Handbook on Bank Branch Audit

CA P.R. Suresh
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This handbook is neither a technical publication on audit nor a technical publication on banking. It is an exercise in compilation of the various issues which the author has come across in the course of professional engagement and interactions with the members of this esteemed profession. The readers and users of this book are requested to look into the relevant Statements, Standards and Technical Publications issued by The Institute of Chartered Accountants of India regarding Auditing and the Reserve Bank of India for guidelines relating to banking, including circulars, notifications and other directives to banks to comply with the requirements of the Banking Regulation Act, 1949.

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Preface

Bank branch audit, is one of the most important assignment in a practising Chartered Accountants’ yearly calendar, more than 90% of those in practice are involved in this annual exercise, thus it speaks volumes for its emphasis. In this book an attempt is made to cover the practical aspects involved in the audit of bank branches, which I hope will be found useful to the readers/users of this book.

CA Sudha Suresh has been a constant source of motivation and always encouraged me in my professional endeavours. My partner, CA K. Anand, has been a pillar of strength for me and has encouraged me to author this book.

It was in March 2005, CA Rajgopal and CA Shivamohan called me, at the recommendation of CA H. Anil Kumar to be a resource person for the Bank Audit Seminar at Udupi. Just three months prior to that, the first stokes were ignited by CA S. Venkataramani, who chided me saying that I am wasting my ability, being in the back stage and should move forward as a speaker, I had then promised him that, I will become a resource person shortly and thus began my role as a Speaker on bank branch audits.

Starting at Udupi Branch at the behest of CA Devanand, in the past 7 years, most of the branches in the Southern Region have given me an opportunity to deliver lectures on bank audit. What started off with practical issues on audit of advances, moved over to areas other than advances, walk-through of a bank branch audit, accounting standards in bank branch audit etc. Not to be left behind are the CPE Chapters in Bangalore, Davangere and Gulburga whose invitations motivated me to reach out to their members. In the journey of being a resource person, I have fine tuned my understanding of the subject, sharpened my skill sets with the interactive sessions and quick fire questions of the members of this learned profession, enabling me to become better informed and more knowledgeable.

And came CA Anant Mutalik, President of KSCAA, asking me to pen this Handbook on bank branch audit, and I readily agreed. Shri. S. Muralidharan combined his more than 3 decades of experience as a banker, by meticulously combing through the material and providing valuable suggestions. The invaluable inputs given by CA Allama Prabhu M.S, and CA S. Pattabiram deserve special mention.

I particularly wish to place on record my deep sense of appreciation and gratitude to CA Prabhudev S. Aradhya and his Senior CA Shivarama Prasad, CA R Sundararajan, CA D Venkataraman and CA A. V. Pal who permitted me with materials to use in this book and CA H.C. Gulecha for his contributions.

I am indebted to CA C.P. Ethirajan whose mentoring, has enabled me to be what I am today. As far as bank audit, it is the baby steps carefully taught to me by Shri. M. Balasubramaniam, pouring over the records of a branch for 3 weeks continuously which fascinated me to take interest on this subject matter in 1985.

I thank M/s. Indian Bank and M/s. Lakshmi Vilas Bank for their contributions, M/s. Sumukha Technologies and M/s. Paramount Colour Graphics for burning midnight oil to bring this book on time. I also thank all other who have contributed directly and indirectly.

Lastly, I do believe ‘to err is human’, therefore I will be grateful to those who will be kind enough to give me their feedback and point out error(s), if any, that may have unknowingly crept in while authoring this handbook.

Place: Bangalore

CA P.R. Suresh
Foreword

CA. S.Krishnaswamy

The Reserve Bank of India, the country's Central Bank, has the exclusive power of granting license for banking, and through that power it directs and oversees the operations of banks. Banking is a unique intermediation function where public money is collected and lent (channelised) for productive sectors of the economy. An audit of such business has as its first requisite the “Knowledge of the Business”. Audit functions are circumscribed by specific standards of which Knowledge of Business is one (AAS 20). Second, the directions of RBI are contained in a series of circulars concerning the various aspects of operations - accounting and reporting that covers both internal and external controls. This requires that the auditor is aware of all the relevant circulars.

Third, every audit requires a plan - macro approach and Audit Programme - micro details of verification, evidence, materiality, analytical procedure, sampling, additional consideration for special items and documentation of such plan and programme, keeping the working papers open to peer review. Lucidly written and practically sequenced the book covers several of these aspects and is a hands-on guide to a practicing CA. Fourth, the LFAR and annexure lay down the minute audit reporting process. LFAR has as its object – a focus on systematic issues and is a lead to the structure of Plan and Programme. Fifth, the type of evidence required in banking envisages basic understanding of several connected legislations and assessment of the powers of bank authorities.

The learned author refers to specific issues on reporting and also looks at tax audit report requirements. A bank that does mostly intermediation function can never be in the red. Its accountability for public funds comprising of capital adequacy – sound asset-liability management, provision for generated 'toxic assets' called NPAs, statutorily prescribed asset classification, avoidance of “greening or camouflage of any variety”, income recognition, have over the years been caught by the RBI’s inspection lens revealing scams. For non-recurrence, RBI has dexterously woven its various directions into the texture and tapestry of controls.

The author’s experience and competence, evident in the book, help the readers in coping with special skills, covers comprehensively compliance with the RBI directions, cogently sequences and explains the verification steps, collects audit standards on planning, documentation, programming, quality control, representation from management, clinically examines the contents and issues of reporting through LFAR, portraying as it does the critical role the members of our profession play in this important statutory function.

My congratulations to the author and commendations to the readers.

CA S. Krishnaswamy
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1. INTRODUCTION

1.1 Role of Banks in Indian Economic Scenario:

Banking is the engine of growth in any economy, more so in India, where due to its diverse background, practices, cultures and large geographic dispersion of citizens, it has played a very vital and significant role in the development of the economy.

Reserve Bank of India vide its policies on priority sector lending to the agricultural, small and medium enterprises ensured availability of banking facilities and finance for such important segments of the society, resulting in uniform and planned development of more than 60% of the Indian population who have been either directly or indirectly employed in these segments.

The financial inclusion plans of the banks covers majority of the Indians under banking, either in the form of depositors having savings bank accounts or deposit accounts, or as borrowers. Indian banks, while true to their definition of being engaged in the core areas of “acceptance for the purpose of lending” have achieved the twin objectives of mobilising the savings of the citizens, which is around 37% of the GDP as well as lending for the purposes of economic utility, resulting in increase of the Per Capita income of beneficiaries.

The social schemes such as PMRY, SEEUY, DRI, subsidised loans to agricultural sectors have brought the borrowers into the fold of the organised banking industry, releasing them from the clutches of money lenders who used to charge exorbitant rates of interest, and have thus served a social cause. Ever since the banks stepped in with the social objectives of the Government to be met, it has transformed the canvas of banking.

The most noticeable part of the Indian banking industry is the security based, collateralised lending, participation of the borrower by way of him bringing in his margin leading to sound banking practices, which distinguished it from the western banking practice of loans with high degree of risks not supported by adequate securities.

The introduction of the Narasimhan Committee’s recommendations on Income Recognition, Asset Classification and Provisioning Norms brought in uniformity and stability to the reported financial statements by the banks. To their credit Indian banking industry successfully withstood the onslaught of the global economic meltdown primarily in the financial sector.

Thus, banking has provided the fulcrum of support to the Indian industries to grow global by providing the financial assistance, after a careful appraisal of the proposals, approved by competent authorities, followed by proper post sanction monitoring and recovery by executives.

Reserve Bank of India’s policies of maintenance of Cash Reserve Ratio, Statutory Liquidity Ratio, Repo Rates, Reverse Repo Rates, Capital Adequacy norms and other controls have significantly strengthened the Indian banking system to comply with the BASEL II norms and has resulted in a robust banking industry ready to challenge the world with its growing competencies.
1.2 History of Bank Audits (including Branch Audits):

Bank audits are governed as per provisions of Sub-Section (1) of Section 30 of the Banking Regulation Act, 1949, which requires that the Balance Sheet and Profit & Loss Account of a banking company be prepared in accordance with the Third Schedule to that Act, to be audited by Chartered Accountants as provided for in Companies Act, 1956, including the Public Sector Banks, State Bank of India and its subsidiaries, Urban Cooperative Banks and Regional Rural Banks. State Bank of India Act specifically provides for Joint Auditors, providing that the affairs of the banks shall be audited by “two or more auditors”.

Audit of bank branches is required as per provisions of Section 228 of the Companies Act, 1956. It is thus obligatory for banks’ branches to get the financial statements duly audited, except where exemption from audit is permitted under the Companies (Branch Audit Exemption) Rules, 1961, as per the guidelines of Reserve Bank of India issued from time to time.

Bank Nationalisation and extending the branch network by the Public Sector banks has created around 65,209 bank branches in the country, apart from which there are 8 Private Sector Banks with 7,089 branches and thus the increased opportunities of bank branch audits to the members of the profession.

Reserve Bank of India, had fixed the limit of Rs. 300 lakhs advances of the branch as a benchmark, below which Statutory Branch Audit was not mandated. Which during the current year the Working Group on the selection of branches for 2011-12 has proposed that Statutory Branch Audit of PSB’s may be carried out:

a. For SBI and other large PSB’s with aggregate business (advances + deposits) of Rs. 4 lakhs Crores and above, would cover all branches with advances of Rs. 50 Crores and above and one fifth of the remaining branches covering rural, urban, semi-urban, metropolitan branches, predominantly including branches which are not subjected to concurrent audit.

b. For all other PSB’s all branches with advances of Rs. 30 Crores and above and one fifth of the remaining branches covering rural, urban, semi-urban, metropolitan branches, predominantly including branches which are not subjected to concurrent audit.

c. Subject however, that a minimum of 85% of advances of a bank would required to be covered by branch audits.

The final word on the actual limit is yet to be decided and finalised by the Reserve Bank of India, which may be bank branches with advance portfolio of Rs. 20 Crores and above.
Thus the bank branch audits which was a wide opportunity for the members of the profession from Kashmir to Kanyakumari from Mizoram to Mumbai is set to shrink in size. Branch audits however will continue, given the criteria of Reserve Bank of India that least 85% of the total advances of the banks being covered under Statutory Audit.

1.3 Role played by the members of the Profession

Our members have been playing a very proactive role in the Audit of bank branches. They update their skill sets required for carrying out the bank audit assignment by regularly attending Seminars held by the Branches / Study Circles / Regional councils of the ICAI.

The Branch audit being an important feature, has always captured the interest of the members for its allotment.

The strength of the Banking Industry in India, significantly owes to the Regulator, viz. the Reserve Bank of India, who have been having a very close watch by way of effective supervision. As part of it, Reserve Bank of India has entrusted the role of watch dog to the members of our profession, who have accredited themselves well. The proof of this was amply evidenced during and post the global meltdown, when the Indian Banking Industry was a stellar exception.

Application of accounting norms, principles, standards and helping the management of banks in complying with all of them have been noted and appreciated by the Reserve Bank of India. The Annual Financial Reviews of RBI generally revealed less than 10% divergence for many years. However recent reports are not very encouraging, a sure sign to be aware of. It is pointed out that audit of some branches needs to be more effective to achieve the purpose of audit.

This coupled with the public sector banks being listed on the stock exchanges, the need to complete the audit and report results within short time has made the bank managements to look at having reduced number of statutory branch auditors to co-ordinate at the time of finalisation of the bank’s balance sheet during April/ May. Cost considerations also have warranted setting up of Working Group.

The audits done by the branch statutory auditors gives comfort and confidence to the Central Statutory Auditors of the bank, apart from the reliance they are able to place on the true and fair view of the branch financial statements, also in terms of the operating parameters such as existence of compliance of the systems, processes, procedures and reporting mechanism as laid down, physical controls on cash, valuables and security documents, post sanction monitoring etc. The Certifications, Tax Audits and reporting in Long Form Audit Report by the branch statutory auditors are providing a great deal of support, in forming the opinion by CSA’s about the overall efficacy and effectiveness of the controls at the branches.
The branch auditors’ visit to the branch and conducting audit also acts as a check and balance for the Central Statutory Auditors and Bank Management that no fraud or other impairments are happening at the branches.

1.4 Future of Bank Branch Audits

The changes in the banking scenario due to moving over to Core Banking System and Technology based operations have enabled the banks to reach customers, provide seamless transactions with lesser dependence on physical applications.

This has meant that the core functions at the branches, such as loan processing and sanctioning, safe keeping of security documents, post sanction monitoring and supervision of borrower’s accounts, accounting of day to day transactions, receipts and payments of cash/cheques, updating passbooks or statements are all either centralised or made online or with the use of ATM’s. Even the space requirement and manpower requirement for banking is progressively getting reduced. In such a scenario, the accounting for all transactions of the banks being from a central server, otherwise known as CORE, is changing the face of bank branch audits.

Reserve Bank of India, on the basis of the representations made by the Indian Banks Association is contemplating increasing the limit for audit of bank branches from the existing Rs. 300 lakhs upwards. What is very clear is that in future the bank branch audits are likely to be scaled down. Whilst this is not a good news for members in practice in general, it is a distinct disincentive for younger members / newly qualified members to take to practice.

The further enhancement of limits for branch audit can only be contained if we take a serious note and continue to act with an independent and professional approach. Use of technology in bank audits, procedures to identify and report frauds or transactions of different shades, qualitative reporting in LFAR and Tax Audits, reporting Memorandum of Changes(MOC) wherever necessary and required will showcase the indispensability of the bank branch audit function rendered by us to the Banking Regulator and by delivering value proposition to the bank management and stake holders.

In the Indian context, while the limits may undergo changes over a period of time, Bank branch audits may continue with significant up-scaling.

It is in the interest of all stakeholders, that the system of appointment of bank branch auditors should be done well in advance, warranting the audits to be more effective, instead of being confined / restricted to the first week after the end of the financial year under audit.

Ideally the branch auditors should undertake a preliminary audit of bank branches during January / February of each year to include, the reports on all matters which have no relevance to the financial year end, such as:
• Physical Inspection of large borrowers’ accounts
• Testing of internal control aspects mentioned in the Ghosh and Jilani Committee Reports
• Documentation and operational deficiencies
• Review of large accounts and whistle blower exercise.
• Identification of sick and potential NPA accounts to enable managements to take effective remedial steps before conclusion of the financial year.

1.5 Expectations of various stakeholders from Statutory Branch Auditors of banks.

1.5.1 Bank Management:

Banks attach prime importance to statutory audit and preparation for the audit is a structured process consisting of allocating branches to auditors, briefing branches in small clusters about the do’s and don’ts, reporting discipline, action on MOC and expected time lines for audit completion. In many cases, a preliminary scrutiny of accounts is undertaken in order to identify and decide on the treatment of cases of ambiguous classification. The concerns of the banks in this area are:

i. Whether the audit will commence and conclude on schedule – It is customary for the banks to decide on the tentative date for bringing out their annual results, all audit activity to be completed within time limit, leaving time for finalization of results. This does put pressure on auditors, but they have also conditioned themselves to this requirement of banks.

ii. Whether the auditor has familiarized himself with the bank’s significant accounting policies, internal guidelines on different aspects, internal notes, information emanating from branch and management response thereto, problem areas etc.

iii. Whether the audit will be conducted in a harmonious atmosphere, meeting the infrastructural and information needs without delay, and the auditor is planning his requirements in a methodical manner.

iv. Whether the bank could expect a generally ethical and professional approach. This is an area of subjectivity, but auditors have generally been found to be reasonable within the limits of their professional authority and responsibility.

v. Whether the auditor is able and willing to guide bank staff in the interpretation of guidelines and bringing risky situations or practices of the branch to the knowledge of the management, with guidance wherever possible.
The above will enable us to construct the role of an auditor insofar as bank audit is concerned. This is attempted in the following sections, organized in the order of importance.

i. The auditing team is an efficient unit which acts upon the assignment letter promptly, visits the branch allotted, participates in pre audit meetings and understands the accounting ‘topography’ of the branch, and is generally well prepared to complete the audit on schedule. This will lead to the auditing team perusing the relevant files, inspection reports, control returns and documents in advance of the commencement of the audit, and familiarize themselves with the IT System.

ii. Conclusions regarding accounts in general and individual cases would be arrived at based on the extant regulatory guidelines, the bank’s views on the transactions and an understanding of the real nature of the transactions or situations. This is a very important aspect because the risk of a loan loss cannot be decided on accounting events alone but on the basis of a study of the account in totality. Any decision to classify solely on the basis of a calendar of events would be inappropriate. Some banks have the practice of preparing internal notes on cases of ambiguous classification of accounts, setting out the history of the accounts, the market in which the customer operates, the transaction in question or account status, and advising the reasons for treating an account as standard or otherwise. Bankers will be bankers, given the pressure that they are subject to, and auditors are bound by their professional compulsions. Without suggesting that ever greening or incorrect asset classification should be allowed, it is submitted that the auditor, given his time constraint and limited exposure regarding the account must keep an open mind and study the submissions of the branch. If this is not done, good borrowers would also stand classified and affected as NPAs accounts. What is important is a balanced view on the account. Such decisions by the auditors must be taken with conviction, so that if a transaction is questioned at a later date, the auditor must be able to stand his ground and not submit to undesirable pressures. This is a very important role for the auditor and demands considerable maturity and balanced judgement on his part.

iii. Ability to guide branch and head office functionaries in aspects of risks involved in certain transactions or accounts or procedures in the bank. An auditor who is able to act as a guide and counsel (rather than as a fault finder without diluting his professional responsibility) would be able to command respect of the bank.

iv. It is in the interest of the bank and the auditors to maintain grace during the course of the audit. On Conflicting issues which may crop up during audit, calls for assertiveness rather than aggression on the part of the auditor and bank official.
There are number of instances where the auditors and bankers would have gained by introspecting on their actions and remarks.

v. The reporting of possible fraud in an account or transaction deserves to be mentioned. It is suggested that the auditor concerned discusses the matter with the Central Statutory Auditor before coming to a conclusion. This will facilitate a report based on a holistic view of the account or transaction.

vi. The matter of noting qualifications on the financial results is a tricky area, as it has far reaching implications for the bank concerned. This is an area which requires tact and accuracy on the part of the auditor. Fortunately, the Central Statutory Auditors have the maturity to draft this area after discussions amongst themselves, the branch auditor and with the top management of the bank concerned such that differences are resolved in a healthy and professional manner.

vii. Finally, the Long Form Audit Report, which provides critical information on the systems and procedures, and practices at the branches is a very important document for the bank. Auditors generally do this exercise with diligence.

1.5.2. Reserve Bank of India:

The branch statutory auditor’s report together with the Long Form Audit Report and various certificates, should reflect the status of the branch in terms of its operations, financial results and the health of its portfolio of loans and advances, specific instances and weaknesses account-wise for taking proper remedial action by the higher authorities of the bank on implementation of internal controls, fraud, off balance sheet items including contingent liabilities etc.,

The Reserve Bank of India can draw comfort that professional scepticism has been exercised by the branch statutory auditor and the affairs at the branches are conducted in an acceptable and reliable manner as stipulated.

Reserve Bank of India looks to the audit fraternity to directly report frauds above Rs.100 lakhs or transactions which are suspicious or which may be in the nature of money laundering for speedy action from their end.

1.5.3 Various statutory authorities:

Tax Audit : Taxation authorities rely on the information provided by the Chartered Accountants in Form 3 CD. Central Statutory Auditor place reliance on the branch auditors reporting after verification of records that the statement of particulars furnished in the Form 3CD at the branches is true and correct.
**Service Tax**: The collection and remittance of service tax on applicable services is an area which the branch auditor will be reporting as part of the branch audit. Service Tax authorities may rely on the information certified by the branch auditor in this regard.

1.5.4 **Shareholders of Banks:**

They are generally concerned about the financial health of the bank and look forward to the branch auditor to bring out issues which could be having an impact on the operation or profitability of the bank including frauds or incidence of NPA of large advance accounts.

1.5.5 **General Public**

The confidence of the general public in the banking system is significantly enhanced due to the branch audits, which ensures that there are adequate checks and controls in banking institutions to put their hard earned monies as deposits in banks.

2. **Gist of RBI Master Circular on Income Recognition, Asset Classification and Provisioning Norms**:

The Regulatory Norms are prescribed by the Reserve Bank of India. As stated earlier, the Indian banking industry operates under the supervision of its Regulator, which codifies the various parameters for Indian Banks, classifying them into Public Sector Banks, Private Sector Banks, Regional Rural Banks, Urban Cooperative Banks and Foreign Banks, further into Scheduled Banks and others, laying down prescriptions.

The functional parameters such as Cash Reserve Ratio, Statutory Liquidity Ratio, Repo and Reverse Repo Rate, adherence to Capital Adequacy Norms, Provision of Risk Weights to balance sheet and off balance sheet items and adherence to a liquidity monitoring system vide Asset Liability Management are prescribed for all banks in India.

In terms of the health of the banking industry, pursuant to the Narasimhan Committee’s report, as per Reserve Bank of India’s directions, banks have implemented the Income Recognition, Asset Classification and Provisioning Norms (IRAC) for advances portfolio, so as to move towards greater consistency and transparency in recognition, measurement, accounting, presentation and disclosure in the published accounts.

The IRAC norms as they have popularly come to be known, have moved from the initial recognition of 365 days from past due date to the current 90 days from the date of overdue and provisioning has become more stringent and conservative, with an overall Provision Coverage Ratio (PCR) of 70% of NPA's for banks.
The Reserve Bank of India has laid down the norms on Non Performing Assets, Classification and Provisioning as follows:

A Non Performing Asset is a Loan asset, which ceases to generate income for the bank. A Non Performing Asset (NPA) is a loan or an advance where;

i. interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan, or

ii. the account remains ‘out-of-order’, in respect of an overdraft/cash credit where outstanding balance remains continuously in excess of the sanctioned limit/drawing power, OR where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, or

iii. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted, or

iv. the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops, or

v. the instalment of principal or interest thereon remains overdue for one crop season for long duration crops

Banks should classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter, and not from the date on which it is charged (currently banks charge interest on month ends).

Hence the branch auditor should call for the terms of sanction of the loan accounts, peruse the operations there in, ensure whether the repayments of interest and instalment are regular as stipulated in term loans/demand loans or operations in cash credit and overdraft accounts are as per norms of being regular in servicing the interest, operations are carried out within the sanctioned limit/drawing power.

2.1 Asset Classification:

Banks are required to classify Non performing assets into:

i. Substandard Assets
ii. Doubtful Assets
iii. Loss Assets

based on the period for which the asset has remained Non performing and the realisability of the dues.
i. **Substandard Assets**

With effect from 31 March 2005, a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months.

ii. **Doubtful Assets**

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets making collection or liquidation in full, on the basis of currently known facts, conditions and values highly questionable and improbable.

iii. **Loss Assets**

A loss asset is one where the threat of loss has been identified by the bank or internal or external auditors or the RBI inspection and the realisable value of security is less than 10% of the outstanding amount.

### 2.2 Guidelines for classification of assets

Classification of assets should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realisation of dues.

Banks should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value accounts.

The branch auditor should obtain the statement of Loan accounts, verify whether the asset classification is done correctly with reference to performing and non performing advances. Where such borrowers accounts fail such test of a performing advance, the branch auditor should ensure the asset classification is Non performing and proceed to determine whether it is Sub Standard or doubtful, based on the elapse of time from the original date of NPA, the further classification as D1, D2 or D3 is to be ascertained.

**Availability of security/ net worth of borrower/guarantor**

The availability of security or net worth of borrower/ guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise.

However, where there are potential threats for recovery on account of erosion in the value of security or non availability of security and existence of factors such as frauds committed by borrowers it will be prudent to classify the same as doubtful or loss straightaway instead of going through the various stages of classification.
The branch auditor should review the loss which may arise to the bank due to inherent weakness in the borrowers account, mere existence of security alone will not entail the account as a standard asset. Wherever threat of recovery exists the branch auditor should proceed to classify the account accordingly as per norms stated above.

**Accounts with temporary deficiencies**

The strict adherence to the concept of DP has brought certain practical difficulties in asset classification; due to delay in submission of stock statements or non renewal of accounts after the term, such deficiencies warrant reclassification of regular and good accounts into Non performing; considering the realities of such situation, Reserve Bank of India, has defined accounts with temporary deficiencies to eliminate arbitrariness and to ensure uniformity, as follows.

The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies, banks may follow the following guidelines:

i) Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. DP is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power 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 even though the unit may be working or the borrower’s financial position is satisfactory.

ii) Regular and adhoc credit limits need to be reviewed/ regularised not later than three months from the due date/ date of adhoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ adhoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of adhoc sanction will be treated as NPA.
The branch auditor while considering the temporary deficiencies arising out of non renewal of limits or non receipt of stock statements should where it exceeds 180 days proceed to classify such accounts as non performing without any further consideration, as they are not to be treated any more with temporary deficiencies.

**Upgradation of loan accounts classified as NPAs**

Accounts which were classified as an NPA due to arrears of interest and/or overdue principal, once paid by the borrower should no longer be treated as non-performing and maybe classified as ‘standard’ accounts.

The branch auditor should exercise care while analysing the movement of NPA to ensure that Upgradation of NPA’s to Standard assets are done strictly on the basis of recovery in the loan account out of genuine sources and not by way any other loan or accommodation by the bank for those classified in the earlier year and by perusing the operation in the account for accounts classified and upgraded during the current year.

**Accounts regularised near about the balance sheet date**

Auditors should pay special attention and care where borrowal accounts with a solitary or a few credits are recorded before the balance sheet date. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors about the manner of regularisation of the account to eliminate doubts on their performing status.

Transactions near about the balance sheet date especially of large borrowers accounts should be specifically covered by the bank branch auditor, as part of his audit process to eliminate instances of window dressing, if any, affecting the asset classification of such borrowal accounts.

**Asset Classification to be borrower-wise and not facility-wise**

i) All the facilities granted by a bank to a borrower will have to be treated as NPA and not the particular facility which has become irregular. Thus the Asset Classification is borrower wise and not facility wise.

ii) Where debits arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the outstanding in that account also should be treated as a part of the borrower’s principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

The exception to the rule is when Bills discounted under LC favouring a borrower may not be classified as a Non-performing advance (NPA), when any other facility granted to the borrower is classified as NPA.
However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

The branch auditor shall call for borrower wise listing of facilities from the system based on customer / borrower code and outstanding as at the year end, to ensure that all accounts which are classified as non performing by the bank tally with all list of the borrower wise accounts figuring in non performing advances, thereby exercising control of borrower wise classification.

**Advances under consortium arrangements**

Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/ or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

Branch auditor should note the record of recovery in the account of the borrower in case of multiple banking or consortium advances for the purposes of asset classification, an upgraded or downgraded status in other banks is no consideration for asset classification in the branch under audit. Non receipt of proportionate amounts of interest or instalment from consortium leader will still warrant classification of the account as NPA, if there are overdue in the books of the bank.

**Advances to PACS/ FSS ceded to Commercial Banks**

In respect of agricultural advances as well as advances for other purposes granted by banks to PACS/ FSS under the on-lending system, only that particular credit facility granted to PACS/ FSS which is in default for a period of two crop seasons in case of short duration crops and one crop season in case of long duration crops, as the case maybe, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS. The other direct loans and advances, if any, granted by the bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.
The branch auditor shall identify the nature of the credit facility advanced to the PACS / FSS as to whether they are meant for on lending or towards direct loans and advances to members of the PACS / FSS. Based on the facts, where one of the account of such PACS/FSS is classified as non performing the determination of the asset classification of other account (s) has to be arrived at by the branch auditor in line with the above norms.

**Advances which are outside the scope of Asset Classification norms**

Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

In case of loans and advances made on the strength of securities such as NSC, IVP, KVP and surrender value of Life policies apart from banks own deposits, the branch auditor shall look into whether sufficient margins are available so that the asset classification norms are not covered for these loans or advances. Where the margins are not maintained and the outstanding are over and above the maturity values, such accounts will also be covered by the prudential norms warranting classification as non performing by the branch auditor.

**Loans with moratorium for payment of interest**

In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes ‘due’ only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence do not become NPA, with reference to the date of debit of interest. They become overdue after the due date for payment of interest, if uncollected.

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/ advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates.

Branch auditor is advised to be cautious in loans for long gestation projects including industrial projects, which are generally prone for delays and consequent restructuring. As part of the project proposal interest during construction period may be part of the project, partaking the character of a funded interest, which will be recognised as income on accrual basis. Whereas upon the project going on stream the recognition of income on interest shall be exclusively on record of recovery. If the account is classified as a non performing asset, then the interest recognised during construction period should also be reversed by passing suitable MOC by the branch auditor.
Agricultural advances

A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. For the purpose of these guidelines, “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops, would be treated as “short duration” crops. The crop season for each crop, which means the period upto harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him.

In respect of agricultural loans, and term loans given to non-agriculturists, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.

In case of conversion or reschedulement, the term loan as well as fresh short-term loan maybe treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms and conditions.

The branch auditor shall familiarise himself with the cropping pattern, notification with respect to floods or drought and circulars in connection with restructuring norms of agricultural loans during the current year. Reschedulement of loans pursuant to approved schemes will enable classification of the restructured advance together with the fresh advance to be classified as Standard Asset.

Government guaranteed advances

The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income. The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirements in respect of State Government guaranteed exposures. With effect from the year ending 31 March 2006 State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/ or principal or any other amount due to the bank remains overdue for more than 90 days.
The branch auditor shall pay attention to the guarantee, whether it is by given by State Government or Central Government, in the case of former they do not enjoy any special status and are to be recognised like any other borrower of the bank. However, if the guarantee is furnished by the Central Government, unless the guarantee is repudiated by them such accounts will not be classified as NPA even if the guarantee is invoked by the beneficiary. Even in such cases of Central government guarantees income recognition will be purely based on the record of recovery.

2.3 Provisioning Norms:

The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI during the Annual Financial Review is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.

In conformity with the prudential norms, provisions should be made on the Non performing assets on the basis of classification of assets into prescribed categories. Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion overtime in the value of security charged to the bank, the banks should make provision against substandard assets, doubtful assets and loss assets as below:

The Provisioning norms have undergone a change for and from the financial year 2011-12 and are as follows:

<table>
<thead>
<tr>
<th>Asset Classification</th>
<th>Provision upto Financial Year 31.3.2011</th>
<th>Provision for &amp; from Financial Year 1.4.2011 onwards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard Advances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture &amp; SME</td>
<td>0.25%</td>
<td>0.25%</td>
</tr>
<tr>
<td>Housing Loan with Teaser Rate of Interest and Restructured Advances</td>
<td>2.00%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Commercial Real Estate</td>
<td>1.00%</td>
<td>1.00%</td>
</tr>
<tr>
<td>All other Standard Advances not included above</td>
<td>0.40%</td>
<td>0.40%</td>
</tr>
<tr>
<td>Restructured Advances upgraded as Standard</td>
<td>0.25% to 1.00%</td>
<td>2%</td>
</tr>
<tr>
<td>Sub-Standard -</td>
<td>10% of balance outstanding</td>
<td>15% of balance outstanding</td>
</tr>
<tr>
<td>Sub-Standard – Unsecured Exposure other than Infrastructure loans</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td>Sub-Standard – Unsecured Exposure - Infrastructure loans</td>
<td>15%</td>
<td>20%</td>
</tr>
<tr>
<td>Doubtful Advance – Unsecured Portion</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Doubtful Advance – secured Portion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>For D-1 upto 1 year</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td>For D-2 upto 3 years</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>For D-3 above 3 years</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

- Figures in bold indicate changes in provision rates compared to earlier years.

**Prudential Guidelines on Restructuring of advances by banks**

Reserve Bank of India has issued guidelines for restructuring of advances (except those covered under separate set of guidelines on restructuring of advances on account of natural calamities) which are divided into four categories as follows:

i) Guidelines on restructuring of advances extended to industrial units.

ii) Guidelines on restructuring of advances extended to industrial units under the Corporate Debt Restructuring (CDR) Mechanism

iii) Guidelines on restructuring of advances extended to Small and Medium Enterprises (SME)

iv) Guidelines on restructuring of all other advances.

The main difference between the above four sets of guidelines on restructuring of advances, is broadly based on whether a borrower is engaged in an industrial activity or a non-industrial activity.

The exception to the asset classification is the major difference, that subject to certain conditions, the accounts of borrowers engaged in industrial activities continue to be classified in the existing asset classification category upon restructuring.

This benefit of retention of asset classification on restructuring is not available to the accounts of borrowers engaged in non-industrial activities except to SME borrowers.

CDR Mechanism and restructuring of advances extended to SMEs are more detailed and comprehensive than those covering the restructuring of the rest of the advances including the advances extended to the industrial units, outside CDR Mechanism. However, the CDR Mechanism is available only to the borrowers engaged in industrial activities.
Since the principles underlying the restructuring of all advances are identical, the prudential regulations are needed to be aligned in all cases. Accordingly, the prudential norms across all categories of debt restructuring mechanisms, other than those restructured on account of natural calamities which will continue to be covered by the extant guidelines issued by the Rural Planning and Credit Department were harmonised in August 2008.

It may be noted that the general principles laid down stipulate that 'standard' advances should be re-classified as 'sub-standard' immediately on restructuring, subject to exceptions, covered on account of the special regulatory treatment or on account of restructuring of Infrastructure projects dealt with below.

The CDR Mechanism will also be available to the corporates engaged in non-industrial activities, if they are otherwise eligible for restructuring as per the criteria laid down for this purpose. Further, banks are also encouraged to strengthen the co-ordination among themselves in the matter of restructuring of consortium/ multiple banking accounts, which are not covered under the CDR Mechanism.

The branch auditor is advised to note that the special regulatory treatment providing for reschedulement of advances was only for such advances which were restructured by the banks on or before 30th June 2009, wherein borrowers had applied on or before 31st March 2009. Any restructuring of a loan or advance warrant downgrading the asset classification as a general rule, subject to the exception of reschedulement / restructuring of projects under implementation and those covered under special regulatory treatment.

**What is a Restructured Account as per RBI?**

A restructured account is one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider. Restructuring would normally involve modification of terms of the advances/securities, which would generally include, among others, alteration of repayment period/ repayable amount/ the amount of instalments / rate of interest (due to reasons other than competitive reasons). However, extension in repayment tenor of a floating rate loan on reset of interest rate, so as to keep the EMI unchanged provided it is applied to a class of accounts uniformly will not render the account to be classified as ‘Restructured account’. In other words, extension or deferment of EMIs to individual borrowers as against to an entire class, would render the accounts to be classified as ‘restructured accounts’.

Branch auditor should be vigilant and note that any change in terms of the time, tenure, instalments, interest or warranting any kind of sacrifice including diminution in the net present value is a restructuring of loans. Accordingly he should determine the asset classification at the branch.
**What are Repeatedly Restructured Accounts**

When a bank restructures an account a second (or more) time(s), the account will be considered as a ‘repeatedly restructured account’. However, if the second restructuring takes place after the period upto which the concessions were extended under the terms of the first restructuring, that account shall not be reckoned as a ‘repeatedly restructured account’.

**2.4 General Principles and Prudential Norms for Restructured Advances**

Eligibility criteria for restructuring of advances: Any account under ‘standard’, ‘sub-standard’ and ‘doubtful’ categories may be rescheduled / restructured / renegotiated by the bank. However such exercise can only be prospective and cannot be with retrospective effect.

While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply. The process of re-classification of an asset should not stop merely because restructuring proposal is under consideration. The asset classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring/ rescheduling/ renegotiation.

In case there is undue delay in sanctioning a restructuring package and in the meantime the asset classification status of the account undergoes deterioration, it would be a matter of supervisory concern, but the asset classification will continue to be the downgraded one.

Normally, restructuring cannot take place unless alteration/ changes in the original loan agreement are made with the formal consent/application of the debtor. However, the process of restructuring can be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.

No account will be taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them, which may be applied on a case-to-case basis, depending on merits of each case. Illustratively, the parameters may include the Return on Capital Employed, Debt Service Coverage Ratio, gap between the Internal Rate of Return and Cost of Funds and the amount of provision required in lieu of the diminution in the fair value of the restructured advance. The accounts not considered viable should not be restructured and banks should accelerate the recovery measures in respect of such accounts. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects/ activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns action.
Borrowers indulging in frauds and malfeasance will be ineligible for restructuring, banks may review the reasons for classification of the borrowers as wilful defaulters specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and satisfy itself that the borrower is in a position to rectify the wilful default. The restructuring of such cases may be done with Board’s approval, while for such accounts the restructuring under the CDR Mechanism may be carried out with the approval of the Core Group only.

BIFR cases are not eligible for restructuring without their express approval. CDR Core Group in the case of advances restructured under CDR Mechanism/ the lead bank in the case of SME Debt Restructuring Mechanism and the individual banks in other cases, may consider the proposals for restructuring in such cases, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.

**Asset classification norms for Restructured advances**

Restructuring of advances could take place in the following stages:

a) before commencement of commercial production/operation;

b) after commencement of commercial production/operation but before the asset has been classified as ‘sub-standard’;

c) after commencement of commercial production/operation and the asset has been classified as ‘sub-standard’ or ‘doubtful’.

Borrowers accounts classified as ‘standard assets’ should be immediately re-classified as ‘sub-standard assets’ upon restructuring, except those covered under the Special Regulatory treatment or covered by the Infrastructure projects.

The Non performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-restructuring repayment schedule.

All restructured accounts which have been classified as Non performing assets upon restructuring, would be eligible for up-gradation to the ‘standard’ category after observation of ‘satisfactory performance’ during one year from the date when the first payment of interest or instalment of principal falls due under the terms of restructuring package.

In case, however, satisfactory performance after the specified period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.

Any additional finance may be treated as ‘standard asset’, upto a period of one year after the first interest/ principal payment, whichever is earlier, falls due under the approved restructuring package.
However, in the case of accounts where the pre-restructuring facilities were classified as ‘sub-standard’ and ‘doubtful’, interest income on the additional finance should be recognised only on cash basis. If the restructured asset does not qualify for upgradation at the end of the above specified one year period, the additional finance shall be placed in the same asset classification category as the restructured debt.

In case a restructured asset, which is a standard asset on restructuring, is subjected to restructuring on a subsequent occasion, it should be classified as substandard. If the restructured asset is a sub-standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion. However, such advances restructured on second or more occasions may be allowed to be upgraded to standard category after one year from the date of first payment of interest or repayment of principal whichever falls due earlier in terms of the current restructuring package subject to satisfactory performance.

**Income recognition norms for Restructured advances**

Interest income in respect of restructured accounts classified as ‘standard assets’ will be recognized on accrual basis and that in respect of the accounts classified as ‘non-performing assets’ will be recognized on cash basis.

**Provisioning norms for Restructured advances**

**Normal provisions**

Banks will hold provision against the restructured advances as per the existing provisioning norms.

**Provision for diminution in the fair value of restructured advances**

Reduction in the rate of interest and/or reschedulement of the repayment of principal amount, as part of the restructuring, will result in diminution in the fair value of the advance. Such diminution in value is an economic loss for the bank and will have impact on the bank’s profitability. It is, therefore, necessary for banks to measure such diminution in the fair value of the advance and make provisions for it by debit to Profit & Loss Account. Such provision should be held in addition to the provisions as per existing provisioning norms, and in an account distinct from that for normal provisions.

For this purpose, the erosion in the fair value of the advance should be computed as the difference between the fair value of the loan before and after restructuring. Fair value of the loan before restructuring will be computed as the present value of cash flows representing the interest at the existing rate charged on the advance before restructuring and the principal, discounted at a
rate equal to the bank’s BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring. Fair value of the loan after restructuring will be computed as the present value of cash flows representing the interest at the rate charged on the advance on restructuring and the principal, discounted at a rate equal to the bank’s BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring.

The above formula moderates the swing in the diminution of present value of loans with the interest rate cycle and will have to follow consistently by banks in future. Further, it is reiterated that the provisions required as above arise due to the action of the banks resulting in change in contractual terms of the loan upon restructuring which are in the nature of financial concessions. These provisions are distinct from the provisions which are linked to the asset classification of the account classified as NPA and reflect the impairment due to deterioration in the credit quality of the loan. Thus, the two types of the provisions are not substitute for each other.

The branch auditor shall carefully go through the above norms of restructuring. Income recognition, asset classification and provisioning of such restructured accounts, including accounting for additional fund based limits, funded interest, provision for diminution in the present value etc.,

2.5 Special Regulatory Treatment for Asset Classification

The Special Regulatory treatment is an exception to the general rule of Asset Classification. It was implemented during 2008-09, due to the unprecedented global economic downturn and considering the extra-ordinary situation prevailing the Reserve Bank of India gave the stimulus package to bank borrowers by significantly reducing the CRR, Repo and Reverse Repo rates and further brought in a sort of an amnesty scheme for restructuring of borrowers accounts under nomenclature ‘Special Regulatory Treatment’; this is applicable only for restructuring done for application made by borrowers on or before 31st March 2009 and approved by the banks on or before 30th June 2009.

The special regulatory treatment for asset classification, in modification to the provisions in this regard stipulated in earlier paragraphs, will be available to the borrowers engaged in important business activities, subject to compliance with certain conditions as enumerated below. Such special regulatory treatment is not extended to the following categories of advances:

i. Consumer and personal advances;
ii. Advances classified as Capital market exposures;
iii. Advances classified as commercial real estate exposures
The asset classification of these three categories of accounts as well as that of other accounts which do not comply with the conditions enumerated, will be governed by the normal prudential norms.

**Elements of special regulatory framework**

The special regulatory treatment had the following two components:

(i) Incentive for quick implementation of the restructuring package.

(ii) Retention of the asset classification of the restructured account in the pre-restructuring asset classification category

**Asset classification benefits**

Subject to the compliance with the under noted conditions in addition to the adherence to the prudential framework laid down:

i) In modification to the norm, an existing ‘standard asset’ will not be downgraded to the sub-standard category upon restructuring.

ii) In modification to norm, during the specified period, the asset classification of the sub-standard/doubtful accounts will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period.

However, these benefits will be available subject to compliance with the following conditions:

i) The dues to the bank are ‘fully secured’; when the amounts due to a bank (present value of principal and interest receivable as per restructured loan terms) are fully covered by the value of security, duly charged in its favour in respect of those dues, the bank’s dues are considered to be fully secured. While assessing the realisable value of security, primary as well as collateral securities would be reckoned, provided such securities are tangible securities and are not in intangible form like guarantee etc., of the promoter/ others. However, for this purpose the bank guarantees, State Government Guarantees and Central Government Guarantees will be treated on par with tangible security. The condition of being fully secured by tangible security will not be applicable in the following cases:

a) SSI borrowers, where the outstanding is upto Rs. 25 lakhs.

b) Infrastructure projects, provided the cash flows generated from these projects are adequate for repayment of the advance, the financing bank(s) have in place an appropriate mechanism to escrow the cash flows, and also have a clear and legal first claim on these cash flows.

c) Dues of Micro Finance Institutions (MFIs) restructured upto March 31, 2011
ii) The unit becomes viable in 10 years, if it is engaged in infrastructure activities, and in 7 years in the case of other units.

iii) The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances.

iv) The restructuring under this Special Regulatory scheme is not considered a ‘repeated restructuring’.

Regulatory Directives: Section 35A of the Banking Regulation Act empowers the RBI to issue directions to banking companies generally or in particular, from time to time and such directions shall be binding on all the banking companies. Vested with such power RBI has issued various circulars regarding banking, supervision, banking operations etc., the circulars issued by RBI deal with issues among other things accounting, Accounting Standard, financial statement disclosures etc., It is the duty of every banking company to follow the directions and RBI closely monitors such compliance. The circulars issued by RBI covers every facet of banking business.

RBI issues Master Circulars every year by consolidating the earlier circulars on the subject and the latest circulars issued are updated. The Master Circular and other circulars are hosted on RBI website www.rbi.org.in. The latest series of Master Circulars were issued by RBI on 1st July 2011 in respect of various matters concerning banking business, valuation of investments, revenue recognition, para banking activities, capital adequacy, frauds classification and reporting, risk management, classification of advances, etc.

The latest RBI Master Circular on Income Recognition, Asset Classification and Provisioning Norms is enclosed in the CD.

The branch auditor shall carefully examine the benefits of the special regulatory treatment and apply them for advances restructured under this scheme. He may also verify its current status with respect to the revised terms and compliance thereof, if the revised terms are not complied with, then the asset classification will revert to the original terms (pre restructure terms).

3. BRANCH AUDIT – Scope, Plan, Program & Standards

3.1 Balance Sheet Audit:

A normal audit process includes evaluation of the internal controls, verification on test basis the recording, classifying and summarising of the transactions into the books of account.

However, in bank branch audit, the existence of an effective system of Internal control, an essential pre-requisite, is enforced due to the existence of the various supervisory controls, reporting mechanism, concurrent audit, revenue audit, internal inspection and statutory audit.
Hence in the case of audit of bank branches, the usual procedures of vouching and verifications are not carried out. On account of the above, the audit of bank branches is popularly known as “Balance Sheet Audit”.

In line with that, the branch auditors’ pay a significant attention to one of the major item figuring in the Balance Sheet namely “Loans & Advances”, to comply with the regulatory requirement for banks to adhere to the Reserve Bank of India’s norms on Income Recognition, Asset Classification and Provisioning relating to advances.

Income Recognition on performing advances are accounted for on accrual basis, whereas income from Non performing advances are recognised strictly on the basis of record of recovery, subject to the policy followed by the banks in the method of appropriation of recovery in non performing advances.

Funded Interest: Income recognition in respect of the NPAs, regardless of whether they are subjected / not subjected to restructuring/ rescheduling/ renegotiation of terms, should be strictly done on cash basis and not where the amount of interest overdue has been funded. If, however, the amount of funded interest is recognised as income, a provision for an equal amount should be made simultaneously. In other words, any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.

Asset Classification is to distinguish the borrowers accounts on the basis of regularity of operations, identification of weakness, symptoms of sickness and threat of recovery, based on which advances are classified as Standard, Sub-Standard, Doubtful or Loss.

Provisioning norms in relation to non performing advances are a method of recognising the impairment, arising out of such borrower accounts, which show tendencies of weakness or threat of recovery, measurement of the irregularity in terms of a time scale and making provisions thereof as per Reserve Bank of India norms. The provisions are only minimum provisions and banks are free to provide more than the minimum prescribed, but are to follow the same consistently.

The nature, scope and extent of the bank branch audit, prima facie is on the attest function performed, viz reporting about the true and fair view of the Statement of Affairs and Profit & Loss account, prepared in accordance with the Third Schedule of the Banking Regulation Act, 1949.

There is also the special purpose reporting vide the Long Form Audit Report which the Reserve Bank of India has specifically entrusted to be done by the bank branch auditors.

The branch Tax Audit is another important area, wherein the Central Statutory Auditors significantly rely on the work done by the branch auditors, so that they will be able to place reliance on the work done by experts.
The various certifications such as Capital Adequacy complying with Basel norms, Asset Liability Management to reflect on the liquidity management and monitoring, Internal control and compliance aspects vide Ghosh Committee and Jilani Committee checklists, Interest subvention, Prime Ministers Rozgar Yojana etc., forming part of the bank branch audit exercise serve the important function of the reliability of such information furnished by the bank branch auditors to enable the central statutory auditors to collate them and furnish the same for the bank as a whole.

Thus the bank branch auditors’ role is a crucial and important role. Considering the areas of attention and reporting called upon from our members, which are significant and comprehensive, to give assurance to the stake holders in general and the regulator Reserve Bank of India, the bank branch audit serves as being more than a balance sheet audit. Therefore it is a misnomer to call it as a balance sheet audit.

3.2 Compliance with Quality Control Standards

Quality control systems, policies and procedures are the responsibility of the audit firm / auditor. The auditor’s obligation is to establish and maintain a system of quality control to provide them with reasonable assurance that, the firm and its personnel comply with professional standards, regulatory and legal requirements and the reports issued by the firm comply with the professional standards.

The bank branch audit, being an attest function carried out by the members, warrants compliance with quality control standards viz., Standards on Auditing, covering general principles and responsibilities, risk assessment and response to assessed risks, audit evidence, audit conclusions and reporting. Standards on auditing establish the overall responsibilities when conducting an audit of financial statements. It sets out the overall objectives, explains the nature and scope of an audit.

The purpose of an audit is to enhance the degree of confidence of the intended users of the financial statements. This is achieved by the expression of an opinion by an auditor as to whether the financial statements are prepared, in accordance with the applicable financial reporting framework and reflect a true and fair view.

The financial statements subject to audit are prepared and presented by the management of the entity. The basis of an auditor’s opinion, flows from the auditor obtaining reasonable assurance from the management whether the financial statements are free from material mis-statements, whether they are free from any fraud or error. Auditor’s Report provides reasonable assurance, it is not an absolute assurance, but a high level of assurance when the auditor obtains sufficient appropriate audit evidence to reduce audit risk.
The concept of materiality is applied by the branch auditor in planning and performing the audit to identify material weaknesses. The Standards on Auditing require the auditor to exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit, identify and assess risks of material misstatements, based on understanding of auditee’s environment and internal controls.

The inherent limitation of an audit arises from the nature of financial reporting, nature of audit procedures and the need for the audit to be conducted within a reasonable period of time and at a reasonable cost. These are very relevant and true in the context of a bank branch audit.

In bank branch audit, there are practical and legal limitation on the auditor’s ability to obtain audit evidence, there is a possibility that branch management may not provide, intentionally or otherwise, the complete information that is relevant to the preparation and presentation of the financial statements. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.

Frauds in bank branches may involve sophisticated and carefully laid down schemes designed to conceal them. Therefore, normal audit procedures used to gather audit evidence may be ineffective, for detecting a collusion to falsify documentation, which may cause the auditor to believe that audit evidence is valid, when it is actually not.

The bank branch audits are compressed for want of time, right from the communication of the appointment, the pressure for timely completion of the audit and reporting is a daunting task. The matter of limitation of available time is not in itself a valid reason for the auditor to omit an audit procedure or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resource available for the conduct of the Audit. Consequently it is necessary for the auditor to:

- Plan the audit, so that it will be performed in an effective manner,
- Direct audit effort to areas most expected to contain risk of material misstatement, whether due to fraud or error, with correspondingly less effort towards other areas.
- Use analytical procedures for Deposits and Advances with respect to the amount of interest paid/ interest earned, comparative analysis, movement of non performing advances and provisions etc.

Branch auditor in the course of obtaining sufficient and appropriate audit evidence shall design to perform audit procedures that are appropriate in the circumstances for the purposes of obtaining sufficient and appropriate audit evidence.
3.3 Audit Plan & Methodology

The objective is to plan the audit so that it will be performed in an effective manner. The bank branch auditor should adopt an overall strategy that sets the scope, timing and direction of the audit and guides the development of the audit plan.

Planning an audit exercise is very critical for an effective audit and an opinion forming exercise. It is all the more critical in a bank branch audit, wherein the time available to conduct the audit is substantially shorter than other audits and hence challenging. Keeping this in mind, it is necessary to plan the audit exercise diligently. In the case of a bank branch audit the following Audit Plan and Methodology may be adopted.

Upon receipt of the letter of appointment:

• Read the appointment letter carefully to understand the nature and scope of the engagement and timelines specified for completion.
• Understand the various reporting requirements
• Identify the different certifications which are to be given as part of the audit, which cast higher responsibility in terms of the statement of true and correct vis a vis true and fair in the audit report.
• Communicate with the previous auditor, for obtaining a No Objection Letter for carrying out the audit, by sending a written letter by registered post, after ascertaining his last known address, even if not furnished by the bank.
• Have a master file and a branch wise file containing the appointment letter, copies of circulars and instructions received from the bank, including the proforma of various certificates to be issued.
• Consider the Audit Materiality and Audit Risk and carefully plan the Audit Sample such that it enables detection of material misstatements. Materiality depends on the size and nature of the item in particular circumstances. Thus materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic. Materiality is also influenced by other consideration such as legal and regulatory requirement. Audit of large advances which individually account for 5% of the advances or Rs. 2 Crores whichever is less are required to be audited compulsorily.

Communicate with the branch calling for the following information:

1. Closing circular issued to the branch / reference in their website to download the same.
2. The extent, size and specialization of the branch
3. The profile of the branch and performance in the past two years.
4. Comparative analysis of movement of interest income and expenses vis a vis advances and deposits respectively for two years.

5. List of top borrowers accounts accounting for 2% of the advances of the branch or Rs. 1 Crores whichever is lower, covering at least 60% of advances of the branch.

6. Copies of last three months Concurrent Audit Reports (if covered under Concurrent Audit)

7. Copy of the summary sheet of the last Inspection Report.

8. Copy of Revenue Audit Report, if any.

9. Copy of IT Audit Report, if any.

10. Copy of vigilance enquiry or any special investigation reports.

11. Details of fresh advances made during the year.

12. Details of major weaknesses, if any, persisting in the branch.

13. List of Potential NPAAccounts – For quarter ending December.

14. Details of loan accounts restructured during the year.

15. Details of advances which are pending renewal for more than 3 months.

16. Details of advance accounts wherein stock statements are not received for 3 months.

17. List of NPA accounts wherein the valuation reports are older than 3 years.

18. List of non corporate entities with working capital limits in excess of Rs. 10 lakhs.

19. List of borrowers accounts which underwent CDR during the year.

20. List of accounts where recoveries are made, where DICGC / ECGC claims have been received.


22. Details of Invoked Guarantees / Letters of Credit and treatment thereof.

23. List of off balance sheet items and contingent liabilities, if any.

24. Details of suspense and sundry entries beyond 1 year.

25. Details of fraud by employee or outsiders, against the bank during the year.

26. List of recoveries in NPA accounts and appropriation thereof.

27. Details of legal expenses incurred and accounting in the books.

28. Details for Long Form Audit Report, including Annexures for advances above Rs. 2 Crores.

29. Details for Tax Audit under section 44 AB of Income Tax Act, with specific reference to additions to fixed assets.

30. Details of section wise tax deducted and remitted including date of deduction, date of remittance and delay if any. TDS mapping for deduction and remittance.

31. Certificate from branch management that TDS has been duly deducted and remitted as per provisions of Income Tax Act, 1961
32. Details for furnishing various certificates.
33. Date when the audit could be commenced.

Once these preliminary information are obtained, document them, use them for performing
the audit exercise. Further, carefully select the team members who possess the requisite skill,
knowledge, experience and ability to undertake the assignment and plan for the following:

- Orient the team members, by updating them with the extent, scope and changes in
  the norms when compared to previous year. Go through the closing circular as well as
  the Master Circulars of RBI and the latest issue of Guidance Note on Audit of Banks
  issued by the Institute of Chartered Accountants of India with the team members,
  mark important areas of concern for the branch / branches under audit.

- Based on the information received, plan out the audit of financial statements, in
  respect of the statement of affairs, audit of incomes, expenditures, or advances with
  specific reference to / Potential NPA accounts under Standard Category, verification
  of restructured accounts vis a vis their Asset Classification.

- Verification of top Non performing advances with respect to classification, existence
  of realisable value of security and provisions to ascertain the correctness.

- Call for appropriate and adequate documentary evidences to enable furnishing
  certificates under various categories.

- Proforma Management Representation Letter to obtain the management’s assurance
  that the financial statements and other information furnished for furnishing certificates
  are truly and correctly prepared and presented by the branch management to the
  branch Statutory auditors.

- To discuss all matters observed and which will be forming part of the Audit Report
  and / or qualification or mention in the certificates including Memorandum of Changes
  that may be proposed.

- To complete the entire reporting at the branch itself, to enable availability of information
  and timeliness of completion of the branch audit.

- Travel and stay arrangements independent of the branch management.

- Maintain independence and a studied professional dignity while carrying out the
  exercise.

3.4 Audit Program

Prepare an Audit Program for each of the branches, based on the size, scope, extent and
specialisation of each branch.
The Audit program will generally include the areas to be covered, allocation as to who will be in charge of specified areas of professional work. How the work carried out by the sub-ordinates will be supervised by the Partner in Charge / Proprietor. Audit program will be a useful guide for carrying out the Audit by the staff in an effective manner.

The Audit program of the bank branch audit should generally include, physical verifications, testing of internal controls, comparative analysis, etc. Physical verifications could include cash, valuable securities, stocks pledged under key cash credit schemes, securities pledged by borrowers in the possession of the branch, loan documents of borrower accounts, fixed assets of the branch. It is also desirable that verification of the stock / receivables of the top borrowers of the branch is undertaken.

Testing of internal controls could be undertaken by perusing the manner in which the records and registers are maintained, periodic exception reports generated and monitored. Regularity in submission of control returns, observations of the concurrent auditors regarding deviations from systems, standards, procedures and powers of the branch incumbents. Perusal of Internal Inspection of the branch in terms of the overall housekeeping, compliance to parameters set out, exceptions and rectifications carried out, the rating of the branch could also be a good indicator of the level of internal control exercised, any slippage in the branch rating when compared to the previous Internal Inspection, should be specifically noted by the bank branch auditor to enlarge his audit methodology to be substantive.

Comparative analysis is a useful tool to give the auditor an overview of the operations of the branch. The analysis of profit / loss vis a vis the increase in the business of advance / deposits in relation to the changes in the rate of interest from time to time, the average cost of funds and average realisation from loan accounts can be good indicator to ascertain the correctness and completeness of account on these heads, similar analysis of income and expenses will enable the branch auditor to satisfy himself of the same.

The movement of non performing advances and the provisioning when compared to the previous year, will enable identification of correctness in asset classification and provisioning and may, in some cases warrant reclassification based on the audit procedures and opinion of the branch auditor, especially considering the subsequent conduct of such NPA accounts.

The bank branch audit program may include the review of reports and replies in connection with the internal inspection reports, in terms of audit of advances - pre sanction credit appraisal, sanction and disbursement, documentation, operation in the accounts, post sanction monitoring and supervision, follow up actions, verification procedures for Income, asset classification and provisioning, verification procedures of fixed assets and other assets such as sundries.
Audit of incomes and expenses should include test checked for interest income, interest expended, other incomes such as processing charges, inspection charges etc., on all new and renewed advances during the year.

Obtaining Confirmations such as Management representations. A model bank branch audit Program is furnished under Audit check lists.

3.5 Audit Documentation

The need for documentation as part of audit process is fundamental to bank branch audit. Documentation enables the review of the audit process employed as to what were the information called for, whether sufficient appropriate audit evidence has been called upon, what are the records, registers and evidences – internal and external, furnished by the client, based on which the audit opinion was expressed.

In bank branch audit scenario, the amount of evidence obtained are generally only internal and not much of external evidence is available, unless a field visit of any of the borrowers unit is undertaken by the statutory auditors. The stock statements submitted by the borrowers are external evidences, inspection by the branch officials and their report are a basis for ascertaining whether the reported stocks / debtors are physically available and are as per the records of the borrowers.

The stock audits and book debts’ certificates from external agencies including professionals are a means of verifying the external evidences.

In the branch audit, the entire audit process, information called for, information obtained, information perused and copies thereof form part of the audit documentation. Audit documentation evidences the auditor’s basis for the conclusion and proof that audit was planned and performed in accordance with standards on auditing and applicable legal and regulatory requirements.

Audit documentation serves a number of additional purposes such as assisting the engagement team to plan and perform the audit, assisting branch auditors to be responsible to supervise the audit done by the assistants, enable the team members to be accountable for the work done by them. It also acts as a record in terms of permanent record, evidences of information furnished and obtained, compliance with statements on peer review. The branch auditor is expected to prepare the audit documentation on a timely basis.

The form, content and extent of audit documentation in a bank branch audit, will depend on various factors, including the understanding of the knowledge of business such as:

- The size and complexity of the branch
- Nature of audit procedures to be performed
3.6 Representations from Management

In the course of the bank branch audit, it has time and again been brought to notice that the bank branches are not providing written representation, there are some instances, wherein as part of the letter of appointment itself, some banks make it clear that no management representations will be furnished by the branches.

This is contrary to the Standards on Auditing which specifically warrants that it is the auditor’s responsibility to obtain written representations from management.
Although written representations are no substitute to the carrying out the audit and arriving at the opinion on the basis of obtaining sufficient appropriate audit evidences about any of the matters connected with audit, the auditor shall request for written representations from the management, that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including wherever relevant, their fair presentation.

The written representations shall be in the form of a representation letter addressed by the bank to the bank branch auditor.

Where requested written representation is not provided, the branch auditor shall:
- Discuss the matter with management;
- Evaluate the integrity of the management and its effect on the reliability of oral or written audit evidences.
- Take appropriate action, including determining the possible effect on the auditor’s opinion.
- Shall disclaim opinion on the financial statements in accordance with Standards on Auditing 705 if the auditor based on his audit concludes that there is sufficient doubt about the integrity of the management.

i.e. the Standards on Auditing, states that in suitable cases, it might even warrant a qualification in the auditor’s report, regarding the reliability of the information furnished for the purposes of audit.

Model Management Representation letter of bank branch is included under Audit check lists.

3.7 Application of Accounting Standards:

Reserve Bank of India has made it mandatory for banks to follow and comply with all the Accounting Standards, with respect to the recognition, measurement, presentation and disclosure requirements there under, as per the Companies Accounting Standard Rules, 2006 as well as any other Accounting Standard issued by the ICAI.

However out of the 31 standards, 5 standards are not applicable to banks. These are:

Two Mandatory Accounting Standards, viz., - Accounting Standard 11 – Effects of changes in Foreign Exchange Rates (Revised) and Accounting Standard 13 – Accounting for Investments,

Three Recommendatory Accounting Standards viz., 30 to 32, dealing with financial instruments.

The balance 26 Accounting Standards are mandatorily to be followed by the banks. However with respect to bank branches only 8 Standards are applicable at the branch level, suitable notes or reference could be made by the branch auditor for employee benefits and taxation, if they are not adequately mentioned as part of significant accounting policy of the branch.
As a ready reference, Accounting Standard wise issues which may arise at the branch are listed below:

<table>
<thead>
<tr>
<th>Accounting Standard</th>
<th>Special points for consideration by the branch statutory auditors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 – Disclosure of Accounting policies</td>
<td>Disclosure of accounting policies are equally applicable to the branches, however it is generally observed that the accounting policy of the bank as a whole is generally appended, though some of the items such as provisions, taxation, employee benefits are not provided for at the branches. The branch auditors should ensure that the significant accounting policy forms an integral part of the financial statements attested by them. He may also ensure that suitable disclosures are made as to items provided for at head office only, unless the same form part of the accounting policy.</td>
</tr>
<tr>
<td>4 – Contingencies and Events occurring after the Balance Sheet Date</td>
<td>The branch auditors may consider the events happening after the balance sheet date having an effect on the balance sheet, such as any fraud, calamities, destruction to branch property or recoveries in borrower’s accounts and may arrive at his opinion accordingly.</td>
</tr>
<tr>
<td>5 – Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies</td>
<td>Determine the policy of prior period as adopted by the board of directors, report prior period items only those as per bank’s policy. Pursuant to the policy of NPA followed by the banks, interest of earlier years received during the year do not form part of prior period since it is not on account of any error or omission. Changes in RBI norms such as increase in the provision requirements are not changes in accounting policies.</td>
</tr>
<tr>
<td>6 – Depreciation Accounting</td>
<td>Note whether there are items of fixed assets which are obsolete, damaged, discarded or destroyed and forming part of the fixed assets of the branch, these are to be provided for in full, as there does not exist any effective useful life of the asset in line with the Accounting Standard.</td>
</tr>
<tr>
<td>Item</td>
<td>Description</td>
</tr>
<tr>
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</tr>
<tr>
<td>Items of fixed assets which are purchased, physically available and put to use by the branches, but not accounted, for want of approval of capital expenses from appropriate authority should be accounted for and depreciation provided thereon. Verify whether items of fixed assets held and used by the branch, but are not recorded in the books of the branch, and hence no depreciation are provided thereon, shall be accounted for by way of MOC or emphasis of matter to be made in the report.</td>
<td></td>
</tr>
<tr>
<td>9 – Revenue Recognition</td>
<td>Verify accounting for Interest on overdue deposits, unclaimed deposits, legal expenses, commission, exchange and brokerage and ensure they are in line with the policy of the bank of accrual or cash basis of accounting.</td>
</tr>
<tr>
<td>10 – Accounting for Fixed Assets.</td>
<td>Items of fixed assets which are purchased, physically available and put to use by the branches, if not accounted, for want of approval of capital expenses from appropriate authority should be accounted for. Ensure that full values of fixed assets are accounted, in some cases the accounting is done at branches on payments basis, with the retention amounts not being capitalised.</td>
</tr>
<tr>
<td>28 – Impairment of Assets</td>
<td>Enquire and obtain written confirmation that physical verification of fixed assets have been carried out by the branch and there are no impairment to the carrying value of assets; if there be so, the quantification thereof and their accounting in the books of accounts needs to be disclosed separately as per the standard.</td>
</tr>
<tr>
<td>29 – Provisions, Contingent Liabilities and Contingent Assets</td>
<td>Ensure compliance with this standard, regarding accounting of clear liabilities as provisions based on estimates which warrants economic resources to be committed in the foreseeable future and contingent liabilities correctly as those which are Contra or off balance sheet in nature.</td>
</tr>
</tbody>
</table>
3.8 Practical approach to bank branch audit

The most appropriate way to approach a bank branch audit, is to plan for it well in advance in having the audit plan, audit program and sufficient training to the team members in place. Upon receipt of the letter of appointment and communication of acceptance, if the branch were to be local or in a nearby place, it would be of great help if the audit could be commenced during March itself. The areas which could be covered could be well over 80% to 85% of the entire exercise.

Except for the Statement of Affairs, Profit & Loss account for the period ending 31st March, Capital Adequacy statements, Risk Weights and Asset Liability Management Certifications, a significant portion of the branch audit could well be completed before the end of March as follows:

**Audit of Expenses**:

The Audit of Expenses of a bank branch, as per Banking Regulation Act, 1949 is to be prepared and presented in Form B being Form of Profit & Loss Account for the year. It may in some banks be prepared as two half yearly statements, mainly consisting of interest expended, establishment expenses on salary, depreciation, law charges and repairs &maintenance.

**Audit of Incomes**:

Audit of Income of a bank branch mainly consists of Interest earned and other income such as commission, exchange and brokerage, processing charges, supervision charges etc.,

The test checking of Interest incomes, other income and interest expenses, establishment and law charges of any month upto February which could be done in March itself, could expedite the audit post the year end when there will be inadequate time to look into them in detail.

**Audit of Advances will include**:

Review and verification of loan applications, process notes, documents and records pertaining to:

- Sanctioning of fresh loan during the current year
- Renewals of Large advances during the current year
- Operation of Large advances - 5% of advances of the branch or Rs. 2 Crores, whichever is less
- Identification of weakness or issues of concerns in such advance accounts

The entire audit of advances including asset classification could be completed on or before 31st March, except for those accounts which are overdue beyond 60 days as at 31st December or such accounts which show tendency towards threat of recovery, or issues relating to valuation of assets and provisioning.
Audit of Potential NPA accounts:
Banks have an in built system of reporting on potential or weak assets to exercise better control. Such control returns are furnished on a monthly basis under various nomenclature by different banks, as weak standard assets / special mention accounts etc, which are in the nature of Potential NPA accounts. It will be advisable for the bank branch auditor to call for this control return and use the same as part of audit and documentation. A review of potential NPA accounts as at 28th February will reveal those accounts which can potentially slip as at 31st March, this can also be done before 31st March.

Audit of NPA Accounts:
Audit of NPA Accounts will mainly revolve around the analysis of movement of NPA, upgradation of accounts and their correctness, downgrading of assets - correctness of classification with respect to date of NPA, asset classification, realisable value of security and provisions made therein. The review of NPA accounts and their movement till 31st December could be carried out during March. The final statements generated after the year end could be verified for changes effected during this quarter alone.

Audit of Restructured accounts:
Audit of Restructured accounts is to be furnished in separate annexures as part of bank branch audit. The branch auditor may call for and verify the restructured accounts and see whether they are in compliance with the RBI norms on restructured accounts with respect to asset classification. Special attention is to be paid to accounts which are not eligible for special treatment on restructure such as Personal Loans or Commercial Real Estates.

Restructure of loans made pursuant to the special regulatory treatment should be checked to ascertain whether the accounts are operated as per the revised terms and conditions. If they are not then the asset classification will revert back to its original terms and accordingly may hasten the classification to a downgraded status.

Audit of Restructured Infrastructure loans before commencement of commercial operations (CCOD) should be verified with respect to the commercial viability and other factors including cash flow projections. The audit of restructured accounts, except those restructured in march could be done prior to 31st March.

Audit of CDR accounts:
The Corporate Debt Restructuring of loan advances are put through to a separate CDR committee, till such time the CDR is sanctioned the asset classification will be governed by the norms. Post the CDR being approved by the Board, then the terms of CDR will determine the character of the advance including its classification together with fresh financing thereto.
Long form Audit Report:

Most of the aspects covered in LFAR as indicated below could be completed before 31st March:

• Cash verification can be carried out any time.
• Securities verification can be carried out during March.
• Insurance cover verification can be inspected before year end.
• Verification of Bank Reconciliation statement upto February can be completed in March.
• Expired Guarantees / Letters of Credit list as at February can be scrutinised to check for old items pending, this will make the branch to give effect to such items during March.
• Sundry Deposit – analysis of old outstanding items warranting provision could be verified before year end.
• Suspense Accounts analysis and provision thereto either as expenses or write off of old items could be done during March itself.
• Divergence analysis of interest expended and interest earned, the average cost of funds and average rate of lending as per reporting Friday could reveal the status of correct accounting and reasons for significant divergence compared to earlier year - the status upto February can be checked.
• Housekeeping activities and document verifications could be carried out during March itself.
• Compliance with policies, procedures, reporting and rectifications is an ongoing exercise at the branch hence does not have any relation to year end.

All the above aspects of audit and reporting for Long Form Audit Report could be undertaken in depth, analysed and preliminary reports could be kept ready without any reference to the year end, which will reduce the amount of time taken for audit post 31st March.

Tax Audit

Tax Audit could be done for all the relevant columns in the Questionnaire in Form 3CD, most of them upto February, items such as deduction of tax at source could be exhaustively covered during March by obtaining the relevant records, verifying the payment particulars and its correctness of accounting.

Perusal of various reports

The branch audit team could peruse the below mentioned reports during March such as:
• Concurrent Audit Report
• Previous year Statutory Audit Report
• Internal Inspection Report
• RBI inspection / divergence reports / audit under section 45 MA which will enable the branch auditor to form his opinion about the existence and effectiveness of internal control systems, reporting, rectifications carried out and major areas of weakness or deficiency if any still persisting, based on which he can decide on the type of audit sample whether it should be substantive or otherwise. Recoveries in claim settled DICGC / ECGC accounts could be verified during March, and recoveries during March alone can be covered post 31st March, which will significantly reduce the time required for covering this area.
• The certification of the weekly statement in 12 odd dates, can be test checked for two or three dates of Friday weekly reporting during March itself, except for the month of March if the date is towards the year end.
• Certifications under PMRY / SEEUY / SEPUP scheme are not having any bearing on the financial statements as at 31st March.
• TUF scheme / Interest subventions upto February could be verified during March.
• Ghosh / Jilani Committee Reports, deal with implementation status w.r.t. internal control and fraud detection which warrant a detailed and elaborate verification, ideal for doing it before the financial year end during March as it has no bearing on 31st March.

In view of the above, it could safely be said that more than 80% - 85% of the audit could well be covered even before the financial year of 31st March of the bank branch. Thus core areas could be covered in detail post 31st March.

4. PRACTICAL ISSUES
4.1 Practical Issues in Audit of Financial Statements

Comparative Analysis of movement of income and expenses

The average cost of funds and average yield as reported by the branch to the controlling authorities could be called for and verified to analyse the movement of interest income and expense as a proportion to the increase in advances / deposits.

Interest on overdue deposits / unclaimed deposits

Provision of interest as per the accounting policy followed by the bank should be verified. As per policy in some cases the accounting may be done at the HO level, in which case a reference of the same in the Audit Report is to be made accordingly.
Funded Interest (FITL accounts)

Interest income of funded interest term loans are not to be recognised, except on cash basis on the record of recovery.

Legal expenses

As per RBI norms, all expenses incurred by banks on law charges are to be debited to the profit and loss account and to be kept in separate memorandum account of the borrower and on record of recovery to be appropriated, as per the recovery policy followed by the bank.

Provision for increase in rent as per lease / rent agreement

Peruse the lease agreement of the branch and verify whether the rent is correctly accounted, increase if any, as per the lease agreement is provided or not, if not, pass MOC. If the same is in dispute ensure it is reflected it statement of Contingent liability in accordance with AS 29.

Processing charges

Carry out a test check of major advances extended during the year, including renewals and correctness of accounting for the processing charges thereon. If concession in processing charges is made, the approval of the competent authority may be verified.

Government business – commission receivable

Verify whether the commission income on government business is duly accounted up to 31st March and compare the income under this head with that of the previous year to ensure proper accounting.

Currency chest accounting

Verify whether the currency chest commission and security expenses upto 31st March, in currency chest branches are accounted for as receivable and payable respectively.

Depreciation

Test check the depreciation accounting including provision for depreciation as per the rates and method followed by the bank, as per statement prepared by the branch. In some banks depreciation is provided for only at its Head office. In such cases reference of the same in the Audit Report is to be made accordingly.

Accounting for fixed Assets

Ascertain the accounting for fixed assets, for its completeness and correctness, peruse advance towards capital items in sundry deposit account or suspense account.
Impairment loss
Ascertain whether the branch has carried out an exercise to determine impairment of assets. If not report the same, considering the policy of the bank on determination of impairment to assets.

Sundries / Suspense accounts
Analyse the sundry deposit / suspense accounts with respect to accounting for the same in the profit & loss account, old items pending may be provided for if they are pending for more than 3 years, unless realisable in the opinion of the management in cash or cash equivalent.

Recoveries in DICGC / ECGC claim settled accounts
Peruse the Register of DICGC / ECGC and determine the system of accounting in claim paid accounts, receipts in such accounts during the current year, check whether proportionate amounts have been remitted to the respective corporations.

4.2 Practical Issues in Audit of Advances
As per Reserve Bank of India norms, a bank branch auditor is called upon to audit all large advances without fail, while he may include advances other than large advances also. As per standards on auditing the sample selection should also include other loan accounts to identify the controls exercised across all spectrum of the advance accounts.

The large borrowal accounts are defined by RBI as those which are 5% of the outstanding balance of the advance portfolio of the branch as at the end of the year or Rs. 2 Crores, whichever is lower. Hence the branch auditor is expected to cover all large advances and may include a few samples of advances below these limits.

Audit of advances is the core of the bank branch audit.
- The audit of advances includes verification of pre-sanction scrutiny of loan proposals, in the form of loan application, documents and supporting papers attached thereto
- Obtaining the documents relating to the organisation
- Verifying the authority of the persons applying for loan
- Scrutinising the charter documents
- Ensuring adequate/eligibility powers to borrow
- Obtain details of collateral securities offered
- Obtain legal opinion
- Obtain valuation reports
- Obtain audited financial statements
- Conduct a physical inspection of the unit and report of the inspecting officer regarding
the existence of the unit, operations and other aspects

• Preparation of the process note by the branch
• Recommendation to respective authority, where the Loan limits are beyond the scope of the branch incumbent
• Sanction the loan where it falls within the scope of the branch manager under his powers.
• Verification of proper exercise of his powers, duties and responsibilities before sanctioning of loan.

The next stage is audit of disbursement of the loans. The auditor should check and take care of the following:

• ensure that the end use of funds are for the purpose for which the loans are sanctioned.
• Ensure loans are disbursed directly to the vendor in case of term loans for acquiring assets.
• In the case of housing loans for purchase of property, ensure the payments are directly made to the sellers at the time of registration of the property, or in instalments for construction purpose.
• In the case of vehicle loans the payments are directly made to the authorised dealers of the vehicle manufacturers.
• In the case of machinery loans payments are made directly to the manufacturers or their authorised agents / dealers.
• In the case of cash credit / overdraft loans entire sums are not allowed to be drawn in one go, but are permitted to be used in the business as per the business requirements.
• The branch should obtain all necessary proforma invoice and after making payments directly obtain the receipts from the parties to whom payments are made.

Post disbursement monitoring is a very important aspect of banking, the audit of which calls for the auditor to be vigilant in monitoring the operations in the accounts, including obtaining the documents, records, proofs, key in the case of vehicle loan, housing loan or key cash credit loans and hypothecation / pledge / mortgage, registrations of charge with Registrar of companies where applicable.

In the case of audit of Cash Credit/ Overdraft accounts, attention should be paid to:

• the frequency of transactions
• the availability of the drawing power, by obtaining the stock / book debts statements on a regular basis
• the regularity in obtaining the QIS information where applicable
• reports of the branch officials on physical verification of the units, for whom the operating limits have been extended by the branch
• number of times the account gets overdrawn, whether it is continuously in excess of sanctioned limits / drawing power
• whether there are only solitary credits
• whether the credits in the accounts are sufficient to discharge the interest applied to the accounts
• whether there are cross transfer of funds, from or / to group concerns
• whether there are any diversion of funds
• whether the repayment in the term loans are being serviced regularly
• whether periodic renewals are being done
• whether audited financial statements are furnished, and qualifications if any, in such financial statements by the auditors.
• whether the qualifications have been considered by the branch/ sanctioning authority while sanctioning / renewing the loans
• whether there are any frequent adhoc being applied and sanctioned
• whether any adhoc is regularised by way of sanctioning a fresh / new loan, whether the primary securities hypothecated to the banks are physically available or whether there are any signs of threats of recovery
• whether there are any circular credits, whether the Letter of Credit / Bank Guarantees of the borrowers are periodically being invoked
• whether restructuring of the account has happened, does the branch frequently resort to repeated restructuring

All these aspects are to be covered while carrying out the audit, this while being exhaustive is not a complete coverage, as there may arise some more applications of audit principles / techniques in the course of the audit of advances.

Further in case of the audit of advance accounts, the Income Recognition, Asset Classification and Provisioning Norms are applicable, in terms of which:

• The asset classification done by the branch has to be audited by the branch auditor to ensure that the classification is correctly made.
• However based on audit, if the branch auditor is of the view that such asset classification is not correctly made, then he should discuss with the branch management and reclassify such accounts by way of Memorandum of Changes (MOC).
• In such cases, the income if any to be reversed, on the basis of record of recovery needs to be made in the MOC.
• Consequently the provisioning requirements may also need to be made vide MOC.
• If the asset classification in MOC is doubtful then realisable value of security assumes great importance and significance and the bank branch auditor will be expected to pay close attention to the realisable value of security, which are different from the stated values / original values and in some cases may vary from the valuation reports also.
• If the valuation report obtained in such doubtful advances are more than 3 years old then such realisable value should have been taken as nil.

On the basis of past experience on bank branch audits, some of the illustrations on the practical issues which arise, and an audit perspective is listed below under the following major heads.

I. Limit / Drawing Power :

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<th>SL.</th>
<th>Issue</th>
<th>Norms / Probable audit perspective</th>
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</table>
| 1   | A & Co, a Partnership firm enjoys a cash credit limit of Rs.100 lakhs the account is operated within the sanctioned limit. The borrowers statements contain the following details stock Rs. 150 lakhs debtors Rs. 50 lakhs and creditors Rs.60 lakhs, margin 25%. | For Asset Classification, the operations in the Cash Credit / Overdraft Accounts are to be assessed with respect to the outstanding balances vis a vis the Drawing Power (DP), hence determination of the DP is critical in evaluation of the account being operated within the Limits / DP whichever is less as per RBI norms

In the illustration, the drawing power is to be reckoned with respect to the terms of sanction in view of which there can be two scenarios:

In the first scenario, there will be stocks less the creditors (unpaid stocks) less margin = DP, which is Rs. 67.5 lakhs. In which case, though the account is operated within the sanctioned limit of Rs. 100 lakhs still, if it is continuously in excess of DP of Rs. 67.5 lakhs, then such account will get reclassified as NPA.

In the second scenario, if the debtors are also to be included as primary security and hence form part of the DP then the available DP will be Rs. 105 lakhs in which case, the account having been operated within the sanctioned limit and Drawing Power will continue to be a standard asset. |
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<td><strong>Take away:</strong></td>
<td>Kindly ensure that the sanction letter copy of the large advances are obtained and the terms of sanction is understood fully while determining the operation in the account with respect to Limit / drawing power.</td>
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<td><strong>2</strong></td>
<td>C &amp; Associates, has reported a stock of Rs.100 lakh in their monthly stock statements, the cash credit limit enjoyed by them is Rs.50 lakhs. The inspection report of the concurrent auditor states that the stock figures reported include dead and slow moving stocks to the tune of Rs.17.50 lakhs, creditors is Rs.30 lakhs. The account is continuously fully operated at the sanctioned limit of Rs.50 lakhs, margin is 25%. For reckoning the stocks, only paid stocks are to be considered, value of slow moving, non moving and damaged stocks are to be reduced while arriving at the Drawing Power. In the instant case, the Drawing Power will be net of the slow moving stocks, consideration for the report of the concurrent auditor needs to be given, based on perusal of the concurrent auditor’s observation for the latest months the drawing power should be revisited to ascertain the operation in the cash credit account and also its status for asset classification. As the DP in this case will be only Rs.39.375 lakhs giving effect to the above, and since the account is being operated continuously around Rs.50 lakhs, the account is likely to undergo a change in asset classification if the branch has classified it as a Standard asset. Take away : Call for and peruse the concurrent auditors report for all large advances, note the deficiencies reported its current status and adequately document them.</td>
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<td><strong>3</strong></td>
<td>Work in progress of a Software product development company which is in the process of developing a new product since the last two years for Insurance vertical amounting to Rs.50 Crores is forming the drawing power towards limit of Rs.40 Crores, with margin of 25% An auditor needs to look into the quality of the assets and its realisable value in the normal course of activity. In the current situation, it would be advisable to see whether the branch has called upon the details of the orders book position for the supply of the product, in the absence of which the stocks may not have the same realisable value as the cost, especially considering the technological changes happening in the software industry with respect to the platform and parameters, the stage of development of the product, the evaluation criteria. If this be a large advance, it will be advisable that the branch auditor may visit the unit to further his understanding before arriving at his opinion.</td>
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| 4 | GOLDSTAR, a 3 star hotel, enjoys a Cash Credit Limit of Rs.100 lakhs against hypothecation of stocks and are regular in furnishing stock statements. Their annual turnover is Rs.10.80 Crores. Operation in the account is satisfactory and within the limit. | As an auditor, as part of the audit, the professional scepticism will be called upon to be exercised, the knowledge of business of the borrower who is being financed will be of use in making assessment and evaluating the regularity of operations in large borrowers accounts. 

In this case, the operations of the hotel, especially its F&B, Bar, stock of linen and carpets, furnishings could form part of the current assets.

The branch auditor, may be in a position to determine that when the monthly average turnover of the hotel being Rs.90 lakhs and the cost of goods sold if it were to be say 60%, then the current assets which are being turned over will be only around Rs.54 lakhs.

He should consider the current asset holding period to evaluate whether in such cases adequate stocks will be available as reported in the stock statement, or whether it calls for him to make a physical visit to the borrowers hotel.

If on the basis of the Auditor’s assessment and / or physical visit if the holding period is found to be less than three months,

there is a possibility of such account undergoing change in asset classification, in spite of the regularity of furnishing the stock statements based on which adequate drawing power may be available.

Take away: As the auditor is called upon to exercise diligence and professional scepticism in large borrower accounts, he is expected to apply himself in terms of Standards of Auditing with an eye to eliminate misstatements, fraud or error.
### II. Classification Date of NPA

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<tr>
<th>5</th>
<th>Elango Engineering was reported as an NPA Since 30.9.2011.</th>
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<tr>
<td></td>
<td>An account is to be classified as a Non Performing Advance, if the interest or instalment is not paid within 90 days from the due date.</td>
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<td>In the case of Cash Credit / Overdraft Accounts:</td>
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<td>The Account is irregular for more than 90 days if</td>
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<tr>
<td></td>
<td>a. There are no operations in the account</td>
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<td></td>
<td>b. There are no credit in the account for 90 days continuously</td>
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<tr>
<td></td>
<td>c. The credits in the account are not sufficient to discharge the interest debited to the account.</td>
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<td></td>
<td>d. The account is continuously in excess of the Sanctioned Limit / Drawing Power.</td>
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<tr>
<td></td>
<td>In the case of Term Loan Accounts where the interest or Instalment is not paid for 90 days from due date.</td>
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<td></td>
<td>In the case of bills purchased 90 days from due date.</td>
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<tr>
<td></td>
<td>In the case of Agricultural Loans for Short term Crop Loan 2 crop seasons from the due date or in case of Long Term Crop Loans 1 crop season.</td>
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<td>In the context of the norms, the date of NPA by aligning it with the quarter ends, is strictly not in line with the RBI norms, since upon an account becoming Non Performing, the first task for the management is to fix or classify the date of NPA, the role of the auditor is to verify the correctness of date from which an account will be classified as a Non performing advance.</td>
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<td>Take the case of the four quarters, in Q-1, April to June there are 91 days, in Q-2, July to September there are 92 days, in Q-3 there are 92 days and in Q-4 there are 90 days, except in cases of leap years (2012) wherein it will be 91 days.</td>
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Hence the date of NPA can never coincide with quarter ends, unless the dates from which the irregularity commences on 1st or 2nd of the beginning of a quarter as the case may be. This automatically means that for non payment of interest no account can have a date of NPA coinciding with quarter ends.

In the above example the date of NPA being 30th September, though it does not materially alter the income recognition or provisioning norms, it is strictly not in line with Reserve Bank norms, more so since, the auditors are called upon both in Long Form Audit Report as well as by way of independent certificate to authenticate that the RBI norms on IRAC as fully complied with.

| 6 | **Francis Furniture was reported as NPA since 3.4.2011** |

Continuing from the above example, it may be well worth the auditors attention, wherever the date of NPA is near about the year end to pay specific attention to determine whether the date of NPA is correctly mentioned or is it due to any error or misstatement, if there be any, then it might warrant reclassification in the asset status warranting proper classification and increase in provisioning.

Take away: Kindly test check the method of determining the date of NPA by the bank / branch and if it is strictly not in line with the RBI norms of 90 days, make a mention / qualification of the same both in LFAR and in the Certificate issued thereto, even though there will be no material impact on the reported financial statements.
### III. Realisable Security Value

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<td><strong>7</strong></td>
<td>Gopi Aqua Ltd., an NPA account had 100 acres of coastal land on which aqua culture was carried on. The land was pledged as security against its loan outstanding of Rs.20 Crores. The unit was infested with a disease and hence the account turned sick. During the boom period for aqua culture the price of these lands was Rs.30 lakhs an acre, the valuation report dated 31.3.2011 showed the value of land to be Rs.5 lakhs per acre.</td>
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<td>Realisable value of security is the actual value which the bank will be able to realise if the asset is sold in the open market in an arms length transaction. Considering the concept of realisable as the “real value” which the bank / branch will be able to realise, the valuation reports obtained to support the secured portion of the Doubtful advances should be closely verified, and if in the opinion of the branch auditor, such values are not realisable values then he may choose to determine the “realisable value” and adopt the same, subject to having proper evidence to that effect. In this case the value of security, needs to be tested, whether such land can be put to any use at all or not. If due to infestation of disease such land is not capable of being put to any use or due to coastal regulations such land cannot be sold then the realisable value of such security has to be considered accordingly and not based on the valuation report only. Note the valuation report should not be older than 3 years as at the financial year end, if it exceeds, the realisable value based on such report should not be considered as secured portion.</td>
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<td><strong>8</strong></td>
<td>Harsha P Ltd., engaged in leather garments, had an outstanding of Rs.50 lakhs the account was classified as a NPA by the branch auditor since August 2009, the unit is not functioning since July 2011. As per stock statement of January 2012 it has a stock of Rs.100 lakhs consisting of raw hides / leather of Rs.20 lakhs, semi finished goods of 70 lakhs and finished goods of Rs.10 lakhs (manufactured to a particular specification) The auditor will need to exercise the knowledge of the constituents’ business, considering that where the unit is not functioning since July 2011, the need for upkeep of stock of leather being an important aspect of preservation of the stocks, may have been impaired, and hence the realisable value of security may be different from the reported stock statements. Further having regard to the finished goods manufactured to particular specification and lying unsold, it may not find ready takers. The semi finished goods of raw leather / hides have an effective useful life, which gets diminished if not properly maintained this aspect will have a bearing in the minds of the branch auditor while determining the realisable value of security.</td>
</tr>
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<td>9</td>
<td>Imaging links, who had availed a Term Loan for purchase of machinery worth Rs.10 lakhs during 2008 has defaulted to repay the loan, the ‘guestimated’ machinery value as per the branch management as at 29th January 2012 is Rs.10 lakhs.</td>
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<tr>
<td>10</td>
<td>Jessi&amp; co, owes a bank Rs. 25 lakhs, the owner has given his property in his remote native village, a single large tract of land of 1000 acres valued at Rs.25 lakhs.</td>
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</tbody>
</table>

There exists a possibility of the realisable value of security at Rs.100 lakhs, or Rs.90 lakhs or Rs.20 lakhs or zero based on facts and circumstances and in the opinion of the branch auditor. It may most likely be different from the value adopted by the bank, if they have considered realisable value at Rs.100 lakhs.

Realisable value of machineries, for want of experts in the field of valuation cannot be a basis of ‘guestimated' value in the case of non performing advances. The branch auditor may in his opinion, apply accounting principles of depreciated values in substitution of ‘guestimated’ values of realisable value, in appropriate cases.

Realisable value will depend primarily upon the ability to realise the asset in cash or cash equivalents, in cases where the realisation of the asset itself could be in doubt, then such assets may have no realisable value. In the given illustration sale and realisation of large tracts of land may pose native challenges and unless demonstrated to be possible may pose questions to the auditors about the likelihood of the realisable value, on which he may have to exercise his professional judgment.

Take the case of a piece of property in the heart of a Metro City, If it is owned by a member of underworld, despite the property having value prima facie, may not have bidders warranting classification of realisable value of such property as NIL for the purposes of provisioning.
### IV. Inter Company Transaction:

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<td>11</td>
<td>R &amp; Co, is a group concern, enjoying loan facilities along with S &amp; Co in the same branch, each with Rs.500 lakhs limit. There are periodic inter transfer of funds between these two firms. But there are no business transactions between the same.</td>
</tr>
</tbody>
</table>
| 12 | Best Shoes Ltd is a shoe exporter enjoying Rs.500 lakhs Packing Credit Limit, Best Leathers Ltd is also in the business of exporting of shoe uppers, shoe intermediaries etc., enjoying Rs.200 lakhs Packing Credit Limit. Best Shoes Ltd did job works for Best Leathers Ltd to the tune of Rs. 50 lakhs during 2011. The Turnover of Best Shoes Ltd for the year ended 31.3.2011 was Rs.25 Crores and that of Best Leathers Ltd was Rs.10 Crores. During the year Best Shoes Ltd received an advance of Rs. 150 lakhs from Best leathers Ltd. | The audit angle could include that when the job works being carried out for a whole year being only Rs.50 lakhs, the receipt of Rs.150 lakhs towards advance for the same between group concerns may mean the following :

  a. Diversion of working capital limits sanctioned by the bank by Best Leathers Ltd to Best Shoes Ltd.
  b. Best Shoes Ltd in the absence of such accommodation would have reflected continuous over drawing beyond 90 days.
  c. If the excess Rs.100 lakhs of bank’s own money is reduced from the limit of Best Shoes Ltd, the asset status may undergo change.
  d. Concerns on assessment of working capital requirements of Best Leathers by the branch / bank.
  e. Post sanction supervision and monitoring by the branch may come into focus and needs to be reported in LFAR. |
Both the companies’ fund based Limits are fully utilized throughout the year and periodically beyond the limits, however not for 90 days continuously.

f. Based on observations on many such accounts as above, the Branch auditors may have to adopt substantive procedures to satisfy themselves about the extent of Internal Control and supervision at the branch.

g. The branch auditor may also pay close attention to any other factor, influencing such accounts, including possibilities of collusion or fraud.

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<th>V. Ever Greening / Restructured Accounts :</th>
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<td><strong>13</strong> Ever Green P Ltd., engaged in horticulture, obtained a Term Loan of Rs.100 lakhs on 1.6.2010, repayable in 50 Monthly Instalment of Rs.2,00,000/- with a moratorium of 15 months. However due to delay in commissioning of the project by 18 months, the loan was rescheduled with the following terms: Repayment to commence from 1.12.2011</td>
</tr>
</tbody>
</table>

Though the Company has been functioning, the capacity utilization was less than 50% and the cash flow position of Ever green P Ltd., was not comfortable and hence sought the rescheduling of the Term Loan Repayable from 1.12.2011 vide their letter dated 30.08.2011, which has been sanctioned by the bank on 3.2.2012.

On restructuring of an advance, it should immediately be downgraded for its asset classification. Refer Chapter 11 of the Master Circular of RBI on IRAC norms. However the exception to the rule are contained in the Circular issued by RBI as follows :

1. Before commencement of Commercial production (DCCB)
2. Restructuring of Infrastructure Lending
3. Special Regulatory Treatment due to the global economic meltdown announced during 2008 and implemented on or before 30th June 2009. (Chapter 14)

Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects/ activity financed by banks would be treated as an attempt at ever greening a weak credit facility.

In the present instance, the borrower has made an application before the due date for repayment on 30.8.2011, when the account is a standard asset, stating that the commencement of commercial operation has begun whereas capacity utilisation is less than 50% of estimates.

The bank / branch has rescheduled the loan on 3.2.2012.

The status of the account as on 1.12.2011 the date from which the repayment is rescheduled is a standard asset.

The question is, what is the date for determination for asset classification of restructured advances?
Opinion: As per RBI norms the status of the account as on the date on which the account is rescheduled by the bank determines the asset classification, therefore since the bank has restructured the account on 3.2.2012 and since the production has commenced and the account is neither covered under Infrastructure nor under Special Regulatory Treatment the account should be classified as NPA.

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<th>VI. Temporary Deficiency - Renewal of Cash Credit, Overdraft and Demand Loans.</th>
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<td><strong>14</strong></td>
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| 15 | Mohan, a Machinery Manufacturer obtained a Temporary Overdraft for 6 months against LIC Policies of Rs.2.5 lakhs on 1st July 2011. |
| | Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts. In view of the above norms LIC policies are not to be treated as NPAs, if adequate margins on the surrender value -are maintained. |
| 16  | Nath, a trader was sanctioned an adhoc limit of Rs.10 lakhs on 15.4.2011 for 6 months and the same was further extended for 4 months on 18.10.2011. | An adhoc facility should be reviewed / renewed within 3 months and if it is not done and remains adhoc for more than 180 days then such accounts may be classified as an NPA. Hence Nath account shall be reclassified as NPA. |
| 17  | Jewel Loans obtained by Jugraj on 30th December 2009 for a period of 2 years is still not redeemed. | Advances against gold ornaments, government securities and all other securities are not covered by the exemption covered for loans under NSC, IVP, KVP and LIC policies. Hence the loan on jewels which is overdue since 31st December 2011 is to be classified as an NPA. |

### VII. Temporary Deficiency – Stock Statements

| 18  | Varadaraj, a spare part dealer does not submit his stock statements for 3 months. | Stock statements relied upon by the banks for determining drawing power 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 borrower’s account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower’s financial position is satisfactory. Stock statements not received from September onwards in any working capital borrowing account will cause downgrading of the account as non performing, on account of non receipt it will become irregular during December and 90 days of such irregularity continuing the account becomes NPA during March. |
The branch auditor during the course of verification of the stock statement of X finds that out of the total stocks reported 25% is reported as non-moving and 15% damaged, the drawing power is less than that of the limit sanctioned. The borrower has been operating within the Sanctioned Limit.

In the course of audit of bank branches, one of the frequently observed feature in some accounts is, significant discrepancies between the stock and receivable statements submitted by the borrowers to the branches on the basis of which the Drawing Power is determined and operations are permitted by the branch, and the Stock / Book Debts figures in the Audited Financial Statements for the same date / period which vary significantly.

In such case, it is advised to rely on the stock / book debt as per the Audited Financial Statements, since reliance can be placed on the work of an expert, and the accounts being audited by fellow members is more reliable evidence than the stock / receivable statements furnished by the borrower.

VIII. Term Loans:

O' Coffee, has defaulted in repaying their Instalments and are classified as a Sub Standard Asset, they have not paid 3 monthly instalments as on 31.8.2011, a scrutiny of the ledger reveals that the instalments not paid pertains to the period 1.4.2009 to 30.6.2009 and such irregularity is continuously persisting with a backlog of 3 months overdue.

Accounts which were classified as an NPA due to arrears of interest and/or overdue principal, once paid by the borrower should no longer be treated as non-performing and may be classified as 'standard' accounts.

One of the primary factors that needs to be done, upon an account being classified as a Non performing advance, is the determination of “Date of NPA”. This date will remain the same till such time, all the deficiencies in such accounts are regularised warranting the account to be upgraded as standard.

In this illustration the irregularity is persisting from April to June 2009, whereas the status of account having been classified as NPA during the current year, warrants the branch statutory auditor to verify the date of NPA with reference to the operation in the term loan account, on the basis of which, it will slip from Sub standard asset classification made by the branch to a Doubtful 2 category.
21 Prince Pens have paid their Term Loan dues of 6 months upto 31st December 2011, on 3.2.2012 by issuing a cheque of Rs.60 lakhs from their Cash Credit Account. Upon transfer the balance Loan outstanding in the Cash Credit Account was Rs.135 lakhs as against a sanctioned limit of Rs.100 lakhs. The manager has reported the excess drawing to the controlling authority.

We do come across situations, when on the face of the audit of advance account, there may not be any serious irregularity, such as account being out of order or overdue for more than 90 days, whereas on closer scrutiny and observation, we may find that the accommodation made in the account, camouflage the hidden weakness.

One such case is the illustration, on the face of it the Cash Credit account is overdrawn for 58 days only and the Term Loan is regular upto December 2011, overdue instalments are only for the months of January & February and overdue is less than 90 days.

The overdrawing in the Cash Credit, conceals the fact that the excess over and above the CC Limit of Rs.35 lakhs has been used for regularising the overdue in the term loan account, but for such accommodation the term loan should have been classified as NPA. The branch auditor is suggested to pay closer attention for such instances and classify such accounts accordingly.

IX. EMI Concepts:

22 Prince was sanctioned a Housing Loan of Rs.72 lakhs on 10.4.2010 repayable in 180 instalments the EMI fixed was Rs. 45000/-. The borrower has been regularly repaying the EMI of Rs. 45000/-. The balance outstanding as at 31st March 2012 is Rs.76.5 lakhs.

As per the terms of sanction, if the EMI is fixed and the borrower is regular, as in the present case, even if the interest is not being fully serviced such accounts need not be classified as NPA provided the repayment of EMI is regular as stipulated.

There can be instances where on account of increase in the interest rates, the EMI would not have been reset upwards, thus the principal balance might be over and above the sanctioned limit.

Such accounts need to be scrutinised to ascertain the asset classification.

Mere outstanding in excess of limit where all terms of sanction are followed and repayments are made regularly by the borrower does not warrant reclassification of accounts.
<table>
<thead>
<tr>
<th>X. Circular Credits:</th>
</tr>
</thead>
<tbody>
<tr>
<td>23 Rajesh was sanctioned a Demand Loan of Rs.20 Lakhs, on the same day he deposited the money into his firm's account, which was used for paying a creditor S, which S, in turn paid towards his Term Loan account with the same branch.</td>
</tr>
<tr>
<td>A branch Statutory Auditor may in the course of his audit come across periodic transfers from one account to another, roundabout the year end; such transactions are fraught with professional scepticism, especially where they are channelled to save downgrading of borrowers account.</td>
</tr>
<tr>
<td>In most such cases, the application of audit procedures will reveal the intent and purpose and establish the factual situation warranting the auditor arriving at an opinion which may differ with the classification made by the branch.</td>
</tr>
<tr>
<td>24 Thomas and Unni are related entities both enjoying Cash Credit Limits of Rs.50 lakhs each. During the year the Credit summation of Thomas was Rs.20 lakhs and Unni was Rs.25 lakhs, the Cross transfer of funds from Thomas to Unni was Rs.15 lakhs and from Unni to Thomas was Rs.22.5 lakhs.</td>
</tr>
<tr>
<td>Credit summations are a tool to assess the healthy operations in the account, apart from the frequency and regularity of operations within the limit or drawing power.</td>
</tr>
<tr>
<td>Credit summations arising out of non business / trade transactions should be carved out in such analysis to arrive at an informed opinion.</td>
</tr>
<tr>
<td>Given this background in this case the credit summations in these two accounts seem to be one of accommodation, if they are genuine trade transactions then the account will be regular and standard account, if they do not have any commercial connection then it needs to be determined accordingly.</td>
</tr>
</tbody>
</table>
## XI. SARAFEASI Notice :

<table>
<thead>
<tr>
<th>25</th>
<th>Z Ltd., could not repay their Term Loan instalment of Rs.5 lakhs for the months of January, February &amp; March 2011 due on 10th of every month. During April the borrower was served with notice u/s 13 for possession of the securities.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The branches are required to issue notice under SARAFEASI under section 13(1), within 30 days of such accounts being classified as an NPA. Mere issue of SARAFEASI notice does not warrant reclassification of the borrower’s account. Nor is the need to apply the Accounting Standard AS-5, events occurring after balance sheet date having an impact on the balance sheet in this specific case to reclassify the advance account as an NPA.</td>
</tr>
</tbody>
</table>

## XII. Financial Statement Analysis – Threat of recovery :

<table>
<thead>
<tr>
<th>26</th>
<th>AAA Hosiery, a proprietary firm, was sanctioned a Cash Credit Limit of Rs. 10 Crores during 2008, the operation in the account is satisfactory, all the interest is paid up and credit summations have been good. The Net Profit for the year 31.3.2011 was Rs.15 lakhs against a turnover of Rs.175 Crores. The Balance sheet of the firm reflects that debtors beyond 2 years are Rs.150 lakhs. Creditors remain unpaid for more than 6 months.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In the audit of Large borrowers accounts, in line with the SAs, application of analytical procedures to Financial Statement will be useful and revealing to the bank branch auditor to determine the health, weaknesses, threat of operations and / or security etc., The fact that the receivables beyond 2 years of Rs.150 lakhs and outstanding creditors beyond 6 months are sure sign of weakness, coupled with the fact that the borrower is operating with wafer thin margin. If the account is a large borrower of the branch, it might be worthwhile to have a unit inspection to arrive at the opinion about the borrower’s status and standing vis a vis the statements submitted by them to the branch and its reliability. On the basis of the Audited Financial Statements, weakness is clearly visible.</td>
</tr>
</tbody>
</table>
Vikram Ltd whose net worth has eroded by 50% was declared sick by the management in the Audited Financial Statements for the year ended 31.03.2011, the Term Loan repayments are irregular as on 31st March 2012, two instalments are pending. The unit has stopped functioning since February 2012.

However, where there are potential threats for recovery on account of erosion in the value of security or non availability of security and existence of factors such as frauds committed by borrowers it will be prudent to classify the same as doubtful or loss straightaway instead of going through the various stages of classification.

Arising out of the above, the unit being declared sick and stopped functioning, the branch auditor needs to determine the threat of recovery while determining the asset classification though the 90 days norm for classification has not arisen as on 31st March 2012.

XIII. Sale of Asset – Threat of recovery:

Zen who had obtained a Term Loan for buying a car had an outstanding of Rs.1500000/- in his account, he has not paid 2 months instalments, however it came to the notice of the branch that he has sold the car on 28th March 2012, there are no other securities/assets with Zen

The sale of the primary security has brought upon the threat of recovery arising out of the non availability of security and existence of factors such as fraud by the borrower which prudentially calls for such account to be straightaway classified as a Loss Asset instead of going through the various stages of classification.
### XIV. Diversion of funds:

<table>
<thead>
<tr>
<th>29</th>
<th>Rohan bought a Hyundai Accent Car, his balance sheet reflected capital including Current Account of Rs.5 lakhs, fixed assets including the car Rs.15 lakhs. He enjoys Rs.10 lakhs Cash Credit Limit and there are no other loans.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>It is a simplistic illustration of diversion of short term funds for long term purposes, it always showcases absence of Drawing Power to enjoy the Cash Credit and the post sanction monitoring weakness in such account.</td>
</tr>
<tr>
<td></td>
<td>As part of audit of advances, the branch auditor may look into instances of diversion of funds such as term loan repayments to other banks / NBFC's made from cash credit advances which are not financed by the bank / branch and which are not factored into at the time of credit appraisal or renewal.</td>
</tr>
<tr>
<td></td>
<td>Diversion of funds could be for long term purposes, to companies under same management or for consumption purposes where the accounts are of proprietors / partnership firms.</td>
</tr>
</tbody>
</table>

### XV. Letters of Credit Devolved / Bank Guarantees Invoked.

<table>
<thead>
<tr>
<th>30</th>
<th>On 30th March 2012 Vikram's Letters of Credit and Bank Guarantees were devolved and invoked by the respective persons; the branch paid the same on 1st April 2012, by keeping them under other assets.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Where debits arising out of devolvement of letters of creditor invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.</td>
</tr>
<tr>
<td></td>
<td>The exception to the rule is when Bills discounted under LC favouring a borrower may not be classified as a Non performing advance (NPA), when any other facility granted to the borrower is classified as NPA.</td>
</tr>
</tbody>
</table>
However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

The amounts paid on 1st April 2012 by the branch should be accounted for by way of MOC and brought on record as dues from Vikram as on 31st March 2012, the asset classification will be same as classification of other accounts, if any, or else will become NPA from June 2012.

### XVI. Borrower-wise Asset Classification:

| 31 | Raghuram has three accounts with the branch, a Term Loan which was a standard asset, a Cash Credit account which was also a standard asset however a Bill Purchased for Rs.10 lakh on 18th December 2011 had not been realized as on 31st March 2012 by oversight. | All the facilities granted by a bank to a borrower will have to be treated as NPA and not the particular facility which has become irregular. Thus the Asset Classification is borrower wise and not facility wise. As the Bill purchased account of Raghuram is a NPA the term loan and cash credit accounts also should be classified as NPA. |
| 32 | Restructured Accounts – fresh limits. | The only exception to the rule is when, any additional finance may be treated as 'standard asset', upto a period of one year after the first interest/ principal payment, whichever is earlier, falls due under the approved restructuring package. However, in the case of accounts where the pre-restructuring facilities were classified as 'sub-standard' and 'doubtful', interest income on the additional finance should be recognised only on cash basis. If the restructured asset does not qualify for upgradation at the end of the above specified one year period, the additional finance shall be placed in the same asset classification category as the restructured debt. |
### XVII. Knowledge of Business:

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<tbody>
<tr>
<td>33</td>
<td>Yash Ltd is engaged in bakery business. The total turnover of Yash Ltd for the current year is Rs. 60 lakhs which is 10% higher than their previous year turnover, the stocks held by them are Rs.30 lakhs as against a Cash Credit Limit of Rs.20 lakhs.</td>
<td>The application of Standards on Auditing play a vital role in the audit of bank branches also, conforming to that, the knowledge of business will enable the bank branch auditor to look through, that the bakery business with turnover of Rs.5 lakhs per month, will have cost of sales which may be about 75% and the need to stock goods which are easily available in the open market may be stocked for a week to 15 days requirement at best. Hence the amount of stocks which are being reported for the purposes of enjoying the higher Cash Credit limit may result in actual DP not being there in such account. In such a case Yash Ltd should be classified as NPA.</td>
</tr>
<tr>
<td>34</td>
<td>Francis, a retailer having turnover exceeding Rs.100 Crores, dealing in FMCG goods very frequently draws huge cash, other than for salaries and other expenses.</td>
<td>Certain Industries operate predominantly using cash for various transactions such as construction activity for paying the labour who may not possess bank accounts, Services and Information technology sectors may transact more through the banking channel, such periodic cash receipts and deposits, is an area of concern, in terms of compliance with the laws and regulations and the auditor’s responsibilities thereto, the branch auditor may call for and look into cash transaction in individual accounts or high value cash receipts / transfer in the branch to ensure that there are no frauds / money laundering which are not reported by the branch. In FMCG retailing frequent cash drawings may not be required; the branch auditor shall undertake a substantive analysis in this account.</td>
</tr>
</tbody>
</table>
### XVIII. Physical Stock Verification:

| 35 | Mr. Rao, the branch statutory Auditor, during his visit to one of the borrowers' premises observed the following: |

|   | a. Stock books are not properly maintained. |
|   | b. The stocks reflected in the stock statement and physical verification showed significant variance |
|   | c. There was slow moving / seconds stocks |
|   | d. There were damaged goods. |

In the audit of large borrower accounts, it may well be recommended to the bank branch auditor to include physical inspection of borrowers’ unit.

In the course of which, if he comes across the situation as observed by Mr. Rao, he may have to give effect to these findings before he arrives at his opinion regarding the regularity of the operations in the Cash Credit accounts.

He may have to report about these weaknesses in the Long Form Audit Report.

He may also make out his observations as part of a separate letter addressed to the branch management as part of communication to those charged with governance as per Standards on Auditing.

### XIX. Government Guaranteed Advances:

| 36 | KBG a power project was outstanding to the tune of Rs.100 lakhs, the original amount sanctioned was Rs.75 Crores. The last date for repayment was 31.3.2011. Ledger Account shows that the amount outstanding is disputed interest on account of excess charged by the branch over and above the refinance rate. |

|   | Loan Sanctioned to the unit was Guaranteed by the Central Government which has become overdue, and the guarantee is invoked. |

The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income. The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirements in respect of State Government guaranteed exposures. With effect from the year ending 31 March 2006 State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/ or principal or any other amount due to the bank remains overdue for more than 90 days. The issue under consideration is not of an NPA account of a Government Guaranteed advance, which has to be decided as above, in this case the interest having been recognised as Income, which was not part of the terms of refinance warrants de-recognition of income by passing an MOC. |
Secondly, though the Guarantee is invoked, the account being guaranteed by Central Government will not become an NPA unless the guarantee is repudiated by the Central Government.

In the case of State Government advances or guarantees they rank on par with any other borrower account.

In the given illustration the excess interest recognised as income in an earlier year need to be reversed by passing MOC. In which case the ledger balance of the borrower will become zero and hence the account need not be classified as NPA.

### XX. Agricultural Advances.

<table>
<thead>
<tr>
<th>37</th>
<th>Muniyappa had taken a crop loan on 25.3.2011 of Rs.25000/-, on 25.3.2012 he took a mortgage loan of Rs. 25000/- which was directly paid to repay his crop loan.</th>
</tr>
</thead>
</table>

the instalment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. For the purpose of these guidelines, “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops, would be treated as “short duration” crops.

The crop season for each crop, which means the period upto harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.

Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him.

In respect of agricultural loans, and term loans given to non-agriculturists, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.

It will be required to see whether Muniyappa is an agriculturist or non agriculturist, though loan is a crop loan.

Secondly, no loan can be repaid by way of a fresh loan; hence Muniyappa’s loan shall be classified as NPA.
<table>
<thead>
<tr>
<th>38</th>
<th>Ramappa had repaid his crop loan by availing additional loan for sugarcane crop which was affected by drought during the year 2010-11.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Drought hit areas are notified and loans are rescheduled. In case of conversion or rescheduling, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms and conditions.</td>
</tr>
</tbody>
</table>

**XXI. Continuous Overdrawing – Discretionary power:**

<table>
<thead>
<tr>
<th>39</th>
<th>Mahesh Associates ledger account in the branch reflected that they had continuously been using Rs.110 lakhs as against the sanctioned limit of Rs.100 lakhs for four months, the branch manager has stated that he has used his discretionary power (upto 20% of sanctioned limit) and hence the account is a performing asset.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The branch manager or controlling authority are vested with discretionary powers, which they may exercise in the course of discharge of their duties.</td>
</tr>
<tr>
<td></td>
<td>Such discretionary powers or reporting to controlling authorities regularising the acts of the bank personnel does not grant the status to the excess permitted above limit as sanctioned limit.</td>
</tr>
<tr>
<td></td>
<td>Hence the outstanding balance having continued to be Rs.110 lakhs as against the sanctioned limit, without questioning the authority for operation by the branch incumbent, asset classification will undergo change as Non performing due to continuous over drawing over the sanctioned limits.</td>
</tr>
</tbody>
</table>

**XXII. Staff Advances against Shares:**

<table>
<thead>
<tr>
<th>40</th>
<th>Prabhu, staff of a bank apart from availing other loans has also availed loans against shares; the market value of such shares has reduced by 50% for the last 1 year due to huge volatility in the stock market. The outstanding is fully utilised upto the limit throughout the year.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loans to staff by banks / branches are generally outside the purview of the norms, mainly due to the reason that the dues are recovered from the salaries of employees and covered by retirement benefits.</td>
</tr>
<tr>
<td></td>
<td>In certain cases, loans are granted like any other commercial loans, loans against shares to employees are one such category of loans given to them.</td>
</tr>
<tr>
<td></td>
<td>The Drawing Power not being available such account will be classified as NPA, consequently all other accounts of the Prabhu will also undergo change in classification.</td>
</tr>
<tr>
<td>XXIII. <strong>Window Dressing:</strong></td>
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<td>---</td>
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</tr>
<tr>
<td><strong>41</strong></td>
<td>There is a solitary credit of Rs.15000/- on 31st March into the account of Venkat in his Cash Credit account when the outstanding balance on 30th March was Rs.112000/- the credit is by way of discounting of a cheque. There were no credits in the account during the last six months except for the above.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>XXIV. <strong>Premises Loan :</strong></th>
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<tbody>
<tr>
<td><strong>42</strong></td>
<td>A Term Loan was given to Raja the landlord by the branch, the terms of repayment was the entire rent to be adjusted towards the Term Loan, The EMI was Rs.80,000/- per month, rent was Rs.70,000/- per month. The landlord has not been paying the additional Rs.10000/- from his pocket since the repayment commenced during January 2008, the account was not classified as a Non performing asset since the branch has the possession and security of the premises.</td>
</tr>
</tbody>
</table>
The landlord has also been asking for an increase in the rent to the extent of Rs.1,00,000/- being the market rent, however as per the agreement rent is to be enhanced by 10% once in two years. The matter is pending settlement including increase as per rent agreement not being paid.

XXV. PMRY Loans:

| 43 | As per PMRY Loan scheme a moratorium of a maximum of 18 months can be offered, however the branch manager has not given any moratorium to Ramesh an unemployed youth to set up his Xerox shop, Ramesh has not paid last 6 months instalment. The branch manager states that the account will remain a standard asset considering the moratorium that is permissible. |
| Classification of assets should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realisation of dues. The operation in the account is to be determined with reference to the terms of sanction. If the terms of sanction, does not provide for the beneficial provisions of any scheme, it cannot be applied later, at the stage of asset classification, where there are well defined credit weaknesses in the account. Hence Ramesh’s account should be classified as NPA. |

XXVI. Advances under Consortium lending:

| 44 | Clive Steels Ltd is a consortium Advance enjoying Term Loan Limit of Rs.800 Crores, the Lead Banker is X who has funded Rs.400 Crores, Bank A and Bank B have lent Rs.200 Crores each. |
| Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks and other aspects having a bearing on the recoverability of the advances. |
In the books of X Ltd the account is standard, whereas there are outstanding for more than 4 months in Bank A and 2 months in Bank B. Further, in the above case, the following factors are found, that Bank X has collected the Term Loan instalments on behalf of Bank A and Bank B and has not remitted it to them though the borrower has paid all the dues to the consortium leader.

Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account will be treated as not serviced in the books of the other member banks and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

On the basis of the RBI norms, in the illustration the account will be classified as NPA by Bank A, whereas in Bank X and Bank B the account will be a Standard Asset.

The recovery made by Bank X on behalf of Bank A or Bank B will not be reckoned as it is an inter se arrangement only, whereas asset classification should be done exclusively on the record of recovery of individual member banks and hence the account will still be a NPA account in Bank A.

XXVII. Advances to PACS / FSS:

| 45 | Balarama Bank had granted loans to Rajya Raitha Sangha a Primary Agricultural Cooperative Society to be on-lent to its 300 members. These loans have been given in four separate tranches of A, B, C & D loan accounts. |
| 69 | In respect of agricultural advances as well as advances for other purposes granted by banks to PACS/ FSS under the on-lending system, only that particular credit facility granted to PACS/ FSS which is in default for a period of two crop seasons in case of short duration crops and one crop season in case of long duration crops, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS. The other direct loans and advances, if any, granted by the bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA. |
Out of Loan Account C, 25 farmers have defaulted in making payment of 3 instalments aligning with crop seasons as at 31st March, the branch auditor has classified the account of the PACS account as NPA. The bank contends that only the Facility C should be classified as NPA and not the entire finance to the Rajya Raitha Sangh PACS.

Asset classification is normally borrower wise and in the normal course all the accounts of the Rajya Raitha Sangha PACS, viz Account A, B, C & D should have been classified as NPA. However since it is an on-lending scheme and each set of loans and borrowers being distinct, the practical difficulties which might arise if all borrowal accounts of PACS / FSS are classified as NPA, RBI has mandated an exception to the general rule by warranting only such credit facilities which are in arrears and not all credit facilities sanctioned to a PACS / FSS should be classified as an NPA.

XXVIII. Loans with moratorium for payment of interest:

46 A Ltd who has taken a Term Loan of Rs.100 Crores for an infrastructure project which has been granted the Loan by R Bank, with the terms that interest during construction need not be paid and forms an integral part of the project cost.

The Loan enjoys a moratorium of 18 months from the date of commencement of first disbursement.

\ Hence the outstanding in the account is more than the sanctioned limit by Rs.2 Crores on account of non servicing of interest during construction.

In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence do not become NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/ advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates.

As per terms of sanction the interest during construction being part of the project cost becomes funded interest. On accrual the interest income recognised on due basis. However if interest applied in the account continues to remain unpaid even after the moratorium period, then such accounts will be classified as NPA and interest income will be recognised only the basis of record of recovery.
### XXIX. **BIFR accounts restructured**

| 47 | Exhausted Ltd whose net worth had fallen below 50% and was referred to BIFR has made an application for restructuring their fund based facilities of Rs.125 Crores, which has been approved by the General manager Credit. |
| 47 | BIFR cases are not eligible for restructuring without the express approval. CDR Core Group in the case of advances restructured under CDR Mechanism may consider the proposals for restructuring in such cases, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package by the competent authority. The CDR proposals are to be approved by the core group and not by the General Manager Credit and hence might warrant auditors’ reclassification of the account. |

### XXX. **Norms for restructuring of Infrastructure projects**

| 48 | Prosper & Co Ltd, who had an ambitious project linking National Highways to the tune of 100 kilometers had availed of Rs.500 Crores as term loan from a bank, however due to delay in acquiring the land due to litigation by the farmers, the State Government was unable to acquire them and provide the same, there was expected to be a delay of 2 years in commencement of commercial operation of the project. |
| 48 | No account will be taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them, which may be applied on a case-to-case basis, depending on merits of each case. Illustratively, the parameters may include the Return on Capital Employed, Debt Service Coverage Ratio, Gap between the Internal Rate of Return and Cost of Funds and the amount of provision required in lieu of the diminution in the fair value of the restructured advance. |
Hence the Loan has been rescheduled by the bank.

In the same case, as part of the rescheduling proposal no further documents, information or financials including cash flow projections have been furnished by the borrower, whereas the restructuring has been done on a summary basis.

The accounts not considered viable should not be restructured and banks should accelerate the recovery measures in respect of such accounts. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects/ activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns/ action.

As the rescheduling of the loan has arisen on account of factors extraneous and due to litigation, it is eligible for restructuring of such infrastructure loans and hence will continue to be classified as a standard asset.

However, care should be taken, if the factors are not external but only internal for the delay in commencement, then in such cases the maximum period for which the CCOD can be extended will be only one year from the original date.

Further, since the financials including the cash flow of the borrower have not been furnished and an active assessment of the viability of the project not having been done, it will warrant supervisory concern of RBI.

The branch auditor may have to call upon further details to satisfy himself about the financial viability before arriving at his opinion of the asset classification.

In the given example since no financials including the assessment of the viability of the project has been made while restructuring the loan, the account of Prosper & Co Ltd should be classified as NPA.
## XXVII. Recognition of Funded Interest and Conversion to Equity:

| 49 | Mars Ltd whose term loan was restructured as per the CDR mechanism converted Rs.10 Crores of Funded Interest into a Zero Coupon Bonds. The borrowers cash credit account was already classified as NPA. The branch is authorised to hold the ZCB investments in the books of the branch. However the ZCB is classified as performing by the branch. |
| FITL / debt or equity instrument created by conversion of unpaid interest will be classified in the same asset classification category in which the restructured advance has been classified. Further movement in the asset classification of FITL / debt or equity instruments would also be determined based on the subsequent asset classification of the restructured advances. In line with the above norms the Zero Coupon Bonds should be classified as Non performing and appropriate provision needs to be made. |

## XXXII. Restructuring of accounts wherein fraud or misfeasance found:

| 50 | Bouncers Ltd has manipulated their stocks and receivables and diverted the working capital limits of Rs.50 Crores enjoyed by them with V Bank. This fraud was unearthed and reported by the concurrent auditors as part of their inspection of units. The liquidity position having deteriorated the company approached V bank for restructuring the advance and classify it as a standard asset. |
| Borrowers indulging in frauds and malfeasance will be ineligible for restructuring, banks may review the reasons for classification of the borrowers as wilful defaulters specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and satisfy itself that the borrower is in a position to rectify the wilful default. The restructuring of such cases may be done with Board’s approval, while for such accounts the restructuring under the CDR Mechanism may be carried out with the approval of the Core Group only. Borrowers who play fraud on the bank or misfeasance are ineligible for their accounts being restructured. In view of this the account should not have been restructured by the bank, unless the circumstances warrant that the action of classifying it as a fraud account is arbitrary or ill conceived. In the present case since the fraud of the borrower is established by external means, such account will continue to be fully provided for and no restructuring should be permitted by the bank. |
4.3 Practical Issues in Audit of Areas other than Advances and LFAR

While it cannot be denied that in respect of Bank branch audit, verification of loans and advances and provisioning requirements thereon constitute an important aspect in respect of materiality, application of professional skill and allotment of time, verification of items other than advances and compliance with the reporting requirements thereon are equally important. This is clearly evidenced vide reporting requirements under Long Form Audit Report, various Certifications, Tax Audit as well as report on the status of compliance of the recommendations of Ghosh and Jilani Committees.

The accounts of the branch which are subjected to audit by the branch auditor is a component of the balance sheet of the bank as a whole and any laxity on his part on examination of the accounts might affect the accounts of the bank as a whole. As in the case of any other audit assignment the motto of the branch auditor of a bank must be to plan, perform and complete the assignment taking into account the Standard Auditing Procedures.

The verification of area other than advance would consist of application of Standard Auditing Practices in respect of verification of assets (other than advances) and liabilities, items of incomes and expenditure and contingent liabilities.

Frauds:

Attention of the branch auditor is drawn to the circular issued by RBI (Circular No.DBS.FGV.(F).No.BC/23.08.001/2009-02 dated 3rd May 2008 relating to the recommendation of Mitra Committee.

The Circular enjoins the branch auditor to report to the RBI and also the C and MD of the bank anything susceptible to fraud or fraudulent activity. As per the said Circular any deliberate failure on the part of the auditor should render himself liable for action.

Compliance with Accounting Standards:

The branch auditor must ensure that the compliance with accounting standards adopted by the bank for recording the transactions pertaining to areas other than advances are adhered to by the branch. Special care must be taken to ensure that the Standards on Auditing are followed in respect of audit of areas other than advances.

Accounting for Premises and other assets

The premises are generally controlled by the central office and the branches do not normally deal in any manner with regard to the acquisition of premises. There may be few instances where the branches are instructed to negotiate the terms and pay advance to the seller of the property.
There may be instances where the branches have been asked to undertake registration formalities of the premises purchased by the bank. Care should be taken to ensure that the registration and legal expenses are not treated as an item of expenditure in the branch accounts.

**Accounting for Fixed Assets and Depreciation:**

- The branch auditor has to ensure that the branch has complied with the instructions of the central office in particular with regard to accounting for Fixed Assets and provisioning of depreciation.

- The branch auditor should ensure the opening balances have been correctly incorporated as per the previous audited balance sheet. The MOCs relating to this issues suggested by the previous auditors while finalising the accounts for the preceding financial year have been given effect to the accounts of the current year.

- There may be a few instances of transfer in and transfer out of assets between branches and controlling offices. Care must be taken to ensure that these transfers are not considered as purchase and sales. The transfer of assets should be done together with accumulated depreciation where the depreciation is charged by the branches.

- There may be instances where the assets (notably computers) have been put into use by the branches but not capitalised awaiting the instruction from controlling office. Sufficient evidence might be available in the branch viz., (issue of certificate by the branch officials regarding installation of the said assets) in which case it is imperative on the part of the branch auditor to insist on provision of depreciation through MOC. In case the depreciation is provided in the central office, the branch auditor must ensure that MOC is given for capitalisation.

- The branch auditor has to ensure that the branch maintains records of all the fixed assets acquired by it as stipulated in the requirements contained in LFAR format.

- The branch auditor must ensure the figures as appearing in the depreciation schedule should tally with the figures as per the fixed assets register and report on the discrepancies if material.

- Some of the banks require branch auditor to undertake a physical verification of certain high value items on furniture and fittings in which event it must be duly carried out.

It is pertinent to note that the guidance note on audit of fixed assets does not indicate any mandatory requirement on the part of the auditors to undertake a physical verification of the assets. It only requires the auditor to ensure that there is an effective programme for the verification of the assets by the management and whether the said programme has been implemented.
Verification of Cash and Bank Balance

The branch auditor should ensure cash is physically verified as a part of Standard Auditing Procedures. He must also take into account the reporting requirements of LFAR on this issue.

OTHER ASSETS

The other assets would normally comprise of Sundry Debtors/Sundry Assets and Suspense Account. The Branch Auditor should exercise utmost care with regard to the verification of the items appearing under this head in particular Sundry Debtors/Suspense accounts. The items grouped and parked under this head consist of transactions which by their very nature are susceptible to frauds/irregularity. The Branch Auditor has to look into the instruction issued by the Central Office to the branches, with regard to the speedy disposal of items appearing in these accounts. The Branch auditor should scrutinise the breakup of items in Suspense Account and recommend provisions/write off, if in his opinion items appearing in these accounts are not recoverable or represents items of expenditure.

Specific instances requiring Branch Auditor’s attention

- Advance to vendors for the supply of equipment or advance to contractors for undertaking repairs/renovation work. The examination of the relevant files might reveal that the equipment has already been supplied and put into use by the branch while the payment made towards account already made would still be shown under Sundry Debtors for want of approval from the higher authorities, so might be the case in respect of renovation or furnishing of the branches. The branch auditor must ensure that suitable MOCs are given for the capitalisation/write off.

- Instances of balance carried forward from earlier accounting years in respect of advances and bills payable in respect of the same transaction, which might remain unadjusted for clearance from Central office. The Branch Auditor must suggest suitable MOCs for matching the transactions.

- Payments to panel advocates towards their fees and expenses (pertaining to suit filed cases and also in respect of cases in which the suits are yet to be filed both in respect of borrowal and nonborrowal accounts) might be included under this head. The RBI has vide Circular dated 13th September 2009 regarding the treatment of legal expenses on suit filed accounts has stated that the legal expenses incurred on suit filed accounts should be expensed at the time of incurrence. Accordingly there is no scope for any legal expenditure on suit filed accounts remaining unadjusted in this account.
4.4 Other Practical Issues

**LIABILITIES – Inoperative accounts**

**DEPOSITS**

The Branch Auditor apart from undertaking the routine audit checks for the verification of deposits must ensure that the branches adhere to norms laid down for the inoperative accounts.

**OTHER LIABILITIES**

The branch auditor must evaluate the internal control procedures and undertake the verification of items under other liabilities with relevant registers. He should look into old outstanding entries in particular drafts payable remaining uncleared. There might be a possibility of drafts payable remaining unmatched with corresponding entries in demand drafts paid without advice.

**ITEMS OF INCOME AND EXPENDITURE**

The Branch auditor must ensure strict compliance of the accounting policies adopted by the banks with regard to the accounting of income/expenditure in particular locker rent, recovery in NPA accounts, Income on Bills Discounted, increase in rent pending sanction etc. The branch auditor should give necessary MOC’s, if warranted.

**INTEREST ON OVERDUE DEPOSITS**

Some of the banks follow the cash basis of accounting with regard to the payment of interest on overdue deposits. Instructions are also issued to branches not to provide interest on overdue term deposits not renewed as on the date of Balance Sheet. Some of the banks provide the system of automatic renewal of deposits on their maturity. It would be necessary for the branch auditor to make a mention in his report regarding the non provision of interest on overdue term deposits if the accounting policy of the bank in this regard is to account for on accrual basis, whereas provision on such accounts are made at the Head office for the bank as a whole.

**VERIFICATION OF CONTINGENT LIABILITIES**

The branch auditor should call for and verify the Complaints register, files wherein claims against the bank / branch have been lodged and their current status.

The branch auditor must look into each and every item listed in the contingent liabilities statements to satisfy himself that none of the items have become crystallised liabilities warranting provision. The branch auditor might come across evidence to indicate that as on the date of his audit that the item shown in the contingent liability statement might have turned out to be crystallised liability. Example: Court Verdict awarding damages for customers, compromise entered into with the landlords for the enhancement of rent for the premises etc., In these context compliance with the mandatory Accounting Standard 4 have to be kept in mind and suitable entries for MOC have to be suggested.
4.5 Practical Issues in Audit in CBS environment

Audit under the Core Banking environment is posing challenges due to the technological changes, wherein the entire double entry system of accounting does not happen at the branch level itself for all transactions, the day end command validates and updates many transactions and completes the accounting function on a day to day basis. Understanding of the core banking will enable the branch auditor to perform his role effectively.

Note on the CBS operations:

Majority of the banks today are functioning on Core Banking Solutions (CBS). CBS is an integrated software system that facilitates integrated and real time processing of data. The paradigm shift in the banking sector warrants changes to audit approach. The traditional audit approach in such a highly complex and computerised environment has been rendered outdated and redundant. The data recording, processing, interface, transmission and storage are built within the system and there are no physical books of account.

The practical issues which may arise in the audit of CBS branches is in obtaining the data which will be in prn or txt files in a zipped format.

The branch auditor should obtain such prn or txt files of exception reports, deposit and borrowers accounts based on which he will be able to perform the audit using such data.

The entire audit of advances can be done by exporting such prn and txt files and converting the same into excel file by way of a series of commands in the process of conversion. The branch auditor should learn and familiarise himself with such conversion into excel file.

Upon conversion into an excel file, the data can be analysed with reference to:

- List of accounts which has not been renewed for more than 180 days
- List of accounts beyond sanctioned limit for more than 90 days
- List of account where no drawing power is available/ inadequate
- List of accounts where no interest has been applied though performing advance.
- List of accounts where interest is short / excess charged than stipulated.
- List of NPA accounts where interest is applied and recognised.
- List of NPA accounts where asset classification is wrongly made
- List of accounts where no processing or inspection charges are debited
- List of accounts where transactions have happened in inoperative accounts
- List of accounts where the maker checker control is not exercised.
- List of accounts where transactions have been put through in non banking hours.
• List of accounts where SoD and EoD are made beyond normal/extended banking hours or on holidays.

MASTER FILE AND PARAMETER FILES

There might be various nomenclatures as per the application package terms but there are basically three main types of data files:

1. Transaction file contains the transactions of the Bank.
2. Master file contains the needed information for processing transactions.
3. Parameter Files contain 'control' elements to avoid high frequency of changes. Thus the TDS rate and Service Tax rate which are known to change frequently will be in a set of files known as 'Parameter files'.

Master file and parameter files should be checked under any audit, as these are sensitive areas for fraud and leakages.

The designing of audit procedures requires the knowledge and expertise of the auditor in doing a proper risk and controls assessment, in line with the audit objectives. Amongst the key objectives from an IT perspective is to assure that internal controls in the branch are commensurate with the size and nature of business. The computer audit check list formulated by the Reserve Bank of India, can serve as a guideline in this regard.

5. LONG FORM AUDIT REPORT

5.1 Long Form Audit Report or LFAR

• LFAR is a report by the Statutory bank/branch auditor meant for Reserve Bank of India in addition to the statutory Audit Report.

• RBI in the year 1985 directed all PSBs to get a report called Long Form Audit Report (LFAR) which codified the earlier practice of branch auditors giving a separate report in addition to the main report.

• Bank Management and RBI attach great importance to LFAR and rectification of all irregularities pointed out by the branch auditors in LFAR.

• LFAR of the branch is useful in framing the LFAR of bank by the Central Statutory Auditors.

• It is a good practice to submit the LFAR along with the Audit Report and better still to finalise the same in the branch itself.

Long Form Audit Report.
I . Assets

1. Cash
   a) Check cash on the day of your visit, work back the cash on 31st March from cashier’s scroll. Include Petty Cash, Teller Cash and Cash held for postage and also ATM cash balance if it is serviced by the branch.
   b) Certain banks insist on separate certificate for cash on 31st March. This can be given on the basis of working back from the date of physical verification.
   c) Insurance coverage on cash on hand and cash-in-transit may not be available at the branch, if available, after specific enquiry, report the same or else report ‘not applicable’.
   d) Study Cash on Hand account in General Ledger to see whether the actual holding exceed the limits fixed. If the excess holding is continuous report the number of days it has exceeded. (With the maximum held at any time during the year).
   e) Random Scrutiny for joint custody and periodic checking by the branch officials may be done.

2. Bank Balances
   Some branches like main branch in a town/city or branch handling clearing work maintain bank accounts with RBI, SBI or other banks. If such account are held, verify the Bank Reconciliation (BRS) and check the confirmation of balance certificate with BRS. No revenue items pending accounting should be shown in BRS. All other items in BRS should be recent and subsequent clearance should be ensured. Any items which are revenue in nature or to be accounted for or adjusted should be carried out by giving MOC.

3. Money at Call & Short Notice
   Balance held at the branch on this account with the general / specific authority of Head Office (HO)/Controlling Office (CO), if any, non-compliance with HO/CO instructions should be reported.

4. Investments
   Generally branches are not permitted to hold investments or account for them, however in some cases to facilitate collection and recording of interest, banks may permit physical holding or accounting or both, in which case;
   a) Physical inventory of the investments should be checked with physical scrips.
   b) If the investments are held in demat form certificate of custody on 31st March from Depository Participant should be obtained and see the same tallies with records of the branch.
c) Inventory of investments duly certified by the branch auditors should be forwarded to CO/ZO/HO according to the closing instruction from the bank.

d) Report separately matured/overdue investments held by the branch which have not been encashed. This will be evident, as the date of maturity of each investment will be recorded in the branch. The nature, amount, maturity date and reasons for non-encashment should be included in the report.

e) Accounting of income on investments-follow the instructions given by H.O. In some cases the income is shown as income from investments at the branch and in most cases it is accounted by H.O

XIII. YEAR WISE BREAKUP OF ECGC CLAIMS TO BE REPORTED:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Number of Accounts</th>
<th>Amount Claimed</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Balance</td>
<td>xxxxxxxxxxxxxxxxx</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add: Claims Lodged</td>
<td>xxxxxxxxxxxxxxxxx</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Claims Settled (year Wise)</td>
<td>xxxxxxxxxxxxxxxxx</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Claims Rejected (Year Wise)</td>
<td>xxxxxxxxxxxxxxxxx</td>
<td></td>
<td>Check whether provision is needed</td>
</tr>
<tr>
<td>Closing Balance</td>
<td>xxxxxxxxxxxxxxxxx</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims ought to be lodged but not done</td>
<td>xxxxxxxxxxxxxxxxx</td>
<td></td>
<td>to be obtained from the branch</td>
</tr>
</tbody>
</table>

Branch Auditors should go through the records/files maintained by the branch. If the previous year’s LFAR contain the details up to 31st March of the previous year, only updating of current year details need to be obtained. Otherwise the position at the branch will have to be worked out.

As regards DICGC / ECGC Claims, check the status of pending claims on 31st March along with that on 31st March of the previous two years. If the same is pending, chances are that DICGC / ECGC may have rejected it and branch may be unaware of it or settled as a whole and details not got from controlling office preferring the same for the bank as a whole. Please ascertain the correct position and see whether any provision is needed for rejected claims, if so pass necessary MOC. In case of claim settled accounts verify whether the proportionate amounts are returned to DICGC / ECGC.

RECOVERY POLICY

- HO may communicate the recovery policy of the Bank through its circulars. Examine cases of compromise, settlement and write-off whether they are in conformity with such policy. If the branch is not aware of any recovery policy, please report the factual position and give appropriate disclaimers.
• Branch auditors may get the benefit of a review of such cases by higher authorities, as in most of the cases such compromise, settlement, write-offs are approved by the RO’s/ZO’s.

• List of details of compromise, settlement, write off involving Rs 50.00 lakhs and above may be obtained from the branch and reported.

a) Guarantees and Letter of Credit
   i) Guarantees invoked, paid but not adjusted
   ii) Guarantees invoked but not paid.
   iii) LC’s Co-acceptances funded by the branch

List to be obtained from the branch, verified and reported as required in the proforma.

6 OTHER ASSETS

a) Stationery & stamps
   i. Verify the records especially for security stationery regarding custody and control.
   ii. If any series is missing on examining the same is to be reported.

b) Suspense account / Sundry assets

Year wise break-up to be worked out from the General Ledger / Subsidiary records and report the same. If the same is available in the previous year LFAR only an updation is needed.

Some banks carry OYT Deposits, non refundable telex deposits, but which should have been written off over certain period continuing as other assets. MOC for write off of such assets should be recommended with the details in LFAR, keeping in mind the materially threshold.

II LIABILITIES

a) Deposits

• As most of the branches are fully computerized, guidelines on the operation of inoperative accounts are system driven, check the same. For manual branches, ensure compliance with circulars on operation of in-operative accounts.
• Peruse the General Ledger for the first few days in April, to check whether there are any unusual movements (increase or decrease) in aggregate deposits. If yes, call for clarification and comment accordingly.
• Overdue/Matured deposits should be identified, listed and reported in LFAR, with the period for which it is overdue and whether branch has provided interest on the same as per bank’s policy.
2. OTHER LIABILITIES
   a) Give year wise break up (i.e. pending for three years and more) of old outstanding in Bills Payable, Sundry Deposit account and other similar payable accounts. Often such information is available in previous year LFAR if so only updation is needed. If not available this figure may be culled out from the subsidiary records.
   b) If there are any large / material debits to these payable accounts during the year, report the number of entries, nature and amounts and scrutinise for correctness.

3. CONTINGENT LIABILITIES

Claims can arise due to the following

I. Cases filed by depositors, customers in consumer courts for deficiency in services, excess charging of interest or other matters. If records are not maintained, lawyer’s bills, correspondence may have to be perused.

II. Claims from Income-tax, on account of TDS remittance, non-remittance, short remittance may have arisen. This information may have to the obtained and reported.

III. Obtain a representation from branch that all contingent liabilities have been disclosed and they do not include any items which are likely to result in a loss, affecting incomes / expenses / assets or liabilities.

4. PROFIT & LOSS ACCOUNT

a) As most of the branches are computerized.
   i. Check out the interest field, as how rates are changed and also whether the system automatically applies the interest or it is manually driven. Errors normally occur in correcting the changes in the interest field. Test check interest application in few large advances / to see whether there are any material variations.
   ii. Please go through Revenue Audit / Income-Expenditure leakage audit, concurrent audit, internal inspection reports for the year under audit for revenue leakage and recovery.
   iii. Procedures for checking interest on deposits are the same as advances.

1. BOOKS & RECORDS

a) Obtain and peruse IS Audit report on the readiness and preparedness of the computer systems, checks and balances. If no IS Audit is done during the year under audit, give a suitable disclosure of the same reporting when the last IS audit was done.
b) Branch manager’s certificate on the functioning of entire computerized systems including compliance with prescribed procedures may help the branch auditor in reporting on the level of compliance.

2. RECONCILIATION OF CONTROL & SUBSIDIARY RECORDS
   1) Call for the reports in all cases instead of merely assuming that in a computerized branch there is balance of control and subsidiary records.
   2) There could be problems with opening balances, while migrating from manual records or switching over to CBS, often two systems may have to be integrated.

3. INTER BRANCH ACCOUNTS
   a) Check how inter branch statements are forwarded to CO/HO but importantly check how the branch responds to check memos of controlling offices. Normally a register is maintained showing the receipts of such memos and how it is disposed off. This must be checked by branch auditors.
   b) Reconciliation of balances as per branch books and HO books are not feasible in most of the banks. Suitable disclaimers may be given in LFAR.

4. AUDIT / INSPECTIONS
   Report whether branch is covered by concurrent audit / Inspection during the year. If so, whether report obtained and reliance placed on the findings of such report in framing the auditors opinion. Especially material weaknesses reported and still persisting should be reported by the branch auditor.

5. FRAUDS
   Check whether a register for Fraud is maintained. If not obtain a management certificate from the branch manager and give a suitable disclaimer in LFAR.

6. MISCELLANEOUS
   1) Check for window dressing by perusing the subsequent General Ledger abstract for the first week of April.
   2) Other suggestions may be divided mainly into
      a) Those for the bank management
      b) Those for Central Statutory Auditors.

Any suggestion which can improve the functioning, profitability of the branch, from observations, interactions of the branch auditors will be of great value to the branch. Please do not hesitate to give suggestions, as it enhances the quality of LFAR.
5.2 LFAR for specialised Branches

A. Branches dealing in Foreign Exchange Transactions
   1. Report on the persistent irregularities pointed out in the reports of Concurrent, Internal Auditors & RBI Inspectors regarding NRI deposit accounts.
   2. Report of the Concurrent Auditors can be relied upon for compliance with guidelines of controlling authorities.
   3. Obtain a list of Nostro accounts maintained by the branch and verify the same for regularity of operations, periodic reconciliation and confirmation.
   4. Confirm that the branch follows the procedures in relation to maintenances of Vostro accounts, along with periodic reconciliation and confirmation.

B. Branches dealing in Recovery of NPAs such as ARMBs

The scope, extent, principles are same as that of regular branch audit with focus only on Non performing advances, efforts made towards recoveries in such accounts, various stages of the legal steps including suit filed, suit filed and decreed, decreed and execution petition filed etc., Major item to be vigilant is on accounting of the legal expenses in the profit and loss account instead of to the borrowers account and Verification of recoveries made in line with the recovery policy of the bank and valuation reports.

C. Service Branches – Branches dealing in clearing House operations:
   1. Periodic review of outstanding entries in clearing adjustment entries.
   2. Old, large, unusual outstanding entries in Inward clearing, outward clearing which remain unexplained should be reported by the branch auditors with Year wise break-up with number and value separately for inward clearing and outward clearing.
   3. Comment on level of compliance with guidelines of CO in regard to clearing operations.

5.3 Special Consideration in LFAR, Tax Audit and Certifications:

While issuing a special purpose audit report or certificate, the auditors should bear in mind the following recommendations made by the Institute of Chartered Accountants of India, in terms of the Guidance Note on Audit Reports and Certificates for Special purposes.

a) A reporting auditor should have a clear understanding of the scope and nature of the terms of his assignment, it is desirable for him to obtain the terms in writing to avoid any misunderstanding.

b) In many cases, a reporting auditor can choose the form and contents of his report or certificate. In other cases the form and contents of the report or certificate are specified by statute or notification and cannot be changed.
c) Where a reporting auditor is free to draft his report or certificate he should consider the following:

i) Specific elements, accounts or items covered by the report or certificate should be clearly identified and indicated.

ii) The Report or Certificate should indicate the manner in which the audit was conducted, e.g. by the application of generally accepted auditing practices, or any other specific tests.

iii) If the report or certificate is subject to any limitations in scope, such limitations should be clearly mentioned.

iv) Assumptions on which the special purpose statement is based should be clearly indicated if they are fundamental to the appreciation of the statement.

v) Reference to the information and explanations obtained should be included in the report or certificate. In certain cases, apart from a general reference to information and explanations obtained, a reporting auditor may also find it necessary to refer in his report or certificate to specific information or explanations on which he has relied.

vi) The title of the report or certificate should clearly indicate its nature, i.e. whether it is a report or a certificate. Similarly, the language should be unambiguous, i.e. it should clearly bring out whether the reporting auditor is expressing an opinion (as in the case of a report) or whether he is only confirming the accuracy of certain facts (as in the case of a certificate). For this, the choice of appropriate words and phrases is important.

vii) If the special purpose statement is based on general purpose financial statements, the report or certificate should contain a reference to such financial statements. However, the report or certificate should not contain a reference to any other statement unless the same is attached therewith. It should be clearly indicated whether or not the statutory audit of the general purpose financial statements has been completed.

viii) Where a report requires the interpretation of a statute, the reporting auditor should clearly indicate the fact that he is merely expressing his opinion in the matter. He should take sufficient care to ensure that in respect of matters which are capable of more than one interpretation; his report is not misconstrued as representing a settled legal position.

ix) An audit report or certificate should ordinarily be a self-contained document. It should not confine itself to a mere reference to another report or certificate issued by the reporting auditor but should include all relevant information contained in such report or certificate.
x) The reporting auditor should clearly indicate in his report or certificate, the extent of responsibility which he assumes. Where the statement on which he is required to give his report or certificate, includes some information which has not been audited, he should clearly indicate in his report or certificate the particulars of such information.

5.4 Summary of frequent observations by Bank branch auditors in LFAR

1. Omission to obtain application, financial statements (audited for working capital limits exceeding Rs. 10 lakhs in the case of non corporate borrowers).
2. Omission to create second charge, non extension of equitable mortgage already created for additional / enhanced limits.
3. Incomplete Stock statement, non-adherence to periodicity.
4. Non-registration of charge / modification with ROC.
5. Non-obtaining of certificate for creation of charge from ROC.
6. Inadequate insurance cover.
7. Irregular and ineffective inspection.
10. Position of all limits of a borrower not available in a single statement.
11. Resolution of board / AGM for creating equitable mortgage / borrowing in excess of the aggregate of paid up capital & free reserves not on record.
12. Non obtention of key in case of vehicle loans
13. Periodic drawings permitted beyond sanctioned limits in operative accounts.
15. Periodic bouncing of cheques of borrower accounts.

With each irregularity, give all instances – it is a must, then alone branch can take corrective action.

5.5 Tips to carry out an effective and speedy Branch audit of Bank

- Study previous Statutory Audit Reports, LFAR, Concurrent Audit report, Internal Inspection Report, RBI Inspection Report. This would give a snap shot of the health of the branch.
- Study the Account closing Circular, intimation from HO on the scope of the audit and Instruction on completion of the audit. List out the statement to be signed and
certificates to be given, how many copies and to whom. Follow the instructions fully given by HO while intimating appointment, in ensuring a speedy conclusion.

- Obtain a copy of the published accounts of the bank and go through the accounting policies and other disclosed policies. Ensure that these accounting policies are implemented by the branch. Wherever these are not followed, the same should be qualified in the branch auditor’s report. Refer to the same in LFAR where questions are asked on the adoption of accounting policies.

- Use the printed stationery supplied by the bank for all reports, certificates, as far as possible, unless a soft copy of the same is available and the auditor is able to get a computer facility at the branch.

- Finish the LFAR first. This will ensure the completion of bulk of your audit. Get the branch manager to sign your copy of LFAR.

- Finish all certificates that can be completed along with LFAR

6. Specific Aspects in Tax Audit

The members of the profession are quite conversant with the Tax Audit themselves, the author does not deem it fit to cover individual items covered in Annexures to Form 3CD, but would like to highlight only the specific / limited aspects in relation to Bank branches.

The proforma supplied by the banks themselves would have marked ‘Not Applicable’ to most of the columns in Form 3CD, however in clause 17(f) under 40(a), even if it is marked as “Not Applicable” the bank branch auditor shall pay attention to see whether any disallowance is called for under the provisions of that section.

The major aspects of Tax Audit in bank branches is significantly restricted to few clauses such as, on Depreciation claims as per section 32 of the Income Tax Act, details of additions to block of assets and on 40(a)(ia) for disallowance for non deduction of tax at source in Clause 17 (f) and corresponding reporting of the same in Clause 27, and repayment of deposits by cash covered under section 269T.

Most other reporting aspects are not applicable to bank branches.

The bank branch auditor should take care to see that the reporting of the Tax Deduction at source and remittance of the same within the prescribed time by the branch is done meticulously. Further reporting of any deficiency, deviation or delay should also find place, wherever necessary in the corresponding clause 17 (f).

7. CERTIFICATIONS

7.1 Certification of Asset Liability Management
Asset Liability Management is the most important tool by which the Reserve Bank of India monitors the liquidity and health of the banking industry and their ability to discharge their obligations to constituents on timely basis. The maturity profiling and monitoring is the method by which the Department of Banking and Supervision of Reserve Bank of India monitors banks in terms of this parameter.

The certification of Asset Liability management is an important one which the Central Statutory Auditor looks upto and relies on the certification issued by the branch auditor.

The Asset Liability Management Statement contains the details of the deposits and fund based Loans and Advances which have different maturity patterns. The maturity patterns are classified into different buckets based on the due dates of their falling due for payment or collection.

The key aspects which the branch auditor should pay attention is to ensure that the figures of Advances and Deposits as per the Audited Financial statements are matching with those in the ALM statement. The Maturity Pattern considers that all Non performing advances are classified in the last bucket.

The branch auditor should undertake test check of the information furnished by way of obtaining print outs, for example the first bucket consisting of Demand Deposits will be the sum total of the balance in savings bank and current accounts under deposit plus credit balance in Cash Credit/Overdraft accounts and Demand Loans under Advances.

The test checking and ascertaining the correctness of the entries made in the master data in respect of maturity data pertaining to large advances and high value deposits as per the statement furnished by the branch is important before the branch auditor proceeds to certify Asset Liability management.

The branch auditor should note to keep in mind that, any change in the asset classification will warrant a change in the bucketing / maturity pattern of such advance accounts to be carried out in the Memorandum of changes. Hence the branch auditor should qualify his certificate stating “subject to MOC” drawing reference thereto.

### 7.2 Certification of Ghosh and Jilani Committee Recommendations

Ghosh Committee Recommendations deal with items relating to frauds and malpractices in Banks and the action thereto, it is in the form of a questionnaire in respect of the implementation status at the branch with answers in the forms of Yes / No mode only and there are no options like - Being done, Sometime / often etc., If the activity does not relate to the branch only then, ‘Not Applicable’ may be indicated.
Ghosh Committee Questionnaire covers vast and wide areas the relevant portions for branch audit, has 54 queries and Jilani Committee questionnaire has 10 questions to be answered for implementation status.

Ghosh committee contains issues related to day to day administrative functions that take place in a bank. It is to ensure the safety of assets, compliances with laid down policies and procedures, accuracy and completeness of the accounting and other records, proper segregation of duties and responsibilities of the staff and timely prevention and detection of frauds and malpractices.

Jilani Committee deals with EDP environment in banks, and those dealing with the inspection / internal audit system and miscellaneous aspects of functioning of banks.

Reserve Bank of India has issued circular to branches covered by concurrent audits and during inspections to verify and comment on the status of implementation of the recommendations of the Ghosh and Jilani Committees.

The responsibility of the implementation of the recommendations and preparation of the certificate is of the branch management, the branch auditor is only to report upon the status of implementation. His audit procedures would comprise mainly of inquiry and confirmation. Accordingly the branch auditor may enquire from the branch whether it has prepared the report on the implementation, then whether the same has been forwarded to the Head Office for necessary action, obtain a review copy, if the status report indicates that any of the recommendations has not been implemented, the branch auditor should request the concerned management to give a written representation as to why the particular recommendation has not been implemented.

The branch auditor should insist on the concurrent auditor’s certification, wherever applicable, on the Ghosh and Jilani Committee reports to place reliance thereon.

Finally, it may be appropriate for the branch auditor to specifically state that the certificate is issued on the basis of the information and explanations furnished to them and that they have themselves not tested whether the implementation has actually been done or not.

### 7.3 Certification of Capital Adequacy Ratio

The statement of capital adequacy deals with the capital resources of the bank in relation to the risks associated with its operations, determined on the guidelines, based on the international agreements entered into by the G-10 nations popularly known as the BASEL Norms. The framework is to have sufficient capital to provide a stable resource to absorb any losses arising from the risks in the business. Capital is divided into tiers namely Tier I and Tier II representing different quality of capital.
While the subject is quite elaborate, at the branch level, it is at a micro level and hence only the risk weight assignment and its correctness is to be checked and certified by the branch statutory auditor. The branch auditor is advised to ensure that the figures of advances tally with the figures reflected in the audited financial statements and the risk weights of the respective categories of the assets are properly reflected.

7.4 Certification of PMRY and SEEUY Schemes

These Certificates are in the nature of general purpose certificates where the correctness of the information is to be verified by the branch auditor, with respect to the records, registers, loan application forms and control returns submitted by the branch on quarterly basis, furnishing details of the amount of subsidies claimed and kept in separate accounts.

The certificate may further warrant year wise, amounts claimed, received, pending and claims yet to be made, which needs to be ascertained by the branch auditor and then certified.

7.5 Compliance Certificate for maintenance of SLR / CRR

Due to the very nature of its operations, banks need to maintain sufficient liquid assets in the normal course of their business. The failure of the bank to meet its liabilities to depositors when called upon will undermine the confidence on the bank in particular and banking system in general. Thus recognising the need RBI to safeguard the interest of depositors has directed banks to maintain a portion of its total demand and time liabilities in liquid assets and by way of Cash Reserve Ratio.

It is an important certificate of the Branch auditor which enables the Central Statutory Auditors to ensure that the data of Statutory Liquidity Ratios furnished by the banks, are correct and that the bank is complying with the requirements of the SLR in terms of investment in specified securities and holding of cash balances. The duty of the branch auditor includes to verify the cash balance on a particular day and ascertain the branch cash balance, bank balance etc on the 12 dates selected and intimated to them.

At the branch level, this is done by verifying the correctness and completeness of the statements sent on reporting dates by the branch. The branch statutory auditor should test check the statement of Assets & Liabilities sent on the specified dates (12 odd dates) selected by the Central Statutory Auditors and certify the same for its correctness.

7.6 Certification of Compliance with RBI Norms on IRAC

Care should be taken by the bank branch auditor especially with respect to audit of advances, asset classification, date of crystallisation of NPA, availability of value of security and provisioning before giving the certificate of compliance with IRAC norms.
7.7 Certification of DICGC / ECGC

The branch auditor should call for the records, register in connection with accounts wherein DICGC claims have been lodged and realised and ensure that recoveries in NPA accounts on claim paid accounts are duly identified to ensure that the proportionate remittances to DICGC corporation is made.

In ECGC accounts, all accounts wherein the ECGC cover is eligible, verify whether the branch has ensured that the premiums are paid to keep in force the cover, in accounts where the claims are to be preferred whether claims are made, details of accounts where claims are made, the status of receipt and pendency could be obtained by the branch auditor for his certification.

Further on ECGC claim paid accounts, upon recoveries from borrowers a statement of account wise recoveries made and proportionate remittances done shall be obtained from the branch by the branch auditor before issuing the certificate.

7.8 Certification of Interest Subvention Schemes for Agriculture / Export Sector:

The branch auditor may:

- call for the relevant circular on advances to agricultural / Export sector based on which interest subvention scheme is implemented,
- identify the loans granted under that scheme,
- check their eligibility for Interest Subvention,
- ascertain the correctness of the information regarding the claim made by the branch.

From the database, call upon the branch to furnish the list of accounts under this scheme and check the accuracy before certifying the correctness of the statement produced.

7.9 Certification of Technology Upgradation Fund (TUF) schemes for textile sector:

To give fillip to the technology upgradation of textile sector, to enable them to upgrade their technology and move over to less polluting technology, a special scheme was introduced for funding the upgradation, towards which subsidies were provided by the Government of India. The banks were entrusted with the task of funding such units which satisfy the requirements of the scheme and were to report about the same as part of the control returns.

The branch auditor should call upon the required information, such as the loan application, eligibility of the borrower to be covered by the scheme, the actual end use, by ensuring that the payments are being made directly to the vendors etc., to enable the branch auditor to satisfy himself about the correctness of the information in the certificate.
7.10 Certification of passing of previous year MOC

One of the certificates which the branch auditor may be required to certify is about passing of the MOC suggested by the previous branch auditor.

While in the normal course, the branches would have incorporated the MOC’s in the books off the branch, entries with respect to reclassification of advances are to be done in the statements which do not form part of the accounting records and hence the branch auditor should take sufficient care to ensure that such MOC’s are effected by the branch, and after ascertaining the correctness of the classification, the branch auditor shall issue the certificate.

7.11 Certification of Provision for Restructured Accounts

As per BASEL requirements the provision for standards assets are to be made, however such provisions are not made at the branch level, but are centralised at the Head office of the Bank.

The accounts which are restructured either under the special regulatory treatment or being an Infrastructure project, being project under implementation as are governed by the Reserve Bank of India norms and on account of which they are classified, even though as Standard, have tendencies of a risky asset.

Considering the additional risk such assets carry, it is mandated to provide for a higher percentage of provision for such restructured advances by the Reserve Bank of India at the rate of 2% of the outstanding balance together with the sacrifice arising out of the change in the terms of tenure and rate of interest calculated at its net present value.

This provision for restructured asset calculation is done at the branch since all details including sanction letters are available at the branch.

Certificate of Provision for restructured advance accounts warrants the branch auditors’ verification of the correctness and completeness of all restructured advances being included in the calculation and provisioning statement.

7.12 Certificate of Sensitive Sector and CRE

Under this certificate the bank branch auditor is required to analyse the loan portfolio to determine the sensitive sectors which are more prone for being easily affected for the credit quality, such as, advances to capital markets, directly or indirectly for subscription to shares to individuals, stock brokers, market makers or for subscriptions to IPO or for convertible bonds / equity oriented mutual funds, or advances made where the collaterals are fund based advances to venture capital funds.
Exposure to commercial real estate is also a highly sensitive sector prone for fluctuations and defaults. The readers are requested to call for and peruse the circular of Reserve Bank of India on the definition and categories covered under the exposure to Commercial Real Estate. Apart from advances directly to real estate such as developers, promoters, contractors this clause also includes hotels & hospitals, mortgage based loans, rent securitisation or rent factoring.

Housing Loan advances in excess of Rs.30 lakhs are also covered under this category apart from residential mortgages such as reverse mortgages, Advances for Property Mortgage Loan (APML) etc. The branch auditor should seek information which bifurcates Housing loans under above 30 lakhs, those covered under APML and reverse mortgages for this exercise.

This is done with a view to provide for the additional risk such assets carry by way of 2% provision on such assets under the Standard Asset category.

8 AUDIT CLOSURE – DOCUMENTATION & REPORTING

8.1 Discussion with management and documentation

Upon completion of the audit process, the branch auditor shall discuss the matters observed by him and arising in connection with the various aspects of the audit with the branch management.

If on the basis of the audit, there arises requirement for passing Memorandum of Changes affecting the Balance Sheet or Profit and Loss Account, Asset Classification and / or provisioning, off balance sheet items such as contingent liabilities, Statement of Asset Liability Management, Capital Adequacy etc., the same shall be discussed with the branch management and it is desirable to obtain their concurrence.

If the branch management is not concurring with the branch auditor, they may be called upon to furnish their written response to support their views / contentions. The branch auditor may then analyse the written submission and then carefully decide to proceed with the determination and accordingly pass necessary Memorandum of Changes. This practice apart from enabling the branch auditor to arrive at the correct conclusions, will also strengthen the audit documentation process.

This is also in line with the Standards on Auditing which warrant that the auditor should communicate audit matters of governance interest arising from the audit of financial statements with those charged with governance of an entity. The discussion may include the potential effect on the financial statements of any significant risks and exposures.
8.2 Methodology for preparing MOC

The branch auditor should read the Closing Circular issued by the banks to the branches, wherein the procedure to be adopted for preparing the MOC will be mentioned in detail. He should acquaint himself with the methodology of preparing Memorandum of Changes, especially the details required to be furnished as part of MOC, the correct account codes, corresponding effect of every debits and credits etc. Wherever the interest or other incomes are reversed on Non performing advances the MOC for provisioning should be net of such reversals.

Care and attention should be paid by the branch auditor to ensure that the MOC’s are backed with adequate documentation and are correctly reflected in the statement of MOC with reasons.

8.3 Arriving at an Opinion

The bank branch auditor may arrive at his opinion, considering the scope of the audit, the extent of the coverage of audit, the policies, procedures and practices prescribed by the bank for its branches, and the deviations if any in the application of the stated policies / procedures.

Compliance with accounting policies and standards, deviations or inconsistencies therein warrant drawing reference either as an emphasis of matter as a paragraph in the report or by way of a modified opinion in the audit report shall be considered.

The Auditor’s report should also contain the management responsibility statement, both in the main report as well as in the Tax Audit Report. The following assertion on the body of the Main Report and Tax Audit report shall form part of the reporting by the branch statutory auditor.

We have audited the attached Balance Sheet of ........................, branch of ................. Bank, as at 31st March ............. and also the Profit and Loss account for the year ended on that date annexed thereto. These financial statements are the responsibility of the branch management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidences supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
8.4 Qualification in the Main Report

The branch auditor, whenever he comes across instances where certain accounting are carried out only at the Head office should ensure that the Audit Report contains details of such disclosure for example ‘subject to MOC’, or expenses towards interest on overdue deposits, taxation, provision for employee benefits or provision on Standard Assets, provision on Non performing advances etc are done only at Head office.

If the format of the audit report of the bank does not include such disclosure, the branch auditor may well include such disclosures to enable the users of the report to understand that the audited financial statements are subject to such exceptions at the branch, which as per the policy of the banks are made / provided for at the Head office.

8.5 Working papers

Having seen the need, necessity and requirements to maintain adequate documentation, by way of sufficient and appropriate audit evidence the working papers, provide the support and evidence when called upon. The working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.

Working papers should be designed and properly organised, the standardisation of working papers such as, confirmation of balance of bank accounts maintained with other banks, record of locker for keeping duplicate keys of the branch / backups, sanction letter copies, statement of accounts, financial statement of major advances, concurrent auditor’s report highlighting weakness in individual accounts which are persisting, control returns, check lists, specimen letters, improves efficiency with which they are prepared and reviewed.

Working papers should be sufficiently complete and detailed for an auditor to obtain an overall understanding of the audit. The extent of documentation is a matter of professional judgment. It is neither necessary nor practical that every observation, consideration or conclusion is documented by the auditor in his working papers. All significant matters which require the exercise of judgment, together with the auditor’s conclusion thereon, should be included in the working papers.

A proforma of working papers is furnished under audit check lists.
9. ICAI GUIDELINES and PEER REVIEW

9.1 Communication with previous auditor

The appointment of the bank branch auditor happens on the basis of the Multi Purpose Empanelment Form submitted by the member / firm of Chartered Accountants, to the Professional Development Committee of the Institute of Chartered Accountants of India. The ICAI, on the basis of the eligibility parameters, forwards the same to Reserve Bank of India. Reserve Bank of India, in turn send the list of eligible auditors / firms to the respective banks. The banks appoint their branch auditors based on the category (I, II, III or IV) providing adequate independence and transparency in the appointment of Statutory Bank branch auditors.

There generally arises doubt or question, whether for such assignments also, it is required to obtain the written consent from the outgoing auditor of the previous year.

As per the Code of Ethics issued by the Institute of Chartered Accountants of India, read with Clause 8 of the First Schedule of the Chartered Accountants Act, 1949, communication with the previous auditor is mandatory even for bank branch auditors. Non compliance with this requirement are fraught with undesirable consequences.

9.2 Ethical Issues and Code of Conduct

The branch auditors render the statutory attest function and hence are prohibited from doing any management related work such as Concurrent Audit, Revenue Audit or Income Audit of a bank / branch, with the only exception being the Central Statutory Auditors representing on tax matters of the bank before the tax authorities, that too only with the prior approval of Reserve Bank of India.

Similarly Concurrent Auditors, Revenue Auditors, Income Auditors, Stock Auditors, Book Debt Auditors, rendering services to the management are not eligible to carry out Statutory Audit of the branch of the bank including limited review for quarter ends.

However, it has come to the notice that many of the banks are appointing the Concurrent Auditors to carry out limited review exercise; the matter has been reported to the Reserve Bank of India by the Institute of Chartered Accountants of India, mentioning the code of conduct. In view of which the members who are branch concurrent auditors and are carrying out the limited review of the branches allotted to them by the banks are cautioned to look out for the Reserve Bank of India’s stand / reply and are then advised to undertake the exercise so that they do not incur the wrath of the accounting regulator.
9.3 Peer Review requirements

Peer Review requirements are mandatory for all Practice Units (PUs) who carry out the audit of bank branches or even concurrent audit and hence the necessity to comply with the Statement of Peer Review is compulsory. The Peer Review requirement is a mechanism, whereby the Institute of Chartered Accountants of India, through peer reviewers enrolled with ICAI and duly trained by them, verify the process, procedures, plan and programs used / adopted by the Practice Units in the course of their attest services.

The review also includes on test basis verification of the sample, the audit documentation maintained and the working papers based on which the compliance with Standards on Auditing, compliance with the technical Standards, Statements, Guidance Notes and other publications of the Institute of Chartered Accountants of India, evidences internal and external to support the existence of the audit having been carried out on the basis of the information called for and obtained which are sufficient appropriate audit evidences are adequately established, evidencing the Correspondence between the auditor & the auditee and the basis on which the opinion is formed.

Post December 2010, there is a paradigm change in the scope of the peer review, which till then was providing a firewall between the peer review and disciplinary. However post December 2010, based on the observations of the peer reviewer the Institute of Chartered Accountants of India may suo motto institute proceedings against any member for any weakness / irregularity observed in the course of the peer review.

In view of the changed scenario, it is advised that the members undertaking the branch bank audit, shall make adequate plan, have documented audit programs, checklists, other documentations, working papers and other records to show case the same at the time of peer review.

10 RBI NORMS FOR EMPANELMENT AND APPOINTMENT OF BRANCH AUDITORS

10.1 RBI norms on Branch Audits

In respect of SBAs, categories of audit firms/ auditors (as prescribed by RBI) would be considered while allotting branches in such a way that larger branches are audited by the bigger/ more experienced audit firms.
Only auditors duly qualified under the provisions of section 226 of Companies Act 1956 which deals with qualifications & disqualifications of auditor of a company and with no adverse remarks/ disciplinary proceeding pending/ initiated against the firm/ any of its partners/ proprietor on the records of ICAI would be considered as eligible for appointment as auditors.

In addition to the requirements of Section 226(3) of the Companies Act 1956, in regard to indebtedness, any audit firm selected for appointment would have to certify that none of the spouse, dependent children and wholly or mainly dependent parents, brothers, sisters or any of them, of any of the partners/ proprietor of the firm or the firm/company in which they are partners/ directors are indebted to the Bank.

A declaration as per the format prescribed by the RBI will be obtained that none of the partners/ proprietor of the audit firms, or their spouse, dependent children, wholly or mainly dependent parents, brothers, sisters or any of them, of any of the partners/ proprietor of the firm or the firm/company in which they are partners/ directors have been declared as wilful defaulters by any Bank/ financial institutions. If any auditor/ audit firm refuses to give such declaration statutory audit assignment would not be allotted to them.

It would be ensured that the all approved auditors/ audit firms are allotted appropriate audit assignments and no distinction would be made between the continuing auditors and the fresh auditors in allotment of Branches.

**Application of Revised Empanelment Norms for Bank branch auditors’ Panel**

Members may please note the application of the new empanelment norms as given in the examples below:

1. A & Co. is a partnership firm of 2 partners B & C. B has a proprietorship firm of his own, B & Co.
   a. A & Co. and B & Co. both apply – B & Co. will be rejected and A & Co. will be treated as a proprietorship firm.
   b. Only A & Co. applies – A & Co. will still be treated as proprietorship firm.

2. ABC is a partnership firm of 3 partners, and all 3 have proprietorship firms A & Co, B & Co. and C & Co. – All applications (ABC, A & Co., B & Co., C & Co. or any combination thereof, or of the individual firms) will be rejected.
### RBI norms on appointment of branch auditors

Revised norms for categorization of audit firms for their empanelment as branch auditors for public sector banks and branch allocation to different categories of audit firms.

<table>
<thead>
<tr>
<th>Category</th>
<th>No. of CAs exclusively associated with the firm (full-time)</th>
<th>No. of partners exclusively associated with the firm (full time) (Out of 2)</th>
<th>Professional staff</th>
<th>Bank audit experience</th>
<th>Standing of the audit firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>I.</td>
<td>5</td>
<td>3</td>
<td>8</td>
<td>The firm or at least one of the partners should have a minimum of 8 years experience of branch audit of a nationalized bank and/or of a private sector bank with deposits of not less than Rs.500 Crores.</td>
<td>8 years</td>
</tr>
<tr>
<td>II.</td>
<td>3</td>
<td>2</td>
<td>6</td>
<td>The firm or at least one of the partners should have preferably conducted branch audit of nationalized bank or of a private sector bank with deposits not less than Rs.500 Crores for at least 5 years.</td>
<td>6 years (for the firm or at least one partner)</td>
</tr>
<tr>
<td>III.</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>The firm or at least one of the CAs should have preferably conducted branch audit of a nationalized bank or of a private sector bank with deposits not less than Rs.500 Crores for at least 3 years.</td>
<td>5 years (for the firm or at least one partner)</td>
</tr>
</tbody>
</table>
Even proprietorship concern without bank audit experience may be considered as hitherto.
(The proprietary concerns of Chartered Accountants with 1 paid CA, 2 professional staff and not having any statutory branch audit experience of a nationalized bank or of a private sector bank with deposits not less than Rs.500 Crores will be treated at par with the partnership firm after deducting their 3 years seniority from the date of their establishment).
11 Audit checklists:

11.1 Model Bank Audit Engagement Letter

11.2 Model Audit Plan

11.3 Checklist of Bank Branch Audit Program

11.4 Model Checklist for Long Form Audit Report

11.5 Model Checklist for verification of advances

11.6 Checklist for Evaluation in computerised environment

11.7 Model Checklist for Documentation of Bank Branch Audit

11.8 Model Communication with previous auditor

11.9 Draft Management Representation letter (two copies are there to be edited)

11.10 RBI Master Circular on Income Recognition, Asset Classification and Provisioning

11.11 RBI Master Circular on SLR / CRR

11.12 RBI Master Circular on Fraud
11.1 Bank Audit Engagement Letter -

The Branch Manager, 

Dear Sir,

Sub: Audit of accounts of your Branch for the year 2011-12 – Audit Engagement / Management Representations.

You have already been informed by your Management, that we have been appointed as the auditors to audit and report on the accounts of the Branch for the year 2011-2012.

We have accepted the appointment, and we confirm that the audit shall be carried out in accordance with the applicable legal provisions and the regulatory requirements, besides the applicable authoritative pronouncements of the Institute of Chartered Accountants of India, with the objective of expressing an opinion on the Branch financial statements. For this purpose we will perform sufficient tests to obtain reasonable assurance as to whether the information contained in the accounting records and other source data is reliable and sufficient as the basis of the preparation of the financial statements; and whether the information is properly presented in the said statements.

You are aware that the responsibility for the preparation of the financial statements including adequate disclosure is that of the Management, and this includes the maintenance of adequate accounting records and internal controls, the selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards. The management is also responsible for making judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the Branch at the end of the financial year and of the profit or loss of the Branch for that period, and the safeguard of the assets of the Bank/branch.

We will conduct our audit in accordance with the auditing standards generally accepted in India and with the requirements of law. These Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the managements, as well as evaluating the overall financial statement presentation. However, having regarding to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements of financial statements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.
In addition to our report on the financial statements, we expect to provide you with a separate letter concerning any material weaknesses in accounting and internal control systems which might come to our notice through the Long Form Audit Report (LFAR), or otherwise.

We also wish to invite your attention to the fact that our audit process is subject to ‘peer review’ under the Chartered Accountants Act, 1949 and the reviewer may examine our working papers during the course such review.

We wish to complete some audit procedures even prior to the year-end, depending on your readiness / response.

In view of the severe time constraints imposed, we are confident you will make available to us, within the dates stipulated, the following Branch returns / statements duly completed, pre-reviewed and duly authenticated, to enable us to furnish our reports in the form and manner desired of us by law or by the Reserve Bank of India and not necessarily in the form and manner prescribed by the Bank.

**Statements / returns:**

(i) Balance Sheet as at 31.03.2012
(ii) Profit and Loss Account for the year 2011-12
(iii) Weekly Statements for the 12 specified dates
(iv) Branch Statutory Audit Report, Financial Statements and LFAR of the previous year 2010-11.
(v) Statement of Loan Advances as per IRAC norms classification.
(vi) NPA statement as at 31.3.2011 and NPA from 1.4.2011 to 31.03.2012
(vii) Previous Internal Inspection reports and compliance by branch.
(viii) Concurrent audit reports of all the months, and compliance / closure report, if any.
(ix) Stock / Book debts statements for CC account till Feb 2012.
(x) Stock Audit Reports of operating accounts with Limits in excess of Rs.5 crores.
(xi) Inspection report copies of borrowers stock / book debts by branch officials.
(xii) Insurance Register along with the details, list of insurance pending renewals.
(xiii) Documents and files relating to Advances sanctioned/renewed during the year Rs.5 lacs and above after latest inspection by your Head Office.
(xiv) Sanction letter copies of borrowers accounts with limits of Rs.100 lakhs and above.
(xv) Statement of account of borrowers with limits in excess of Rs.100 lakhs and above.
(xvi) List of accounts which are due for renewal as at 31st March 2012 for more than 3 months.
(xvii) List of Weak Standard Assets / Potential NPA Accounts control return copy.
(xviii) Closing and other Circulars issued by the bank during the year.
(xix) Invoices for Fixed assets purchased during 2011-2012.
(xx) LFAR duly filled in to the extent possible (One copy).
(xxi) Details of LCs devolved & BGs invoked, if any
(xxii) Details of accounts restructured / rescheduled, if any
(xxiii) Quarterly / half yearly returns for NPAs.
(xxiv) Exception Reports for the Year
(xxv) Statement in respect of movement of NPAs, with detailed workings for all figures.
(xxvi) Details for sector wise, Security wise and Asset classification of advances.
(xxvii) Details of Capital Adequacy statement
(xxviii) Audited financial statements for Large borrowers accounts for the year 2010-11.
(xxix) Income Tax remittance challans for Tax deducted at source (For Tax Audit).
(xxx) Details in respect of various certifications to be given as part of the branch audit.

To enable us to monitor the progress of the audit and completion of the assignment, please indicate the actual dates(s) of completion as well as handing over to us of each statement / return / confirmation or other information required to be prepared by your (as per the contents of the letter of appointment sent to us), by your endorsement on each such statement / return / confirmation, before the same (duly authenticated) are handed over to us on 1st April, 2012. We await your commitment.

As part of the audit process, we will expect to receive from the Management, written confirmation of the representations made to us and a written response (Para-wise), to our requirements is imperative, and such response is to be based on your verification of facts.

We shall be grateful if you could confirm the name(s) of the Officer(s) designated by the Branch to comply with our requirements in connection with the audit, so that our reports are expedited.

We shall appreciate your co-operation in the matter.

Thanking You
Yours faithfully
For Chartered Accountants
Propriitor / Partner
Membership No.


11.2 Audit Plan

Upon receipt of the letter of appointment:

Check for the Scope of Work.

- Communicate with the previous auditor, for obtaining a No Objection Letter for carrying out the audit, by sending a written letter by registered post, after ascertaining his last known address, even if not furnished by the bank.

- Read the appointment letter carefully to understand the nature and scope of the engagement and timelines specified for completion.

- Understand the various reporting requirements including LFAR and Tax Audit.

- Identify the different certifications which are to be given as part of the audit, which cast higher responsibility in terms of the statement of true and correct vis a vis true and fair in the audit report.

Selection of Audit Team.

Carefully selected experienced members of the audit team and identify the Partner in charge in case of partnership firm, include Articled Assistants even if they are not experienced as part of the team.

Ensure that an orientation program / technical training session is conducted or bank audit seminar conducted by the Branch or other POU of ICAI is attended by all.

Planning Activity:

Plan the audit by establishing audit strategy commensurate with nature and size of the branch under audit by :

- Selecting the important areas for the audit.

- Audit Materiality and Audit Risk with respect to the size and scale of the branch. To enable detection of material misstatements.

- Understand the Materiality as per the accounting policy of the bank for different items of income / expenditure / asset or liability.

- Plan to cover all advances above Rs.2 Crore or 5% of outstanding advances of the branch, preferably a lower limit is desirable.

- Orient the team members, by updating them with the extent, scope and changes in the norms when compared to previous year.
Go through the closing circular as well as the Master Circulars of RBI and the latest issue of Guidance Note on Audit of Banks issued by the Institute of Chartered Accountants of India, mark important areas of concern for the branch / branches under audit.

Based on the information received, plan out the audit of financial statements, in respect of the statement of affairs, audit of incomes, expenditures, or advances with specific reference to / Potential NPA accounts under Standard Category, verification of restructured accounts vis a vis their Asset Classification.

Documentations & Communication with the branch calling for the following information: Have a master file and a branch wise file containing the appointment letter, copies of circulars and instructions received from the bank, including the proforma of various certificates to be issued.

Call for the following information / records / details / evidences for the purposes of audit:

1. Closing circular issued to the branch / reference in their website to download the same.
2. The extent, size and specialization of the branch
3. The profile of the branch and performance in the past two years.
4. Comparative analysis of movement of interest income and expenses vis a vis advances and deposits respectively for two years.
5. List of top borrowers accounts accounting for 2% of the advances of the branch or Rs.1 crore whichever is lower, covering at least 60% of advances of the branch.
6. Copies of last three months Concurrent Audit Reports (if covered under Concurrent Audit)
7. Copy of the summary sheet of the last Inspection Report.
8. Copy of Revenue Audit Report, if any.
9. Copy of IT Audit Report, if any.
10. Copy of vigilance enquiry or any special investigation reports.
11. Details of fresh advances made during the year.
12. Details of major weaknesses, if any, persisting in the branch
13. List of Potential NPA Accounts – For quarter ending December.
14. Details of loan accounts restructured during the year.
15. Details of advances which are pending renewal for more than 3 months.
16. Details of advance accounts wherein stock statements are not received for 3 months.
17. List of NPA accounts wherein the valuation reports are older than 3 years.
18. List of non corporate entities with working capital limits in excess of Rs. 10 lakhs.
19. List of borrowers accounts which underwent CDR during the year.
20. List of accounts where recoveries are made, where DICGC / ECGC claims have been received.
22. Details of Invoked Guarantees / Letters of Credit and treatment thereof.
23. List of off balance sheet items and contingent liabilities, if any.
24. Details of suspense and sundry entries beyond 1 year.
25. Details of fraud by employee or outsiders, against the bank during the year.
26. List of recoveries in NPA accounts and appropriation thereof.
27. Details of legal expenses incurred and accounting in the books.
28. Details for Long Form Audit Report, including Annexures for advances above Rs.2 crore
29. Details for Tax Audit under section 44 AB of Income Tax Act, with specific reference to additions to fixed assets.
30. Details of section wise tax deducted and remitted including date of deduction, date of remittance and delay if any. TDS mapping for deduction and remittance.
31. Certificate from branch management that TDS has been duly deducted and remitted as per provisions of Income Tax Act, 1961
32. Details for furnishing various certificates.
33. Date when the audit could be commenced.
34. Proforma Management Representation Letter to obtain the management’s assurance that the financial statements and other information furnished for furnishing certificates are truly and correctly prepared and presented by the branch management to the branch Statutory auditors.

Once these preliminary information are obtained, document them, use them for performing the audit exercise.
Other Matters.

- Verification of top Non performing advances with respect to classification, existence of realisable value of security and provisions to ascertain the correctness.

- Call for appropriate and adequate documentary evidences to enable furnishing certificates under various categories.

- Discuss all matters observed and which will be forming part of the Audit Report and / or qualification or mention in the certificates including Memorandum of Changes that may be proposed.

- Complete the entire reporting at the branch itself, to enable availability of information and timeliness of completion of the branch audit.

- Travel and stay arrangements shall be made and communicated to the branch management with request to keep all statements / information / records ready.

### 11.3 BRANCH AUDIT CHECKLIST:

**Check list of Bank Branch Audit Program**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Yes</th>
<th>No</th>
<th>NA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Review of Report &amp; Replies of</td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>- Inspection Audit of Branch Inspectors</td>
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<tr>
<td></td>
<td>- Inspection Audit by RBI</td>
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<tr>
<td></td>
<td>- Revenue Audit/Income &amp; Expenditure Audit</td>
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<tr>
<td></td>
<td>- Preceding Year(s) Statutory Branch FAR Auditors</td>
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<tr>
<td></td>
<td>- Concurrent Audit</td>
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<tr>
<td></td>
<td>- Report findings in LFAR</td>
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<tr>
<td></td>
<td>- Circulars for annual closing of accounts</td>
<td></td>
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<td></td>
<td>- MOC’s of last year</td>
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<tr>
<td></td>
<td>- Two year’s Half yearly returns</td>
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<td></td>
<td>- Ascertain present status of issues raised in the above mentioned reports</td>
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<td></td>
<td>- Make notes of continuing adverse remarks</td>
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</tr>
<tr>
<td></td>
<td>- Prepare a list of advances referred in the reports</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>2</td>
<td>Balancing &amp; Tracing:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Check arithmetical accuracy of Annual Returns</td>
<td></td>
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<tr>
<td></td>
<td>- Verify that the books of accounts have been balanced as at the end of the year.</td>
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<tr>
<td></td>
<td>- Check for proper carry forward of previous year balances to the General Ledger.</td>
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<tr>
<td></td>
<td>- Check whether balances have been properly carried forward from sub-ledgers to the General Ledger.</td>
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</tr>
<tr>
<td></td>
<td>- Trace the balances from the General Ledger to the Annual Returns, Balance Sheet and Profit &amp; Loss Account.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Physical verification of cash, security, stationary & stamps:

- Verify if possible by physical verification, cash held as on date of commencement of audit (preferable).
- Tally the day's cash with Cash Scroll.
- Ensure that cash is physically verified at prescribed intervals by the branch staff independent of the cash section.
- Verify the reasonableness of amounts so held/Ascertain cash retention limit.
- Ensure that the closing cash is held overnight in the safe under the custody of joint key holders.
- Ensure that the movement of cash is properly recorded and authorized.
- Ensure that the cash remittances (both inward and outward) are made with adequate escort staff and accounted / acknowledged within reasonable time.
- Ensure that adequate insurance cover is available for the cash holding.
- Verify the bank reconciliation statement and ensure that the balances agree.
- Ensure that adequate control is exercised over the security items, stationery, stamps, etc.

### Advances:

#### A. General:

- Obtain list of the different types of advances (borrower wise) at the branch and number of accounts under each type of advance.
- Selects Sample size and identify advances selected for verification.
- Identify "Large Advances" for reporting in LFAR (Large advances are those account, whose aggregate outstanding exceeds 5% of Branch advances or Rs.2crores which ever is less).
- Verify whether prescribed registers for periodical inspection of units determination of drawing power, review of credit facilities, etc., are maintained properly.
- Report any cases where the branch has not followed the instructions of the H.O in all them at terslike taking legal action for recovery of advances, recalling of advances, etc.
- Enquire whether the branch irregular in reporting matters relating to sticky/sick advances.
- Enquire whether the branch irregular in reporting matters relating to over drawls in the accounts.
- Are credit card dues recovered promptly?
- In the case of Written off accounts/Account under Recovery verify the Register (Shadow Account) and balancing, Ascertain efforts for recovery.

#### B. Appraisal/Sanction/Documentation

- Obtain bank circulars/manuals prescribing forms of documentation for each type of advance.
- Ensure proposal reviewed by authorised bank personnel before sanction for.
- Policy of the bank
- Viability of the unit
- Experience of management
- Net worth of the promoters and guarantors
- Adequacy and nature of security offered
• Legal opinion on the title and ownership of property offered as security in respect of immovable property
• Pre & post sanction / disbursement Inspection of unit
• Sanctions are within the delegated powers of the authority sanctioning the same
• Such other matters as may prescribed
• Ensure that all the terms and conditions laid down in the sanction letter are met by the borrower before disbursement.
• Ensure that copies of Deed of Partnership or Memorandum of Articles or such other document as may be applicable are obtained
• Ensure existence of borrowing powers of partners (clauses in Deed of Partnership) or directors (Articles of Association, Board resolution)
• Ensure that charge has been created on the security in favour of the bank, that legal opinion has been obtained where considered necessary
• If the branch is the lead banker ensure that the documentation done is communicated to other consortium members
• If the branch is a consortium member, ensure that a:
  ▪ Communication from lead banker is received regarding documentation obtained.
• In case of multiple banking, ensure that the documents obtained by the branch create charge in favour of the branch sufficient to cover its exposure.
• Verify whether the following are obtained periodically on time in accordance with terms of sanction.
  ▪ Stock statement
  ▪ Receivables statements
  ▪ Insurance policies covering the value of securities
  ▪ Acknowledgment of debt
  ▪ Encumbrance certificate
  ▪ Financial statements (audited for advances in excess of Rs.10 lakhs)
  ▪ Certificate of registration of charges
  ▪ Review/renewal proposal
  ▪ Statement of net worth or borrowers/guarantors
  ▪ Periodical Management Information Reports as prescribed for large advances or in the sanction.

C. Asset Classification

• Study provisioning norms as prescribed in various RBI/Branch circulars
• Report instances of Bank circulars contradicting or otherwise not being in conformity with IRAC norms prescribed by RBI
• Review operation in the advance accounts selected for audit.
• Test check classification of advances in accordance with prudent norms as prescribed in Various RBI/Bank circulars
• Report material variances in the Main report (Memorandum of Changes) as well as the Long Form Audit Report.

D. Income Recognition

• Ensure that the branch has recognised income in accordance with the Bank circulars on Income Recognition norms
• Report material variance in the Main Report (Memorandum of Changes) as well as the Long Form Audit Report
• Ensure that recoveries if any in an account classified in preceding years as NPA is first appropriated towards interests suspense and recognised as income (the audit or may take into consideration the provisions created against such advances before recommending transfer of realization to income account) or recovery in NPA a/c is appropriated as per the bank's policy in vogue.

• Verify whether interest on NPA a/c's has been computed properly and kept /separately in Interest Suspense account or as per the extant policy guidelines of the Bank.

E. Provisioning

• Ensure that the Branch has recommended creation of provision in accordance with the RBI/Bank circulars

• Report material variances in the main report (Memorandum of Changes) As well as the Long Form Audit Report

• Despite proper classification of an advance if it is doubtful of recovery ensure that adequate provision is created by the branch; if not recommend higher provision as necessary in circumstances of the case.

• Enquire whether the Bank is a subscriber to the DICGC scheme for considering provisions in respect of priority sector advances. If yes,

• Obtain the limits of DICGC claim entitlements available for different types of priority sector advances and ensure that the same are followed

• Verify whether the claims in DICGC have been made in time

• Check whether money recovered from the client is shared between the branch and DICGC as per the proportion agreed to.

• Ensure that the valuation of the security held for the NPA accounts are based on the latest valuation certificate/stock statement or as per the policy of the Bank and provisions against secured portion of doubtful advances are made correctly.

F. Valuation of Security

• In case of hypothecation advances, ensure that

• The value of inventories is adjusted for discrepancies reported in the stock audit report, if any.

• Age wise analysis is available for receivables hypothecated and those outstanding for more than 6 months are excluded

• Loans and advances are considered in accordance with the bank policy.

• Fixed assets are physically verified and valued in accordance with the bank policy.

• In case of pledge accounts ensure that

• The inventories pledged are physically verified.

• Stocks lying since 6 months or more are valued appropriately.

• Ensure that accounts of Sundry Creditors out standing is considered for working out drawing powers

• Ensure that all existence of security available with the bank is reasonably established through periodical inspection of the unit and report there on, stock statements, financial statements etc., furnished by the borrower.

• Ensure on test check basis that the value of security mentioned in the annual returns and/or drawing power or security registers is as per latest stock statements, inspection reports, valuation reports, etc.
• Report material variances in the Main report (Memorandum of Changes) as well as the Long Form Audit Report.

• Ensure that unpaid stocks are excluded while arriving at the drawing power.

• In the case of mortgage advances ensure that periodical valuation certificates are obtained from the approved value’s and the valuation makes sufficient provision for wear and tear and depreciation.

• In the case of other types of securities (other than hypothecation, pledge and mortgages) ensure that latest valuation of the securities has been obtained.

• Ensure that there is no substantial erosion in the value of securities held by the bank exposing the bank to greater risk.

5 FIXED ASSETS:

• Verify whether any purchases/sales of fixed assets are made during the year and as certain whether prior approval of the Controlling authority is obtained.

• Verify whether the Fixed Assets register is properly maintained.

• Check whether physical verification of the Fixed Assets is effected periodically.

• In case of immovable Assets verify whether the title deeds are registered in the Banks name and are held at the Branch /Registered office.

• Report on Fixed Assets not in use but existing in the books of accounts.

• Verify depreciation on Fixed Assets is provided in accordance with branch insurrection.

• Ensure that the fixed assets are adequately insured and properly maintained.

6 OTHER ASSETS:

• Inter Office Adjustment (Net) Obtain a schedule of Inter Office Adjustments.

• Enquire on personnel in charge/responsible for Inter Office Adjustments.

• Ensure that there has been regular job rotation of the personnel in charge/responsible.

• Report unadjusted long outstanding items.

• Ensure that provision is made for non realisable items Accrued interest.

• Test check calculation of incomes accrued.

7 DEPOSITS:

• Test check all types of deposits for Application forms for receipts issued.

• Original receipts for matured deposits paid.

• Correctness of rate of interest on fresh as well as renewed deposits.

• Renewals/Rate of interest for the overdue period.

• Payment of interest on matured deposits done as per Bank's policy.

• Large deposits made at the yearend.

• Report on window dressing.

• Verify transaction of last 2 days for:

  • Transfers from loan / overdraft / cash credit accounts to current / deposit accounts.

  • Purchase of cheques/bills and credited to current/deposit account.
8 OTHER LIABILITIES:

A. Bills Payable
- Test check the items outstanding in Bill payable account with relevant registers
- Report on old items/paid without advice
- Report on old items in LFAR

B. Other Items
- Verify all other liabilities like provisions etc., for their Correctness.

9 INCOME RECOGNITION:
- Ensure that the branch has recognised income in accordance with the Bank circulars on Income Recognition norms.
- Report material variance in the Main Report (Memorandum of Changes) as well as the Long Form Audit Report.
- Ensure that recoveries if any in an account classified in preceding years as NPA is first appropriated towards interest suspense and recognised as income (the audit may take into consider at ion the provisions created against such advances before commending transfer of realization to income account) or recovery in NPA a/c is appropriated as per the bank's policy in vogue.
- Verify whether interest on NPA a/c's has been computed properly and kept/separately in Interest Suspense account or as per the extant policy guidelines of the Bank.

10 PROFIT & LOSS ACCOUNT:

A. Interest Income
- Test check interest calculations covering all types of advances accounts.
- Ensure that no interest is applied on all Non Performing Advances on accrual basis.
- Ensure that rates of interest charged is as per sanction letter including interest tax or as subsequently revised.
- Verify whether the interest income leakage reported by concurrent auditors/ internal inspectors/ income leakage auditors have been collected / recovered/MOC passed.
- Ensure that changes in rates of interest duly applied to all accounts affected
- Check whether penal interest is levied in accordance with the terms and conditions of sanction.
- Report material variances in recognition of interest income on account of classification of advances of Income Recognition norms and other material mistakes noticed.

B. Other Income
- Test calculation of other income by way of commission, exchange and brokerage on Bills Purchased / discounted, Bills sent for collection, LCS, Guarantees, Demand Drafts, Pay Orders, Mail Transfers, Telegraphic Transfer, Agency business etc.,
- Ensure that proper adjustment entries passed for commission on non fund based business/Bills discounted collected but not accrued to the branch at the end of the year
- Test check locker rents collected/due
• Test check in come realisable on investment balances with RBI, SBI other banks, if any
• Ensure that charges recoverable from customers have been duly recovered/debited to their accounts
• Verify whether any debits made to in come head accounts are in order and approved by competent authority.

C. Interest expended
• Test check interest paid on various savings accounts and deposits
• Ensure that provisions created for interest payable on various deposit accounts are in accordance with the Bank’s prescribed procedures/instructions
• Conduct trend analysis on interest expended and total deposits
• Ensure that interest is not paid to a/c’s / deposits for which such payments are prohibited/not permitted.

D. Other Expenses
• Scrutinize general expenses register/ledger for unusual items
• Ensure that the provisions created for expenses incurred during year but not paid are as per instruction from HO
• Test check the procedure followed and amount charged off to profit and loss account towards stationery consumed during the year
• Test check depreciation charged on branch’s fixed assets
• Test checks the calculations of notional interest paid / received on HO funds borrowed/lent.
• Ensure that all expenses in excess of delegated power have been ratified by competent authority
• Ensure that TDS is effected as per rules on all applicable payments.

11 COMPUTERISED ENVIRONMENT:
• Enquire whether the software is customized or standard
• Enquire levels of authorization and use of password
• Scrutinize authorizations / documentation for changes in software made during the year.
• Obtain report of Computer system audit and consider major observations
• Ensure that procedures for protection of data / master files updation and backup are satisfactory
• Enquire in to system failures during the year, if any.
• Verify whether the system is protected by antivirus capabilities.

12 MISCELLANEOUS
A. Capital Adequacy Ratio/ Risk Weighted Assets
• Verify the classification of assets into respective risk weights and the totals tallied with the Balance Sheet Heads of accounts.

B. Memorandum of Changes
• Verify MOC for all changes including changes in the provision are correctly written.

C. Long Form Audit Report / Tax Audit Report / Certificates to be given by Auditors including Jilani Committee & Ghosh Committee
• Verify the items/contents in the report/certificate and give views appropriately.
### D. Others
- Besides the above illustrative checklist for Branch Audit Programme, Branch Audit or may prepare separate checklists for other areas as of operations at the Branch level depending upon the nature of business / specializations of business handled at such branch like
- Remittances Bill Collection Foreign Exchange Credit Card Customers Service Returns statutory and other submission Service tax collection, remittance & credit utilized Deduction and remittance of TDS as per Income Tax Act, 1961

### 11.4 Check list for Long Form Audit Report

**LONG FORM AUDIT REPORT (LFAR)**

**A. ASSETS:**

1. **Cash**
   - Obtain a schedule of denomination of cash
   - Tally physical balance with Cash Scroll and the General Ledger as on the date of verification
   - Ascertain the retention limit of cash fixed by the head office. In case the balance exceeds the Retention Limit the same may be reported in the following format:
     - Cash Balance in excess of Rs.
     - Date: Amount Rs.
   - Verify the insurance cover taken on transit cash.
   - Verify whether cash is maintained in effective joint custody of two or more persons
   - Ensure that are responsible official verifies physical cash on a daily basis.
   - Check whether the cash balance has been verified periodically by the Branch Manager in addition to the Head cashier.

2. **Balances with other Banks**
   - Verify whether the branch has any balances with other banks.
   - Obtain confirmatory letter from the bank or branch wherever applicable.
   - Ensure whether BRS is prepared periodically.
   - Verify BRS on a test check basis.
   - Check for un responded credits/debits found in the BRS and report the same.
<table>
<thead>
<tr>
<th>3 Investments</th>
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<tbody>
<tr>
<td>• Obtain the schedule of investment held by the branch.</td>
</tr>
<tr>
<td>• Check for appropriate authorization issued by H.O/ Controlling Authority</td>
</tr>
<tr>
<td>• Conduct physical verification of investments and tally with the above schedule</td>
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</tbody>
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<tr>
<th>4 Advance</th>
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<tbody>
<tr>
<td>• Ensure that monitoring of slippage of accounts from standard to sub-standard/doubtful is done and reported promptly to the Controlling Authority.</td>
</tr>
<tr>
<td>• Ensure that recovery measures are promptly taken.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>5 Other Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Stationery/Stamps</td>
</tr>
<tr>
<td>• Obtain schedule of Stationery Stocks</td>
</tr>
<tr>
<td>• Ensure that the physical balance tallies with the above schedule.</td>
</tr>
<tr>
<td>• Suspense Accounts/Sundry Assets.</td>
</tr>
<tr>
<td>• Obtain an schedule/return of suspense account and verify the items for long out standing items.</td>
</tr>
<tr>
<td>• Report unusual/long outstanding items.</td>
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<tr>
<td>• Verify transfer to H.O during the year</td>
</tr>
<tr>
<td>• Does the scrutiny of accounts under various sub-heads reveal balances, which in your opinion are not recoverable and would require provision/write off.</td>
</tr>
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</table>

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<thead>
<tr>
<th>B LIABILITY</th>
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<tbody>
<tr>
<td>• Bills payable, Sundry deposits etc.,</td>
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<tr>
<td>• Does the scrutiny of account under various sub-heads reveal odd balances?</td>
</tr>
<tr>
<td>• Report the number of items and aggregate of amount of old outstanding item spending for 3 or more years</td>
</tr>
<tr>
<td>• Check amount received against suite filled accounts</td>
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<tr>
<td>• Check unidentified deposits e.g. Excess cash found in the branch etc.,</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>C PROFIT AND LOSS ACCOUNT</th>
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</thead>
<tbody>
<tr>
<td>• Ensure that the branch has followed the income recognition norms stipulated by RBI</td>
</tr>
<tr>
<td>• Test check calculations of interest on deposits forex cess/short credit of material amount if so give details thereof.</td>
</tr>
<tr>
<td>• Study preceding 2 years half year returns for divergent trends in major items of income and expenditure and report those which are not satisfactorily explained by the branch</td>
</tr>
<tr>
<td>• Indicate the effect of changes if any in accounting policies on the items of income and expenditure.</td>
</tr>
</tbody>
</table>
### D. GENERAL

- **House keeping**
  - Ensure whether the branch is regular in furnishing a house keeping return to the Controlling Authority.
- **Verify whether the branch maintains the books and records properly in accordance with the H.O guidelines.**
- **Ensure that the balances are duly linked and properly authenticated by responsible official /authorised signatories?**
- **Report the lapses in balancing procedures**
- **Report differences in crystallised balances lying unattended**
- **Ensure that the control and subsidiary records have been reconciled at they ear-end or at the prescribed intervals**
- **Inter Branch Accounts**
  - Are there any double responses or wrong responses in H.O A/c.
  - Indicate the outstanding entries in the inter branch accounts together with a statement of reasons for their remaining outstanding and the steps taken by the management in respect thereof.
- **Are there any frauds discovered during they ear under audit and report if any.**
- **Does the examination of the accounts indicate possible window dressing?**
- **Are there any matter ,which you as branch auditors would like to bring to the notice of the management or the central statutory auditor.**
- **Tax Audit U/s44AB of I.TAct,1961**
  - Audit Report to be made in form3CA
  - Obtain verify and certify particulars required in form3CD

### Other Certifications

1. **PMRY, SEEUY and SEPUP scheme certification**
   - Ensure that correct claim/subsidy is calculated

2. **DICGCscheme**
   - Verify whether the information furnished is correct according to the books/records maintained by the Branch.
   - Verify whether the recoveries effected in the Claims Received A/c have been proportionately remitted to the corporation.

3. **Ensure that the certificates required are with in the scope of audit e.g.**
   - Certification that the debts are fully secured.

**AUDIT INCHARGE:**

(Signature) ________________________
(Date) ________________________

**PARTNER INCHARGE:**

(Signature) ________________________
(Date) ________________________
11.5 Model Check List for Audit of Large Advances

<table>
<thead>
<tr>
<th>SL. No</th>
<th>Particulars</th>
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<tbody>
<tr>
<td>1</td>
<td>Name of the borrower</td>
</tr>
<tr>
<td>2</td>
<td>Date of Loan Application</td>
</tr>
<tr>
<td></td>
<td>Whether loan application is processed duly obtaining all records / documents, Audited Financial Statements and unit inspection</td>
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<tr>
<td></td>
<td>Date on which recommended by branch</td>
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<td></td>
<td>Whether approved by competent authority</td>
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<td>Date on which duly approved</td>
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<tr>
<td>3</td>
<td>Nature of Limit</td>
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<tr>
<td></td>
<td>Fund Based</td>
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<tr>
<td></td>
<td>Cash Credit</td>
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<tr>
<td></td>
<td>Overdraft</td>
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<td></td>
<td>Term Loan</td>
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<tr>
<td></td>
<td>Bills purchase / discounting</td>
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<tr>
<td></td>
<td>Non Fund based</td>
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<tr>
<td></td>
<td>Letters of Credit</td>
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<tr>
<td></td>
<td>Bank Guarantees</td>
</tr>
<tr>
<td></td>
<td>Total Exposure</td>
</tr>
<tr>
<td></td>
<td>Classification Priority / NPS</td>
</tr>
<tr>
<td>4</td>
<td>Date of original Sanction</td>
</tr>
<tr>
<td></td>
<td>Due Date of renewal</td>
</tr>
<tr>
<td></td>
<td>Date of renewal / review</td>
</tr>
<tr>
<td></td>
<td>Number of days overdue since</td>
</tr>
<tr>
<td>7</td>
<td>Sanction terms</td>
</tr>
<tr>
<td>8</td>
<td>Primary security</td>
</tr>
<tr>
<td>9</td>
<td>Collateral security</td>
</tr>
<tr>
<td>10</td>
<td>Facility wise margin</td>
</tr>
</tbody>
</table>
### 11 Special terms and conditions for compliance

- Documentation
- Execution of Hypothecation and other documents
- Registration of Charges if company
- Legal opinion
- Valuation report copy
- Audited financial Statements
- Margin requirement and additional capital infusions
- others

### 12 Disbursement – is it done directly in term loan accounts

- Are there bullet disbursement in Housing loan for construction
- Deficiencies in disbursements
- Is the operative account allowed to be utilised in single disbursement
- Ensure end use of funds
- Verify and if applicable, Report diversion of funds at the point of disbursement

### 13 Post disbursement monitoring

- Is the facility operated with the limit, identify number of days when it is beyond limit / DP
- Verify adhoc and the manner of adjustment of adhoc
- Deviation from sanction terms

### 14 Whether stock statements are being obtained regularly

- Whether book debt statements duly certified by CA's / as per terms are obtained regularly
- Is the Drawing power correctly marked in the system
- Is there delay in obtaining the above
- Whether penal interest is charged for delay in submission of stock / book debt statements
- Whether stock statement are perused and checked by branch officials
- Whether stock inspections are carried out by branch officials / concurrent auditors
- Report of inspections / Concurrent auditors
- Is the stock statement / book debt statement as at 31st March of previous year tallying with the Audited Financial Statement of the same date.
- Deviations if any, how dealt with
If the deviation is significant whether it has any impact on the drawing power determination and consequent asset classification.

Whether insurance cover is obtained

Is it fully insured or under insured – quantum of under insurance

Whether RC book, Key and transfer forms obtained for vehicle loans

Whether term loan disbursements are done directly

Whether receipts of payments made to vendors obtained

15 **Operation in the account**

- Whether operation in the account is satisfactory
- Whether frequent overdrawing is authorised / approved
- Whether term loan repayments are regular
- If overdue, number of instalments and whether any instalment is regularised by way of additional facility or accommodation
- Any other observation / deficiency in the account

16 **Whether processing and inspection charges are charged and recovered**

17 **Whether the Sector wise classification is correct**

18 **Whether the securities offered are in place to ensure correctness of security wise classification**

19 **Whether asset classification is correctly made**

20 **Whether interest and legal charges on NPA accounts are not debited to borrowers account.**
11.6 Specimen checklist for evaluating the CIS Environment in a Bank branch

(Note: This is only an illustrative checklist and cannot be considered to be exhaustive. The Auditor should consider adding/modifying/deleting any of the clauses based on his judgment and evaluation of the audit environment).

**Evaluating Internal Controls: (As required by AAS29):**

<table>
<thead>
<tr>
<th>Issues</th>
<th>Associated Risk</th>
<th>Findings</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data made available for processing is correct and complete. Errors are detected and corrected on a timely basis.</td>
<td>Data integrity is of concern. Material Financial Assertions may not be correct.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>System restart on account of any disruption ensures completeness of transactions and records.</td>
<td>Transactions may not be accounted or may be accounted more than once.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accuracy and completeness of output is ensured.</td>
<td>Data Integrity is of concern. Material Financial Assertions may not be correct.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unauthorized amendments to programs are prevented.</td>
<td>Pervasive effect of errors in data. Material Financial Assertions may not be correct.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Physical and logical security is ensured. Source code of application software is adequately safeguarded.</td>
<td>Unauthorized modifications to data are possible.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Evaluating Operating Systems (OS):**

<table>
<thead>
<tr>
<th>Issues</th>
<th>Description</th>
<th>Findings</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Verify whether Bank has recommended OS hardening guidelines and the same has been implemented in the Bank.</td>
<td>The OS configuration may not be in line with Bank’s Security Policy and practices. Risk of unauthorized intrusion xists.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Verify whether access to DOS Prompt is disabled.</td>
<td>Access to DOS prompt enables back-end access to data files. Date can be changed without being detected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Verify whether access to application software Compilers (such as COBOL Compiler) is possible.</td>
<td>Unauthorized code can be compiled in the branch machine. Such code can be executed to process unauthorized transactions in the branch.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issues</td>
<td>Associated Risk</td>
<td>Findings</td>
<td>Conclusion</td>
</tr>
<tr>
<td>-----------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>----------</td>
<td>------------</td>
</tr>
<tr>
<td>Access to data files such as Deposit Application, GL Application, etc. is secured.</td>
<td>Unauthorized modification to transaction data in DD and GL application may go undetected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>List of Users and User Profile related parameters not provided by the System.</td>
<td>It is not possible to determine who are the users and whether all users are authorized.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Verify whether access to Services not required by Users has been restricted.</td>
<td>Unauthorized access to systems, programs, data is possible. Unauthorized programs can be installed.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No trails for troubleshooting/maintenance work carried out by the Systems Officers.</td>
<td>Unauthorized modifications to systems configurations, if any, may go undetected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Logs of System related activities are not enabled or reviewed by an independent person.</td>
<td>Any exceptional activity will not be detected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Access Control in OS:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The System Administrator does not have any responsibilities related to data entry or authorization of transactions.</td>
<td>Unauthorized access to data files and modification cannot be prevented or detected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The System Administrator does not have any responsibilities related to data entry or authorization of transactions.</td>
<td>Unauthorized access to data files and modification cannot be prevented or detected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>User rights are configured in accordance with their roles &amp; responsibilities.</td>
<td>Unwarranted rights and privileges for use of system resources can result in authorized activity that cannot be prevented or may not be detected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The security administrator only endorses or grants system access to users based on the original request form with authorized signatures verified.</td>
<td>Unauthorized Users may not be prevented or detected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Redundant User Ids exist, which can be used for unauthorized activity.</td>
<td>Redundant User Ids exist, which can be used for unauthorized activity.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Issues

<table>
<thead>
<tr>
<th>Password Management:</th>
<th>Associated Risk</th>
<th>Findings</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum Password Length is not appropriately set.</td>
<td>Unauthorized access cannot be prevented or detected if the password policy is not sufficiently strong.</td>
<td>-do-</td>
<td></td>
</tr>
<tr>
<td>Password complexity Requirement is not configured.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Account Lockout policy is not configured appropriately.</td>
<td>An Intruder can make unlimited number of attempts to detect passwords.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Password Change Period is not set.</td>
<td>If same password is used for longer time Password detection risk increases.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Initial passwords are conveyed to end-users in a secure manner and users acknowledge receipt of passwords. Conveyance through third parties or disclosure of passwords is prohibited.</td>
<td>Password may be captured by unauthorized users and intruders.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>There is regular review of access violation log.</td>
<td>Failed attempts may not be detected which may lead to successful intrusion later.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>User ID modification is not captured in Event Log.</td>
<td>Un-authorized user account creation cannot be detected.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Evaluating Application Software

#### Operational & Access Controls

<p>| Closed Accounts details are not available after the date of closure. | Any unauthorized adjustments during closure of accounts may go undetected. | | |
| Lien/Hold on deposits is not marked in majority of Deposit Loans. | Deposit withdrawal may be permitted by application, for deposits pledged as mortgage for Deposit Loans. | | |
| Customer/Account History not available / accessible | Any unauthorized modification to Customer information or account may go undetected. Source documents for authorized modifications cannot be traced. | | |</p>
<table>
<thead>
<tr>
<th>Issues</th>
<th>Associated Risk</th>
<th>Findings</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Evaluating Data Files / Database</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Database management, Data Integrity &amp; Access controls</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Appropriate Policies, procedures and guidelines are in place for data definition, Table/file creation or deletion, add or delete field / data elements, such that the Database meets the data requirements of the Management</td>
<td>Inappropriate Data Modeling will lead to inadequate controls on Data integrity of the Data base.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Triggers are implemented in accordance with the applicable IT procedures.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Integrity control and Indexes are implemented in accordance with the data integrity and procedures.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Integrity checks are run periodically as required by the Information Security Policy.</td>
<td>Data integrity is of concern. Material errors and irregularities may not be prevented or detected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adequate Control Totals are built in Day end procedures.</td>
<td>Inadequate/absence of Control Totals will lead to incomplete data updated to the database.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Audit Trails:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. The Retention period for each part of the database audit trail has been determined.</td>
<td>Errors will not be detected and rectified.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Audit Trails should trace source transactions to control totals and control totals back to the initial transactions.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Audit trails should provide evidence needed to reconstruct transaction processing.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. An independent person should review audit trails.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

125
Audit trails should be protected against unauthorized deletion or modification.

A proper Day end execution plan is followed.
Independent Review of day end logs is carried out.

Incomplete update of data due to failure in execution of day end jobs / program.

<table>
<thead>
<tr>
<th>Issues</th>
<th>Associated Risk</th>
<th>Findings</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adequate Input Validations in the form of filer Definitions like Filer Code, Executive Definitions, Foreign Key, Journaling etc is implemented.</td>
<td>Inadequate Input Validation will lead to updation of incomplete data and affecting the Data integrity of Database.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access privileges have not been configured and administered in Oracle Database.</td>
<td>Unauthorised access can be gained to database and data can be altered, which can to undetected.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Default User ID in Oracle is not disabled.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to SQL scripts is not restricted.</td>
<td>These scripts help an intruder in identifying critical data Tables.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Default User ID “SA” is not disabled in SQL Server. Password set for SA user is not strong.</td>
<td>Any once can access SQL server and in turn Application security Tables.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access controls are not enabled for critical Tables including user Id and User Rights Tables maintained for Applications in both the SQL Server Instances.</td>
<td>An Intruder can manipulate profile related tables in SQL Server and gain authorized access to Applications.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>User Roles and Rights are not defined in SQL Server.</td>
<td>&quot;SA&quot; user has access to all objects in SQL Server and has DBA rights.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Evaluating Networking Issues:

<table>
<thead>
<tr>
<th>Issue</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Encryption</td>
<td>Encryption is done in NTLM. Encryption used for sending challenge/response relating to user ID and password, is weak in NTLM, compared to NTLMv2.</td>
</tr>
<tr>
<td>Access to Router configuration files</td>
<td>Unauthorised access can be gained to system resources and data of the Branch. Denial of access can also be enforced to bring Branch operations to a halt.</td>
</tr>
<tr>
<td>All Network &quot;Ports&quot; are open</td>
<td>An Intruder who can gain access to the Intranet, would be able to access the Branch Server and critical resources, using open &quot;Ports&quot; in TCIP/IP.</td>
</tr>
</tbody>
</table>

### Evaluating Data Migration issues:

<table>
<thead>
<tr>
<th>Issue</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-conversion and post-conversion Reports</td>
<td>The pre-conversion and post-conversion Reports (Trial Bal- ances / General Ledger Bal- ances, subsidiary ledger balances etc,) have been approved / signed off by the Branch Manager and Officer in charge of Roll-out.</td>
</tr>
<tr>
<td>Risk of Material errors and irregularities</td>
<td>Risk of Material errors and irregularities exist, if proper migration and roll out proce- dures are not observed.</td>
</tr>
<tr>
<td>The exception report</td>
<td>The exception report (errors/ integrity error reports) generated during data migration procedure have been verified. All the exceptions have been rectified and necessary sign off has been obtained.</td>
</tr>
<tr>
<td>-Do-</td>
<td>-Do-</td>
</tr>
</tbody>
</table>
| Customer Information file (CIF),
generation of new account number with old numbers is verified. Whether multiple CIF exists for a single customer has been verified and rectified. Whether CIF’s have been created for all the joint account holders. Whether address and all-important data have been input in the system or else kept blank. |
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>-Do-</td>
</tr>
<tr>
<td>The break up between principle and interest and the fields like term deposit and category has been correctly retained.</td>
</tr>
<tr>
<td>-Do-</td>
</tr>
</tbody>
</table>
| Interest has been accrued till the date of migration in the old system and correctly carried over to the new system.
The carry over of individual entries |
| -Do- |
| In suspense debtors (others) in the new system has been verified and certified. |
| -Do- |
| Outstanding OB C’s are correctly carried over to the new system. |
| -Do- |
| Pay orders payable account of all the outstanding pay orders have been carried over to the new system. The Pay orders Payable account is reconciled on the day of conversion. |
| -Do- |
Carry over of Standing Instructions, Stop payment instructions in SB, Current, CCOD, Demand Drafts, special notes with regard to Lien, Deceased A/c, Stop Payment of cheques, attachment order, Garnishee order etc., was verified and correctly carried over to the new system.

-Do-

Cheque books issued to the account holders are carried over to the system.

-Do-

The Data migration should have been verified and certified for correctness by a team, independent of Branch personnel.

-Do-

Evidence for having done so should be preserved by the Branch.

-Do-

Verify the trails for a sample of data migration.

-Do-

**Physical Security Issues:**

<table>
<thead>
<tr>
<th>Question</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Whether the computer facility (terminals, UPS, Batteries, Main Switches, etc., is located in least accessible area or/and access is limited to authorized personnel only?</td>
<td></td>
</tr>
<tr>
<td>Whether unauthorized physical access to the SERVER, Hub, Routers and Data back-ups restricted?</td>
<td></td>
</tr>
<tr>
<td>Question</td>
<td>Answer 1</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>----------</td>
</tr>
<tr>
<td>Whether access to the Computer Room is restricted to prevent unauthorized access?</td>
<td></td>
</tr>
<tr>
<td>Whether visitors (AMC vendor representatives / auditors / bank's technical staff etc.,) are allowed access to the server room only with authorization?</td>
<td></td>
</tr>
<tr>
<td>Does the branch practices the discipline of deputing an officer to oversee the visitor's access to the critical IT assets?</td>
<td></td>
</tr>
<tr>
<td>Whether a Visitor Book / Register is maintained for visitor's access to the IT Assets including the Server?</td>
<td></td>
</tr>
<tr>
<td>Whether the access to the security items such as blank cheques, demand drafts and other critical documents controlled?</td>
<td></td>
</tr>
<tr>
<td>Whether these instruments are kept locked in a secure location when unattended?</td>
<td></td>
</tr>
<tr>
<td>Whether these instruments are periodically inventoried?</td>
<td></td>
</tr>
<tr>
<td>Whether the placement of burglary alarm sirens and related electrical cabling installed in the branch is such that physical access is reasonably restricted?</td>
<td></td>
</tr>
</tbody>
</table>
# 11.7 Model Bank Branch Audit Documentation:

## DOCUMENTATION

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>Remarks</th>
<th>Page Nos.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Appointment Letter</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Audit Engagement Letter</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Copy of Audit Plan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Duly filled in checklist of Audit Program</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Current Year Financial Statements &amp; Others Schedules related to it</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Weekly Statement as on 31st March as per Branch</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Copy Exceptional &amp; Special Mention Reports Generated by the System as on 31st March</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Loan Statements of Standard Assets of Large borrower &amp; related documents, borrower wise</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>a) Sanction letter copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b) Statement of account</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Stock statements copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>d) Branch Inspection Report extract</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>e) Concurrent Auditors observations</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>f) Stock Audit report copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>g) Internal Inspectors observations</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>h) QIS information copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>i) Audited Financial Statements copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Loans Statements of irregular accounts &amp; related documents i.e</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>a) Sanction letter copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b) Statement of account</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Stock statements copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>d) Branch Inspection Report extract</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>e) Concurrent Auditors observations</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>f) Stock Audit report copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>g) Internal Inspectors observations</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>h) QIS information copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>i) Audited Financial Statements copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>j) Valuation reports</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>k) Restructure terms copy</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Description</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>-----------------------------------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td><strong>Fixed Asset</strong>&lt;br&gt;Copy of invoices for Additions made during the year&lt;br&gt;Sanction letter from competent authority</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td><strong>E – TDS Filed Details with TDS Paid Challans section wise.</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td><strong>Copy of Service Tax Paid Challan</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td><strong>Copy of Service tax return filed</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td><strong>Rental Agreement if rented</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td><strong>Confirmation of Balances from HO</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16</td>
<td><strong>Confirmation of balances from Other Branches / Head office / controlling office of the Same Bank / inter bank reconciliation statement</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17</td>
<td><strong>Confirmation of balances from Other Banks with whom accounts are maintained.</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td><strong>Copy of relevant extracts of bank Inspection Report</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19</td>
<td><strong>Copy of relevant extract of Concurrent Audit Report</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td><strong>Photo Copy of Cash scroll Book on the date of cash verification</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21</td>
<td><strong>Copy of Control returns sent to H O</strong>&lt;br&gt;a) PMRY Claims&lt;br&gt;b) Recoveries in DICGC Claimsettled accounts&lt;br&gt;c) Statement of ECGC claims / settlement&lt;br&gt;d) Statement of Potential NPA Accounts&lt;br&gt;e) Exception reports on frauds&lt;br&gt;f) Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td>22</td>
<td><strong>Duly filled in check list of Long Form Audit Report</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23</td>
<td><strong>Duly filled in check list of evaluation of Computerised Environment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>24</td>
<td><strong>List of Expired Guarantees or Letters of Credit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25</td>
<td><strong>Details of Sundry Assets / Suspense Accounts</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>26</td>
<td><strong>Details of Claims against the bank not acknowledged as debts</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>27</td>
<td><strong>Details of Invoked Guarantees or Devolved LC’s pending payment as on 31st March</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>28</td>
<td><strong>Details of frauds, if any, during the year and status.</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>29</td>
<td><strong>Statement of depreciation and working for income tax purposes U/s 32 of Income Tax Act, 1961</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Documents to be collected for Certificates Issued</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>▪ Control Returns send to H.O. with respect to DICGC Claims &amp; Settlements.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Control Returns send to H.O. with respect to PMRY Claims &amp; Settlements.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Copy of ATM Cash Register</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Service Tax return</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Statements regarding loans given to Capital Market</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Fixed Asset – Documents for Transfer in &amp; Transfer Out of Fixed Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Fixed Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Copy of the Documents for Sale of Old Assets if any.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>Copy of the Depreciation working done for the year 2011-12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>32</td>
<td>Others</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
11.8 Model for Communication with the previous Auditor.

To
CA
Chartered Accountants

Dear sir,

Sub: Audit of ............... Branch of ............... Bank - N O C - Reg.

Ref : Letter of Appointment from ............ Bank, dated...........

In connection with the above referred matter, we have received a letter of appointment as Branch Statutory Auditors of ............... Branch of ........... Bank for the year ............... 

We have been informed that you were the Statutory Auditors for the previous year ending on ............... 

Kindly request you to intimate us in writing as to whether you have any objection professional or otherwise, which might warrant us not to accept the appointment.

We would be very much obliged if you can let us know your objection or otherwise within ....... days and oblige.

Your early response will be highly appreciated.

Thanking You,

For .........................

Chartered Accountants

CA. .....................

Partner
Management Representation Letter of Branch of Bank

To

M/s.....................
Chartered Accountants,

...........................

Sub: Management Representation - Audit of .................. Branch of .................................. Bank

With reference to the audit of Branch of Bank, We hereby certify that your firm / staff have carried out the audit of our Branch commencing from .................. and concluding on ............... We confirm to the best of our knowledge and belief and as disclosed by books of accounts and record, We herewith furnish the following information called for and produced to you and further certify that the same are true and correct.

Management’s Responsibility Statement on financial statement:

1. The Balance Sheet as at 31st March prepared by us is a true and correct balance sheet properly recording all items of Assets and Liabilities.

2. The Profit & Loss account for (two half years ended 30th September & 31st March) / the year ended 31st March shows the true and fair view of the Profit/ Loss of the branch.

Compliance with Accounting Policies & Norms of Reserve Bank of India.

3. All the Accounting policies of the bank have been duly complied with by the branch while preparing the Profit & Loss Account and Balance sheet as at 31st March.

4. All Incomes and Expenses are recognized and accounted for on accrual basis except for Interest Incomes on Non Performing Assets as per RBI Norms, and as per the Accounting policy adopted by the board of directors of the bank and disclosed in the accounting policies.

Statement of Physical Verifications:

5. Cash, Stamps and Stationery is physically verified at periodical intervals by officers other than the cashier and no discrepancies were noticed on such physical verifications.

6. Fixed Assets have been properly accounted, physically verified and no discrepancies have been noticed between the physical verification and books. There is no impairment to any of the fixed assets, warranting any provision thereto as per Accounting Standards.
Statement of compliance with Accounting Standards and policies of the bank:

7. Depreciation on Fixed Assets has been properly accounted for as per the rates prescribed by the Head office.

8. Interest on all deposit accounts has been properly accounted for including interest on overdue deposits lying as at the balance sheet date.

9. Interest income on all advance accounts has been properly accounted. Interest income on Non performing advances is duly accounted as per the appropriation policy adopted by the bank.

10. There are no items of long outstanding nature in inter branch adjustment accounts, which require any adjustment at the H.O./Provisions to be made or in the nature of un reconciled transactions warranting write-off.

11. Advance accounts are properly accounted & classified as per Sector Wise & Security Wise.

Statement on Contra and Contingent Liabilities:

12. All Bank Guarantees issued by the branch are backed with Counter Guarantees of the borrower, during the year there were no guarantees which were invoked/the guarantees invoked during the year have been paid by debiting the borrower’s account and effective recovery actions have been initiated/recovered.

13. All Letters of Credit, if any, issued by the branch are backed with Counter Guarantees of the borrower, during the year there were no Letters of Credit which were devolved/the Letter of Credits devolved during the year have been paid by debiting the borrowers account and effective recovery actions have been initiated/recovered. There are no Letters of Credit as at 31st March 2012.

14. There are no contingent liabilities/claims in the nature of the Claims against the bank which are not acknowledged as debts other than those reflected in the Annexure forming part of the closing returns. The branch has maintained/not maintained complaints register, complaints/no complaints are pending as on 31st March 2012.

15. Bills purchased/discounted being clean loans are allowed only to reputed parties and does not tantamount to double financing.

Accounting for Income and Expenses:

16. Interest rates charged on deposit/advances accounts are as per the rates in force, as per head office instructions and sanction terms.

17. All processing charges on fresh advances and renewal of working capital limits and Inspections charges have been duly recovered from borrowers accounts.
18. Stationery, the accounting for stationery as expenses and as stock is as per the extant instructions of the head office, the valuation of which is not done by the branch.

19. Recoveries in written off accounts, are after proper remittances to DICGC/ ECGC accounts where claims have been settled.

**Statement on reliability of assets:**

20. Utility Services & Miscellaneous Deposit Accounts are in the nature of deposits are recoverable in full and does not contain elements of expenditure.

21. Details of Suspense Account balance if any, is furnished in the statements enclosed with the closing returns. The details of long pending items are furnished/ not applicable.

**Statement on Internal Control:**

22. Cash is maintained in effective joint custody of two or more officials, the Insurance cover for the cash on hand and cash in transit is done at the H.O.

23. Balance confirmations certificates in respect of balances with State Bank of India/ other banks have been obtained/ not obtained as at the year end and reconciled/ not reconciled. There are no differences in respect of cash transactions remaining un responded, revenue items requiring adjustment/ write off and or old outstanding balances remaining unexplained/ unadjusted.

24. There are no Money at Call and Short Notice, Investments at the branch. Information regarding Control of Sanctioning/ Review / Monitoring / Supervision & Disclosure of Advances:

25. During the year there have been instances/ no instances of credit facilities sanctioned beyond the delegated authority or limit fixed for the branch/ incumbent, All advances are sanctioned after proper appraisal of the loan proposals. Details of ratification obtained/ not obtained for sanctions beyond the delegated authority, if any, are furnished herewith.

26. All working capital accounts have been duly renewed after obtaining all relevant documents, list of cases which have been technically reviewed are furnished separately.
Details of accounts overdue for review/ renewal is as follows:

<table>
<thead>
<tr>
<th></th>
<th>No. of cases</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>- between 6 months and 1 year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Over 1 year.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

27. We have complied with all the procedures and instructions, and have obtained all required loan documents, DPN’s, Agreements of Hypothecation, Agreements of Pledge, Lien on deposits, deposit receipts duly discharged, Letters for Creation of Equitable Mortgages, obtaining of original Title Deeds, parent deeds and Legal Opinions, Invoices/ receipts for Term Loans disbursed etc, preparation of proposals for grant/ renewal of advances and enhancement of limits. There are no instances wherein credit facilities have been released without execution of necessary documents.

28. Post sanction follow up and credit supervision is undertaken by the branch, including monitoring the operations in the accounts, inspections of borrowers accounts and in all cases of overdrawing or credit weaknesses have been reported to the controlling authority.

29. All advances accounts are properly classified as per Reserve Bank of India’s norms of Income Recognition Asset Classification and Provisioning norms, subject to MOC, if any.

30. All Confirmation of Balances and Renewal of Loan letters have been obtained in respect of borrowers accounts, there are pending/ no pending CBRLs./ AOD’s. Details of pending CBRL/ AOD’s are furnished herewith.

31. Stock /Book debts statements and other periodic operational statements are received/ not received regularly from the borrowers and scrutinized and suitable action taken inappropriate cases. List of borrowers’ accounts where stock statements/ book debts/ Operational Statements not received/ received with substantial delay is furnished herewith.

32. List of Non Corporate Asseseeses with limits beyond Rs.10lakhs wherein the compulsory audit reports as per RBI norms to be obtained /has been obtained/ not obtained.

33. All cases in which legal action needs to be initiated before the expiry of the limit period have been served / not served with legal notices and action initiated/ not initiated within the stipulated time. List of cases where legal action is not initiated/ time barred, if any, is enclosed herewith.
34. Insurance covers have been obtained/not obtained in all borrowers accounts to which the same is applicable. Details of pending Insurance covers, if any, listed herewith.

35. Periodic Inspections of securities charged to the bank are carried out on borrowers accounts, which did not reveal any significant discrepancies with records.

36. Valuation reports are obtained from approved valuers in respect of Non Performing Assets, the valuation reports are not more than 3 years old.

37. All Non performing advances as ascertained by the branch have been promptly reported to the relevant controlling authority of the bank.

38. Details of Advances, if any, in which rehabilitation programme has been sanctioned is enclosed.

39. All appropriate claims for DICGC/ECGC, wherever applicable have been duly lodged the details of status of pending claims are given in the schedule annexed.

40. There are no Compromise/ Settlement and Write-off Cases / Details of Compromise / Write-off cases involving waivers in excess of Rs.50 lakhs are as follows:

41. Details of outstanding amounts of guarantees invoked and funded by the branch as at year end & invoked but not funded enclosed herewith.

42. Adequate Internal Control is exercised on custody and issue of stationery comprising of security items such as Term Deposit Receipts, Drafts, Pay Orders, Cheque Books, Travellers Cheques, Gift Cheques, Credit Cards, Kissan Cards, Debit Cards and ATM Cards.

43. There are no missing or lost items of the above valuable stationery including tokens.

44. Items debited to Suspense Account/ Sundry Assets are expeditiously cleared details of outstanding entries are furnished as part of closing returns.

45. Inoperative deposit accounts are controlled effectively, operations are monitored and no suspicious transactions were observed during the current year in such accounts, all guidelines of the bank have been followed.

46. The overdue matured term deposits as at the year end is as follows:

<table>
<thead>
<tr>
<th>Particulars of deposits</th>
<th>No. of Accounts</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term Deposit others</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home Loan Account</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Deposit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recurring Deposit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-investment Deposit</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
47. Details of Bills payables and Sundry Deposits pending for more than 3 years is annexed as part of closing circular.

48. There is/there is no system of estimating and providing interest accrued on overdue/matured term deposits.

49. All figures as at the year end in the control and subsidiary records have been reconciled. Details of accounts where reconciliations are done/pending is enclosed.

50. In terms of Inter Branch Accounts, daily statements are forwarded to the designated cell/Head office debits/credit transactions relating to other branches.

51. There are no outstanding debits in the Head Office Account in respect of Inter Branch Transactions.

52. There have been no frauds discovered during the year under audit. There have been no frauds reported by or against the branch or any of its employees during the year.

53. There has been no window dressing.

54. Details of large advances, if any, of Rs. 2 Crore to a single borrower sanctioned and maintained at the branch level, forming part of the Annexure to Long Form Audit Report is prepared correctly and all required information are correctly stated therein.

55. The repayments of the Instalments during the period 20xx-xx together with the interest thereon in compulsory Deposit Scheme, 1974 is not applicable/is made correctly in accordance with the relevant rules.

56. There were no deposits under the Special Deposit Scheme 1975 for the accounting period 1.4.20xx to 31.3.20xx.

57. There were no recoveries in claims settled account of DICGC, 1971 & 1981 Schemes. The share of remittances on claims settled accounts of DICGC 1971 & 1981 Schemes has been duly remitted to the corporation out of recoveries effected.

DETAILS REGARDING COMPLIANCE WITH TAX AUDIT

58. The books of accounts maintained by the branch for Tax Audit purposes is Weekly ALM Statement, General Charges Register, General Ledger, Daily Cash Scroll, Subsidiary Ledgers & Balancing Books.

59. The method of accounting employed is Mercantile except for Income Recognition as per RBI norms and Interest due on overdue deposits which are provided only when the constituent renews the deposit.

60. There is no change in the method of accounting when compared to the previous year.
61. The particulars of depreciation allowable as per Income Tax Act, 1961 in respect of each asset or block of asset is not possible since the branch is not an independent assessable entity, the identification of opening balances of each block and depreciation admissible U/s 32 of Income Tax Act is not possible.

62. Payments towards sums received from employees towards contributions to any Provident Fund / Super Annuation Fund or any other fund is done at H.O.

63. Details of expenditure incurred in clubs, if any, enclosed herewith.

64. No expenditure for penalty/ fine for violation of any law have been paid by the branch during the year.

65. Prior Period Income & Expenditures other than RBI norms on Income Recognition is Nil.

66. Details of capital expenditure incurred during the year and debited to Profit & Loss account is enclosed.

67. No payments for expenditures in excess of Rs.20,000/- was made otherwise than by a crossed account payee cheque.

68. There was no repayment of deposit of Rs.20,000 or more during the year otherwise than by way of a crossed Account Payee Cheque/ Bank Draft/ Credit to account of the deposit or as per section 269T of Income Tax.

69. Taxes Deducted at Source that are required to be deducted under the Income Tax Act, have been duly deducted as well as remitted within the time stipulated under the Income Tax Act, 1961. There are no failures to deduct tax which attract the provisions of section 40(a) (ia) of the Income Tax Act, 1961.

70. Details of failures to deduct tax at source on Interest, Rent, Professional charges, Contracts, Salary, Commission, if any, including the gross amount is furnished herewith.

**INFORMATION FOR CERTIFICATIONS**

71. PMRY Accounts Sanctioned During the year……

<table>
<thead>
<tr>
<th>Disbursed during the year......</th>
<th>No. Of accounts</th>
<th>Rs......</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims lodged during the year ......</td>
<td>No. Of Accounts</td>
<td>Rs......</td>
</tr>
<tr>
<td>Claims pending lodgement............</td>
<td>No. Of Accounts</td>
<td>Rs</td>
</tr>
<tr>
<td>Claims Received during the year</td>
<td>No. Of Accounts</td>
<td>Rs</td>
</tr>
</tbody>
</table>
| Claims Pending ................... | No. Of Accounts | Amount | Rs...

Pending PMRY Claims of current year
Pending PMRY Claims of earlier year
72. Data pertaining to maintenance of SLR/ CRR are furnished herewith.
73. The status of implementation of Ghosh Committee Recommendations relating to
frauds and malpractices in banks has been correctly filled in as per proforma.
74. The status of implementation of Jilani Committee Recommendations relating to
Internal Control and Inspection/audit systems in banks has been correctly filled
in as proforma.
75. Details of lending to Sensitive Sector is given in Annexure.
76. The classification of loans and advances including the margins held for Capital
Adequacy Statement as on 31.03.20xx is correct as per Annexure and tally with
the figure of Advances in the Balance Sheet as at 31.03.20xx.
77. The classification of OFF Balance sheet items like Letters of Credit and Guarantees
with details of Cash Margins tally with the Balance sheet as at 31.03.20xx and are
correctly stated as per Annexure.
78. The Statement of Asset Liability Management per Annexure is prepared with
diligence and caution to correctly reflect the actual maturity pattern of Term Deposits
and Advances outstanding as on 31.03.20xx.
79. Service tax is collected & remitted to the Service Tax Department, all service tax
dues are correctly accounted, paid and returns filed within the due dates.
80. Service Tax Credits have been availed/ not availed while paying service tax.
81. All controls required to be exercised in connection with Branch computerization are
adequately carried out, there has been no weakness pointed out in the IS audit.
82. Systems Administrator is periodically visiting and checking that the software are
not tampered with and that being supplied from the Controlling authorities are only
used and are without bugs.
83. Password controls and protection are seriously adhered to and to the best of our
knowledge there is no leakage of such information to other staff and/ or outsiders.

DETAILS FOR OTHER MATTERS
84. The Branch was subjected/not subjected (strike wherever not applicable) to (a)
Revenue Audits/Internal Inspection/RBI Inspection/credit Audits. The previous
Branch Auditors’ Reports and LFAR and Compliance thereof are furnished to you
during the course of Audit.
85. The effect of MOC, if any, for the previous year 2010-11 is incorporated in the
accounts of the current year 2011-12.
86. Information furnished in the annual closing returns is complete and correct.
87. No loans or advances or any other payment has been made to the directors/persons having substantial interest in the Bank or their relatives.

88. All documents relating to the advances of the Bank are properly filled up and not kept blank. All these documents are current and not barred by time. A list of borrowers whose documents are kept blank/time barred are as under.

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Loan No.</th>
<th>Name of the Borrower</th>
<th>Nature of advance</th>
<th>Amount Outstanding</th>
<th>Date of Expiry of Documents</th>
<th>Reasons for keeping documents blank</th>
</tr>
</thead>
</table>

89. In all case of write off of advances, necessary approval has been obtained from controlling authorities. The details are:

<table>
<thead>
<tr>
<th>Name of the customer</th>
<th>Amount</th>
<th>Action directed</th>
<th>Approval ref</th>
</tr>
</thead>
</table>

90. There are no claims against the branch not acknowledged as debt.

All the above information and certifications are issued as part of the replies and information called for by your firm.

**For Bank**

Manager