

SEMINAR ON BANK AUDIT FOR CENTRAL STATUTORY AUDITORS

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DEMONETISATION

The onerous task of the auditors at the central level is to address and satisfy the internal controls and the laid down procedures of the banks in dealing with the demonetisation. The Reserve Bank of India has issued many procedural and compliance circulars to the bank in respect of the demonetisation. Among the other aspects, the CSAs are expected to give thrust to

- Satisfy the efficacy of the internal control and reporting system between branches and Head office and with RBI in respect of handling the SBNs at the micro level and at the macro level.
 - Verify and ensure that the SBNs (*specified bank notes*) collected at the branch are properly transferred to the currency chest of the RBI and proper reporting done on time.
 - Certificate of bank balance with other banks both at branch level and HO level to be scrutinised. Branch LFAR to be verified for any discrepancies of bank balances at branch level.
 - Any pipe line entries emanating from confirmation and acknowledgement at branch level and HO level should be dealt with properly.
 - The balance of SBNs as on 31.3.2017 with the bank has to be consolidated and dealt with for presentation in the global Balance Sheet.
 - The change in the system parameters for relaxation of prudential norms for selected loan categories as per RBI Circular No. RBI/2016-17/198 DBR.No.BP.BC.49/21.04.048/2016-17 dated on 28.12.2016 should be verified at the CORE platform.
 - The manual interventions to the parameterisation at the branch or CORE level should be verified with its impact by a structural walk through of the programme module.
- 1) **SALE OF ADVANCE/ASSET TO RECONSTRUCTION COMPANIES.**
- The sale of stressed assets to ARCs are introduced by the RBI vide instructions in circular No RBI/2013-14/502 DBOD.BP.BC.No.98/ 21.04.132/ 2013-14 dated 26.02.2014 and amended on 01.09.2016. The concept of the sale is to be verified with special reference to the
- The mode of sale as “*with recourse*” or “*without recourse*” as spelt out in circular No RBI/2016-17/56 DBR.No.BP.BC.9/21.04.048/2016-17 read with para 6 of the IRAC norms master circular 2015.
 - The policy document framed by the board for the sale of assets to ARC and its covenants should be properly vet and any inconsistencies of such policy with the disclosed accounting policy of the bank and the Accounting Standards.
 - The procedure of dealing with any amounts received by the bank directly from the borrower against such assets sold to ARC to be verified.
 - The agreement of sale with the ARCs should be verified with the clauses of management fee, Incentive of yield, Indicative Yield, upside sharing etc..
 - The treatment of Non fund based exposures of assets sold and crystallised during 2016-17 and earlier years should be verified with special reference to the bid documents.
 - The NFB exposures of assets sold should continue to be an off balance sheet item in the books of the bank, till such time it is devolved and paid. The Capital Adequacy for such exposures should be maintained till it is continued as NFB exposure.

- The valuation of SRs (**Security Receipts**) issued by the ARCs should be vouched for making appropriate provisions on a progressive basis year on year. The NAV as given by the ARC has to be correlated with the Rating Agency reports and trend of ratings.

2) **RESTRUCTURING OF ADVANCES.**

The restructuring of advances has been dealt in by the master circular No DBR.No.BP.BC.2/21.04.048/2015-16 dated July 1, 2015 and the continuing circulars and guidance issued by the RBI. The main points to be given thrust by the CSA at the global level may be briefed as follows:-

- The terms of restructuring should be vouched with the entries passed at branches for reversal of interest , creation of FITL and corresponding Sundry Creditors A/c , creation of WCDL , etc
- Ensure that the portion of FITL has a corresponding credit in the SUNDRY LIABILITIES account vide para 14.2.2 of the master circular
- The provisions created at the branch level /head office for the diminution in the net present value of the restructured loan vide para 12.4.2 of master circular of RBI DBOD.No.BP.BC.9/21.04.048/2014-15 has to be confirmed.
- Verify that the aggregate of NPV and NPA provision for restructured accounts does not exceed 100% of the outstanding exposure.
- Verify that the system generated NPA excludes FITL portion of the advance of such restructured accounts as there is already 100% provision coverage in Sundry Creditors account.
- Verify that the borrowers comply with the repayment terms as stipulated by the restructuring package during the year under audit. Any default by the borrower in adhering to the repayment commitments has to be dealt with in the manner prescribed in Annexure 7 of master circular on IRAC norms, which inter alia include;
 - To withdraw the concessions/reduction granted while restructuring and restore the account at the pre-restructured status.
 - To classify the advance as per regular course from the original date of NPA at the pre-Restructured amount.
- Verify that any prepayment/closure or EXIT out of restructure by the borrower is allowed only after exercising the **right to recompense**. i.e the compensation specified while restructuring for prepayment should be collected. Refer para 5.7 of annexure No 4 of master circular.

3) **MACRO INCOME RECONCILIATION WITH CORE AND P& L.**

This is a very vital area of a central statutory audit. The incomes of the banks are mostly controlled by the CBS. The application of interest and other charges are centralised at the HO level. It is pertinent to note that the interest applied by the CBS may not hit the respective accounts at the branch due to various technical/interface issues. This will result in difference between the gross interest applied by CBS and the interest income CREDITED in the Profit and Loss account of the branch/bank. This coupled with the manual reversal entries passed at the branches will lead to a sizable difference between the total interest applied by CBS and the net interest credited to income account as per Profit and Loss account of the Bank. The CSAs are expected to reconcile the difference at the global level and satisfy that there is no leakage of revenue in the process. It is noted that many debits to advance accounts to be passed by the branches by drawing the INTEREST FAILURE CHECK REPORT, is not properly made leading to leakage of revenue. Moreover, the chunk of the manual reversal passed on restructuring of advances is also erroneously made at branch level leading to huge loss of revenue to the bank. This should be verified by the CSAs with specific reference to CBS.

The CSA should obtain listings of manual DEBITS in income account and manual CREDITS in expense account to check the veracity of the entries and its impact on the Profit and Loss Account.

4) OVERNIGHT POSITIONS – CREDITS/DEBITS IN RECONCILIATION OF NOSTRO ACCOUNT, REGULARISATION OF PIPE LINE DEBITS/CREDITS IN FOREIGN CURRENCY TRANSACTIONS.

The International Banking division is not allowed to hold any overnight positions of foreign exchange by any banks "OPEN". All transactions are required to be hedged or covered by forward contracts every day. The CSA should verify the system, procedures and reporting of such positions on a daily basis to ensure better control.

While verifying the international division, foreign business of the bank, it is noted that the CSAs are given reconciliations of NOSTRO accounts of bank held abroad in foreign currency. These reconciliations would contain many items of credits/debits which eventually would be squared off by corresponding debit/credit in the constituents account at the base branch. These entries would have a character of two tier pipeline nature. One between the NOSTRO account held with the overseas banker and the balance with the mirror account at HO. The other between the consolidated balance at the Head office and the balance at branches. The RBI as well as the ICAI has given many guidelines to bring down all pipe line entries to minimum to give a true and fair view of the financial statements. The CSAs should focus attention to eliminate these reconciliation entries on the basis of the information available post balance sheet date. All entries originated prior to 31st March lying in reconciliation or as pipe line entries should be eliminated by passing necessary MOCs at the global level. A consolidated entry or different entries may be passed.

5) BUCKET WISE ANALYSIS OF INTEREST ON ADVANCES/DEPOSITS.

This is a global exercise to be done to ensure analytical verification of the interest earned on advances and paid on deposits. The various interest rate brackets ranging from the lowest to the highest should be segregated into the *interest rate buckets*. The verification of the interest earned and paid should be analytically matched with the global profit and loss account. The abnormal rate buckets considering the loan and deposit product also may be identified for corrective action. In many cases it was observed that erroneous feeding of the master at the branch level have resulted in abnormal interest rates both for advances and deposits falling in very high/low interest buckets. A cross matching of the product wise loan/deposit balance and the interest paid for each product as per the interest bucket would reveal any discrepancy in the overall interest aberrations. Any major deviation should be further scrutinised by obtaining branch wise details and micro analysis of the interest applied branch wise and the product segment. The same bucket wise interest analysis also would reveal the inconsistencies in arriving at the cost of deposits and yield on advances on a global basis which is used for MCLR and other calculations.

6) INTER BANK PARTICIPANTS NOTES.

This is a form of advances granted to facilitate bulk finances among banks against a bundle of loan accounts. The bundle of loan accounts would be sold as a bunch to the other banks for a specified period of 90 days up to 180 days at an agreed rate of interest. This attaches the risk of carrying the advance accounts to the lender bank during the tenancy of the IBPC. As central auditors, it is imperative that the entire exposure under IBPC is reviewed with the following:-

- The policy of the bank to lend against the IBPC has to be reviewed with specific reference to the RBI Circular DBOD.No.BP.BC.57/62-88 dated 31.12.1988.
- The risk ranking of the assets underlying the IBPC and its prudential status should be vouched to assess the overall risk of the exposure.

- The periodical monitoring of the underlying advance accounts and its health rating as per prudential norms should be verified as on 31.3.2017.
- The delinquency of performance, if any, during the currency of the IBPC should be viewed seriously for recommending appropriate provisions as per prudential norms.
- Many cases were observed where the advance account/constituent accepted in the bundle of IBPC is also a customer of the lending bank. In such cases, it should be reviewed comprehensively to assess the risk considering the health of the account maintained at the lending bank.
- The IBPC held as on 31.3.2017 and the roll over, if any made has to be verified with reference to the overall risk and performance of the underlying assets.

7) GLOBAL RECONCILIATION OF PPF, SCSS, TAXES A/C, OLTAS, PENSION FUND A/C, SUBSIDY UNDER PMRY/IRDP SCHEMES.

The banks are holding the PPF funds and the deposit accounts of the various funds under Senior Citizens Savings Scheme, Pension Funds etc... The deposit accounts would be lying at designated branches. These would be controlled by a NODAL branch which will deal with the fund and scheme authorities for the bank as a whole. Thus, it involves a three way reconciliation process. One, between the deposit holders sub ledger and the GL balance at the branch level. Two, between the branch balance and the balance with the Nodal Branch/centre. And, three with the nodal branch and the fund. The first reconciliation is the domain of the branch auditors. The second and the third legs of reconciliation have to be done by the CSAs. The CSA should vouch the procedures, documentation and obtain the confirmation from the respective funds and ensure proper reconciliation of the balance of fund in the NODAL Branch account and as per the confirmation obtained from the fund. The figures of the respective fund account between the branch consolidated trial balance (Code wise) and the balance at the NODAL Branch also should be reconciled.

The taxes collection account operated from various branches for State Government and Central Government taxes are consolidated within the bank at a designated NODAL branch. The procedures, pipe line entries, squaring off procedure, transfer of funds to government account etc.. should be ensured to be done as per the laid down procedures of the bank and the stipulations of the Government.

The branch balance sheets would contain a balance in CREDIT for subsidies received on behalf of borrowers falling eligible category. These subsidies and assistances are eventually to be credited to the advance accounts on completion of its tenure or fulfilment of the conditions of the subsidy/assistance. The timely transfer of these subsidies to the advance accounts should be ensured as it has direct impact on the fair representation of the advance balance and may also contribute for the overall reduction of NPAs in many cases.

10) SUBVENTION CLAIMS.

The CSAs are expected to verify that the claims shown as receivable under interest Subvention against Export Credits, Education Loans, Agricultural Loans etc.. as depicted in the Global Balance Sheet is true and fair. The following points may be considered while conducting the verifications.

- The balance lying at the Central Office/Nodal Branch of the bank has to reconcile with the branch consolidation account code wise.
- The rejection/resubmission of claims as insisted by the concerned authority has to be vouched with the tenability of such claims.
- The certificate obtained, if any, by any experts should be verified with specific reference to the guidance's issued in SA 600 (Using the work of another Auditor) for work performed by others.
- The loss if any on account of long pending claims which are doubtful of recovery may be provided for or DEBITED to constituents account at branch level as per the laid down instructions of the bank.

11) DOCUMENTATION, WORKING PAPERS, AUDIT EVIDENCES.

The CSAs are expected to more focus on the audit working papers, documentation and audit evidences in the process of audit as per SA-320, Audit Documentation. The RBI-AFI gives much thrust on the later while conducting the inspection of the bank. This is becoming more important in the wake of the **quality review** conducted by the QUALITY REVIEW BOARD of the ICAI. The broad sketch of the important documents/working papers and audit evidences are narrated for general guidance of the CSAs. The list is only indicative.

- The list of area/department allocation among CSAs as signed by all CSAs and the bank officials specifically to ensure Joint and individual responsibility as per SA-299- Responsibility of Joint Auditors.
- The branch allocation list for all audits and quarterly reviews of the CSAs.
- Minutes of all meetings among CSAs and the meeting with TOP management of the bank.
- Working notes and papers of branch audits conducted by the CSAs
- Observations made at the time of branch audit in case of individual advance accounts and discussed with the branch heads, while conducting the branch audit by CSAs.
- The work allocation of list among the partners of the CSA firm and their roles and responsibilities.
- Minutes of the meeting of the partners of the CSA firm including discussions on major issues connected to the bank audit.
- The work allocation chart and review chart of all qualified assistants, articled clerks and other audit staff within the CSA firm.
- The working notes, working papers with supporting audit evidences for all observations connected with the audit.
- All evidences are to be properly grouped and arranged for every audit including quarterly reviews done by the CSAs.