Lakhs & above - CTRs

## Cash – Sample Response

As mentioned in management letter dated \_\_\_\_\_ Head office /regional office vide letter dated \_\_\_\_\_ has fixed cash retention limit of Rs. 20.00 lakhs . On 125 occasions carrying cash is more than retention limit. On 15 occasions it has exceeded Rs. 40.00 lakhs. Excess carrying cash is not reported to controlling authorities.

## 2. Balances with other RBI/Other Banks

- ⇒ Whether ***balance confirmation*** certificates obtained & reconciled
- ⇒ **Cash transactions remaining unresponded**
- ⇒ Revenue items requiring adjustments/ write-off
- ⇒ Item deserves special attention
- ⇒ **Old outstanding balances remaining unexplained/ unadjusted**
- ⇒ ***Ageing analysis of the old entries- more than six months/one year(specific comments)***

### 3. Money at Call & Short Notice

- ⇒ Branch level
- ⇒ Go thru the instructions from HO or controlling authorities
- ⇒ Deviations, if any to be reported

## 4. Investments

- ⇒ Investments portfolio is managed at H O
- ⇒ Kept for safe custody at some branches
- ⇒ Physically verify Investments – Certificate
- ⇒ Dividend/ interest received/ credited to H O account
- ⇒ Matured or overdue investments should have been encashed
- ⇒ RBI guidelines/Bank guidelines regarding valuation of Investments complied with

## 5. Advances

- ⇒ Outstanding amount is in excess of 5% of the aggregate advances of the branch or Rs. 2 Crore whichever is less are LARGE ADVANCES
- ⇒ Appraisals/Review/Monitoring -?
- ⇒ ***Fresh Loans during the year: Whether appraised properly?***
- ⇒ Whether adverse remarks of field officer are over ruled by seniors?
- ⇒ Sensitive Areas identified by RBI: Real Estate/ Securities/ Commodities
- ⇒ Housing Loans

## 5. Advances...

- ⇒ Loans approved by an authority just prior to his/her retirement
- ⇒ Stipulated installments/interests are being paid regularly
- ⇒ Terms and conditions of the loan complied
- ⇒ Credit facilities sanctioned beyond delegated authority or limit fixed by Bank
- ⇒ ***Advances given to a specific group during the year?***



## 5. Advances ...

### Review/monitoring/supervision

- ⇒ Assess procedures for **Periodic balance confirmation/ acknowledgement of debts.**
- ⇒ Analysis of accounts overdue for review/renewal between 6 months & 1 year and over 1 year
- ⇒ **Stock/debts statements** and other periodic operational data and financial statements etc received regularly from borrowers and duly scrutinized
- ⇒ **Physical verification** of securities charged to banks
- ⇒ Frequent/ unauthorized overdrawing beyond limits
- ⇒ Branch identified and classified advances into standard/sub-standard/doubtful assets as per RBI

## 5. Advances... Critically Scrutinise

- ⇒ Sanctioning
- ⇒ **List of non-corporate borrowers enjoying limits over Rs. 10.00 Lakhs**
- ⇒ Inadequate Insurance, Over drawings, Fall in DP and security
- ⇒ DICGC/ECGC claims lodged or not
- ⇒ Valuations once in three years (including NPA)
- ⇒ Devolvement/ Invocations
- ⇒ Sanctioning huge non-fund based limits without proper margins
- ⇒ Credit card outstanding
- ⇒ Debit balances in SB & CA
- ⇒ Debit balances in Sundry Deposits/Clearing difference a/c, Suspense Accounts

## 6. Other Assets

### a) Stationery and Stamps

- ⇒ Internal control over issue and custody of security items like TDRs, Drafts, Payorders, cheque Books, Gift Cheques
- ⇒ Periodical verification
- ⇒ **Internal/Concurrent Auditors- whether checking**
- ⇒ Cases of missing/ lost items of such stationery
- ⇒ Issuance of security to items to persons other than accountholder
- ⇒ **ATM Cards/PIN – Register, custody, segregation of duties**

## b) Suspense Accounts, Sundry Assets

- ⇒ **Suspense account/ Sundry Deposit account –**
  - ⇒ adjustment accounts - temporarily posted & authorization is pending for approval
  - ⇒ Upon authorisation – are reversed
- ⇒ Ledger scrutiny of suspense accounts to be seen – Year-wise break-up & Analysis
- ⇒ Check the nature of entries parked in such Accounts
- ⇒ Check any movement in such old balances and whether the same is genuine and has been properly authorized by the competent authority
- ⇒ **Squared off during the year & any provisions**
- ⇒ Check for any revenue/expense items lying in such accounts and whether proper treatment has been given for the same

## **II. Liabilities**

- 1. Deposits**
- 2. Other Liabilities**
- 3. Contingent liabilities**

# 1. Deposits

- ⇒ New Accounts opened & soon closed
  - ⇒ KYC norms & Anti Money Laundering Act
  - ⇒ Heavy transactions during a period
  - ⇒ Trace entries to see final deposit or withdrawal in which account and report
- ⇒ Inoperative Accounts
  - ⇒ Letter of request with signature
  - ⇒ Branch manager authentication
  - ⇒ Verify withdrawal entries, if authorised
  - ⇒ Accounts of different parties proposed by a single person/ Group
- ⇒ Unusual large movements in the Deposits - Clarify
- ⇒ **Overdue/matured term deposits at the year end**

## 2. Other Liabilities

### Bills Payable/Sundry Deposits, etc

- ⇒ Adjustment accounts in which certain credit transactions are temporarily posted whose authorisation is pending for approval
- ⇒ No. & Aggregate amount of old outstanding entries -
  - ⇒ Any unusual items or debits in the accounts
  - ⇒ Obtain a year-wise break-up – three years & more
  - ⇒ Obtain details of each old entry – as per format
  - ⇒ Whether Register maintained for such entries?
  - ⇒ Check movement in old entries and its authorisation

### 3. Contingent Liabilities

- ⇒ List of major items & whether branch is having system & records
- ⇒ Eg. are
  - ⇒ Litigation cases against branch for claims of Govt
  - ⇒ List of cases filed against the branch by the customers in consumer court etc
  - ⇒ Any other demand by others
  - ⇒ Cases are clear- accounting liability must be disclosed
- ⇒ All need to be included in the list
- ⇒ Obtain management representation letter from the branch



### III. Profit & Loss Account

#### ⇒ Interest on Advances:-

- ⇒ **Test Check - Software Calculations.** Manually check and compare results with software generated results, change of interest rates/Master data (circulars)
- ⇒ If errors observed, whom does it benefit – a few borrowers/ group?/Penal Interest (Revenue Audit)

#### ⇒ Interest on Deposits:-

- ⇒ Test check if errors benefit a few depositors/ group
- ⇒ Estimating & providing interest accrued on overdue/matured deposit – See Bank's policy
- ⇒ Effect of changes in accounting policies on items income and expenditure – Material amount

#### ***Internal Inspection/Concurrent Audit Report***

### III. Profit & Loss Account

- ⇒ Commission Income
- ⇒ Check sudden spurt in Commission income: From Guarantees/ LCs?
- ⇒ Whether rates of commission are normal?
- ⇒ Check sanctions, invocations, devolvment's-Interest applied? – **Higher ROI**

# PROFIT & LOSS ACCOUNT - Verify

- ⇒ Excess / short credit/ debit of interest & commission - Debit balances in income account and credit balances in expenses account
- ⇒ Determine whether the discrepancies noticed are intentional or by error
- ⇒ General or in respect of some specific clients
- ⇒ Proper authority in sanction and disbursement of expenses
- ⇒ Check accrual of income/ expenditure especially for the last month of the financial year
- ⇒ Divergent trends in income/ expenditure

# III. Profit & Loss Account

## Divergent Trends:

- ⇒ Interest to deposits/ advances compare current year with previous year
- ⇒ Co relate the total interest paid on average deposit figures & total interest income to total average advances
- ⇒ Where divergent trend is observed, obtain an explanation along with supporting evidences like monthly average figures, composition of the income/ expenditure, etc and comment
- ⇒ Check System to detect discrepancies in interest/ discount and for timely adjustment thereof
- ⇒ If discrepancies exist in many cases, consider its impact and ascertain qualification in auditors report?

# IV. General

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## 1. Books and Records

Manual

Computerised Bank & Bank Branches

- ⇒ All reports are generated regularly and duly signed
- ⇒ **Exception reports – Beyond powers, Inoperative accounts, overdue balances reports, TOD's, Clearing TOD's, Changes in Master data for advances**
- ⇒ Back up & offsite storage facility – branch level screen objects (front end screens web pages)/network fails – offline mode deposits/withdrawals-EOD GL accounts balances
- ⇒ **Contingency & Disaster Recovery plans (BCP) –**
- ⇒ **Owners/BM Manual – sign off**
- ⇒ **BCP -**
- ⇒ **Anywhere/anytime banking**
- ⇒ Access & data security measures-
- ⇒ Adverse report in Computer audit report- whether rectified
- ⇒ Login ID & Password deleted – for the staff left the branch
- ⇒ Facility of change password
- ⇒ Inoperative accounts – Proper authorisation

# IV. General...

## 1. Books and Records

- ⇒ Improvements –
  - ⇒ Anti virus(FLD)
  - ⇒ Users passwords
  - ⇒ Router – kept under closed area/general public
  - ⇒ No games or pirated software
  - ⇒ USB port
  - ⇒ Maintenance report from system for uptime
  - ⇒ Battery filled/UPS/generators maintained-Small Branches
  - ⇒ A/C cooling – system, dust free, heatfree, cool

## 2. Reconciliation of Control and subsidiary records

# Auditing in CBS .....

- ⇒ No visible audit trail
- ⇒ Walk thru of the transactions – from start to end and document
- ⇒ Inadequate segregation of duties and risk to integrity of data
- ⇒ Check rights of access – to staff members & its level
- ⇒ Computer generated “*Error Reports*” to verify accuracy of interest rates, date of NPA, etc, if available
- ⇒ *System suspense entries* - – are parked in CDM, suspense a/cs
- ⇒ *Exceptional reports*
- ⇒ Check whether the recurrence of such discrepancies is general or in respect of some specific clients
- ⇒ Auditor to go to root cause of the problems

### 3. Inter-Branch accounts

- ⇒ Branch forwards on a daily basis to a designated cell / Head office, a statement of debit/credit transactions in relation to other branches
  - ⇒ **Fraud Area –**
  - ⇒ Look for large volume of Inter Branch Transactions
  - ⇒ Large number of un-reconciled entries
- ⇒ Outstanding debts in the head office account in respect of inter-branch transactions – Provisioning/ reversal
- ⇒ **Isolated old/large outstanding transaction/entries as at the year end which remained unexplained**
- ⇒ Major adverse comments rising out of the latest reports of the previous auditors, concurrent auditors, stock auditors or internal auditors or RBI inspectors.



### 3. Inter-Branch Accounts...

- ⇒ Whether the branch responds promptly to error advices received from H.O.
- ⇒ Whether the branch is vigilant about expeditious clearance of high-value entries?
- ⇒ Whether IBR statement are regularly received from HO & promptly attended?
- ⇒ Whether branch has written details on IBR statement for pending entries?
- ⇒ Test-check IBR statement to ascertain existence of high value items
- ⇒ Whether originating debit entries/ cash transactions are liquidated within a reasonable period of time?

## 4. Audit/Inspections

- ⇒ Is the branch covered by concurrent audit/internal inspection
- ⇒ Major Adverse comments of above reports in LFAR

## 5. Frauds:

- ⇒ *Particulars of frauds discovered during the year* together with recommendations to minimize recurrence - Obtain register of frauds
- ⇒ Recommend ways and means to minimize occurrence of frauds

## 6. Miscellaneous

- ⇒ Does the accounts indicate possible window dressing? – Year end deposit & advances
- ⇒ Does the branch maintain records of all fixed assets acquired-
  - ⇒ Do not purchase at branch levels
  - ⇒ **Records to be maintained + depreciation**
  - ⇒ Inter-branch transfer - Whether accounted properly?
  - ⇒ Assets in employees residences, shifted alongwith transferred employees
- ⇒ Other matters for consideration of management/ RCS's-
  - ⇒ Notes to accounts –Particulars of Restructured accounts/Exposure to reality sectors/Exposure to Priority sectors/Prior period items, etc
  - ⇒ House keeping/documentation/registers/Security arrangement

# Foreign Exchange Transactions

- ⇒ Material adverse features pointed out in various reports
  - ⇒ Concurrent auditors, internal auditors, RBI's inspection report
- ⇒ Deposits, Advances, export bills, bills for collection, etc.
  - ⇒ As per circulars issued
- ⇒ List of Nostro accounts-
  - ⇒ Kept with overseas branches/other banks abroad-Check reconciled periodically or not
- ⇒ List of Vostro accounts-
  - ⇒ Kept in Indian branches by overseas branches/foreign banks-Check reconciled periodically or not

# Asset Recovery Branches

- ⇒ Advance account more than Rs. 2.00 Crore - comments
- ⇒ Accounts upgraded from Non Performing to Standard during the year and reasons therefore –
  - ⇒ Ensure that accounts are upgraded only after proper and adequate recovery in the account
- ⇒ List of recovery & their agewise analysis –
  - ⇒ appropriations against interest and principal
  - ⇒ accounts closed/settled/written off during the year
- ⇒ List of new borrower accounts transferred to the branch – all related papers/documents/confirmations

# Service Branches

- ⇒ Periodic review of the outstanding
- ⇒ Any unexplained – old/large/unusual outstanding entries
- ⇒ Agewise break up – in number & value as per format
- ⇒ Guidelines followed of controlling authority

# Some Formats

- In our opinion and as per the explanations and information given to us, the branch has identified and classified advances in line with RBI norms subject to our comments and observations in Annexure ...
- As per the explanations and information provided to us and based on our test check basis it appears prima facie that bank ensures control over issue and custody of stationery comprising of security items i.e. Term Deposits Receipts, Drafts, Cheque Books, Travelers' cheques, Gift Cheques, etc.
- We have obtained from the management a statement explaining divergent trends in I&E in cases where the variance between the CY & PY figures differs by 20%. The explanations given by the Management regarding the variations are found to be satisfactory.
- The regular back ups have been done at the branch. As explained to us, offsite storage is not maintained as per the guidelines of the controlling authorities
- Fully under core banking, no such separate register maintained.

# Some Formats.....

- On test check basis, we found that there is no significant material differences in following guidelines laid by the controlling authorities of the bank.
- As per the explanations and information given to us and in our opinion, on our test checking the branch has compiled with the income recognition norms prescribed by the Reserve Bank of India
- On test check basis and as per the explanations and information given to us, the branch does not have system of estimating interest on overdue/matured term deposits.....
- On test check basis and as per the explanations and information given to us, there are no divergent trends in major items of income and expenditure. The trends in interest earned on advances and interest paid on deposits is given in ANNEXURE – B We have obtained from the management a statement explaining divergent trends in I&E in cases where the variance between the CY & PY figures differs by 20%. The explanations given by the Management regarding the variations are found to be satisfactory



# Execution of Work

- ⇒ Execution must be done as per the Audit Programme
- ⇒ Obtaining Audit Evidence and Management Representations, where ever applicable
- ⇒ Audit working papers - complete
- ⇒ *Simultaneous compilation of data(checklist, etc)*
- ⇒ *Timely discussion and rectification of queries*

*Queries, IF ANY*

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*Thank You*

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