

A man in a dark blue suit and light blue tie is pointing his right index finger directly at the viewer. The background is a gradient of blue, transitioning from light to dark. A semi-transparent white box with a blue border is centered over the image, containing the title text.

STATUTORY BANK BRANCH AUDIT - COMPLEXITIES IN BANK BRANCH AUDITS

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BY
CA SANJAY KHEMANI
SKKHEMANI@MMNISSIM.COM

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Branches - Public vs Private Sector Banks

SN	Public Sector Banks	Private Sector Banks
1.	Decentralised Operations	Centralised Operations
2.	Decentralised Decision making	Centralised Decision making
3.	Decentralised monitoring of Transitory accounts, Sundry/ Suspense accounts	Centralised monitoring of Transitory accounts, Sundry/ Suspense accounts
4.	Mandatory Staff Rotations	Specialised staff deputations

Branch Audit - Appointment Formalities

- Appointment Letter from head/central office or local head office
- Communication with Previous Auditor of the Branch (before acceptance of engagement)
- Acceptance of engagement- Compliance with RBI Circular
- Engagement Letter (to be acknowledged and signed by the branch manager)
- Closing instructions issued by HO/SCAs (to be obtained from branch head, if not part of the closing pack received with the appointment letter)

Branch Audit - Planning Formalities

- Understanding the branch's business and its environment
- Determination of Materiality
- Scoping in and scoping out of areas based on materiality and qualitative factors
- Preliminary Analytical review
- Identification & Assessment of Fraud Risk
- Evaluation and use of work of concurrent auditors and internal auditors
- Process walkthrough
- Evaluation of IT environment
- Planning meeting with the Branch head
- Preparation of requirement list
- Audit Timetable
- Audit Team & Review responsibilities

Key Information Access to the Branch Auditors

- Internal/Concurrent Audit Report of the branch
- Observations pertaining to branch in RBI inspection
- Management inspection report
- Customer complaints
- Previous auditors' LFAR report
- MIS report generated from the system
- Closing instructions received by branch from HO
- Accounting manual and critical accounting entries (including month end and year end) passed by the branches
- Details of manual interventions if any done by the branches in NPA classifications
- Access to the audit logs/ trails maintained for capturing events such as changes in master data/ parameters, activities carried out through administrative privileges and through backend access etc.
- Major exception reports

Challenges of Branch Auditors

Branch auditors confront following practical issues at fully computerised branches:

- Accounting manual, entries, calculations and framework are built in computerised accounting systems.
- Critical IT controls are centralised at HO level.
- Limited access to periodical MIS, exception reports, NPA related reports generated by the system.
- Documentation of critical processes performed for accounting and bookkeeping.
- Access to primary records and entry level transactions.
- Hard copies of transactions.
- Independent IT Audit at branches, etc.
- Staff ignorance about various aspects of the IT applications and IT infrastructure at the Branch.

Statutory Bank Branch Audit – Auditable Areas

- Physical Verification – Cash at Branch, Cash at ATM, Stamps, Stationery, Bills under LCs
- Verify the accounting entries passed for the MOCs issued during the last year
- Review of Exceptional reports generated
- Review of the Trial Balance and Balancing Files (Loans & Deposits)
- Calculation of Interest Income on Loans
- Calculation of LC/ BG Commission – Card Rate/ Concession
- Calculation of Interest Expenses on Deposits
- Expenses Vouching – TDS/ GST ITC
- Fixed Assets and Depreciation

Statutory Bank Branch Audit - Auditable Areas

- Review of suspense accounts, system suspense, technical suspense, sundry deposit accounts, inter office reconciliation, banker's cheque, DD Purchase account.
- Bank Account Reconciliation
- Revaluation of Foreign Currency Assets/ Liabilities
- Contingent Liabilities - LC/ BG/ Acceptance/ FX Contracts
- Reading of various reports - Last year's LFAR, Concurrent Audit reports, internal/Management Audit report
- Ratio Analysis with previous year (interest yield, cost of deposit, key expenses)
- Reading of Closing Manual prepared by the Head office
- Capital Adequacy Return
- Returns and Other Certificates

Auditable Areas-Cash and Security Stationary

- In PSU branches, the cash at ATM is being managed by the branch to which the ATM is associated.
- Mismatch in actual count of stamp paper vis-à-vis stamp register due to non recording of stamp papers issued on timely basis.
- Ratification in case of breach of cash retention limit is not obtained by the branch officials
- There may be instance of non-reporting of fraud related to cash reported at the branch.

Auditors to carry out physical verification of cash at teller, vault and ATM to ensure the completeness and accuracy of cash lying in the branch.

Tally the cash amount with the GL balance generated from CBS.

Loans and advances-Auditable Areas

Fund Based facilities

- Cash Credit
- Overdrafts
- Working Capital Demand Loan
- Term Loans
- Bills: Purchase of bills/
Discounting of bills/ Advance
against bills under collection
- Export Credit: Pre Shipment
Credit/ Post Shipment Credit

Non - Fund Based facilities

- Bank Guarantee
 - Performance Bank Guarantee
 - Financial Bank Guarantee
- Letter of Credit
- Buyers' Credit
- Acceptances
- Letter of Comfort

Loans and Advances- Key considerations

Indicative list of exception reports from CBS

- Advances snapshot covering all important parameters
- Accounts with overdue in excess of 90 days and are classified as Standard Assets
- List of LCs devolved during the period / year and current status of account, including list of forced debits pertaining to the devolvement, not debited to the operative accounts of the borrower i.e. parked separated either under advances or office accounts.
- List of BGs invoked during the period / year and current status of account, including list of forced debits pertaining to the invocation, not debited to the operative accounts of the borrower i.e., parked separated either under advances or office accounts.
- Standalone Non-Fund Based Limits granted to customers
- List of SMA / Watch list / Probable NPA/Weak accounts
- Backdated updation of stock and book debt statements (Difference between date of updation in CBS and date of actual receipt of the Stock Statement)
- List of accounts wherein the facility is not renewed / reviewed
- List of accounts slipped to NPA during the current period
- List of accounts wherein there is an amendment in date of NPA
- List of accounts written off during the period / year
- List of accounts upgraded (along with date of upgrade and the over dues on the date of upgrade)
- Quick Mortality (NPA within 1 year of Original Sanction Date)
- List of NPA Accounts with Security Valuation not carried out within the prescribed period

Loans and Advances-Key considerations

- Key details such as interest rates, limits, covenants, etc. are captured.
- Cases of frequent renewals/ roll over of short-term loans
- Issues in tracking of covenants and post disbursement monitoring documents.
- Not obtaining proper documentation from the borrowers such as end-use certificate, old stock statement, etc.
- Delay in updation of receipt of post disbursement documents (such as insurance, stock statement, end use certificates, etc.) which may have financial implication and lead to customer complaints.
- Incorrect classification of priority sector lending (PSL)
- Loan to MSME- Whether loan to a partner/ director of MSME qualify as MSME.
- Proper Flagging of schemes such as CGTMSE, ECLGS, CGFMU etc.

Loans and Advances- Key considerations

- Error in capturing of Security details in system
- Error in calculation of drawing powers (since DP is calculated manually in excel spreadsheets and captured in the CBS)
- Blank documents, signed by the borrowers, are accepted by the branch officials.
- Mismatch in amounts in key details as per Credit Appraisal Memo (CAM) vis-à-vis sanction letter.
- Non execution of memorandum of deposits of title deed
- In case of multiple valuation reports and huge differences in their amounts
- Mandate of debiting EMI amount contain entire loan amount instead of EMI amount.
- Thorough review of stock audit report carried out for accounts having funded exposure above Rs. 5 crores.

Loans and Advances - Asset Classification

- **Cash Credit/ Overdraft Facility**

Non receipt of stock statement - The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

Pending Review - An account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

- **Derivative Contracts**

The overdue receivables representing positive mark-to-market value of a derivative contract will be treated as a non-performing asset, if these remain unpaid for 90 days or more. However, any amount, representing positive mark-to-market value of the foreign exchange derivative contracts (other than forward contract and plain vanilla swaps and options) that were entered into during the period April 2007 to June 2008, which has already crystallised or might crystallise in future and is / becomes receivable from the client, should be parked in a separate account maintained in the name of the client / counterparty.

Loans and Advances - Asset Classification

- **'Overdue' status - Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank. The borrower accounts shall be flagged as overdue by the banks as part of their day-end processes for the due date, irrespective of the time of running such processes.**

Example: If due date of a loan account is March 31, 2023, and full dues are not received before the lending institution runs the day-end process for this date, the date of overdue shall be March 31, 2023. If it continues to remain overdue, then this account shall get tagged as SMA-1 upon running day-end process on April 30, 2023 i.e. upon completion of 30 days of being continuously overdue. Accordingly, the date of SMA-1 classification for that account shall be April 30, 2023.

Similarly, if the account continues to remain overdue, it shall get tagged as SMA-2 upon running day-end process on May 30, 2023 and if continues to remain overdue further, it shall get classified as NPA upon running day-end process on June 29, 2023. (RBI Circular - November 12, 2021)

Instalment or principal due from December 31, 2023 not paid by March 31, 2024 will be classified as NPA.

Loans and Advances - Asset Classification

Guidelines for classification of assets

- **Appropriate internal systems for proper and timely identification of NPAs -** Appropriate internal systems to comply with the requirements of the RBI circular dated Sep. 14, 2020 on Automation of Income Recognition, Asset Classification and Provisioning processes in banks (as updated).

Accounts regularised near about the balance sheet date

- The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity.
- Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA.

Verify SMA 2 reports and Probable NPA Reports of previous month with actual NPA reports as on March 31, 2024. Accounts not marked as NPA to be reviewed as part of Sample

Advances against Term Deposits, NSCs, KVPs, etc.

- Need not be treated as NPAs, *provided adequate margin is available in the accounts.*
- Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

Loans and Advances - Asset Classification

Post-shipment Supplier's Credit

- EXIM Bank has introduced a guarantee-cum-refinance programme whereby, in the event of default, EXIM Bank will pay the guaranteed amount to the bank within a period of 30 days from the day the bank invokes the guarantee after the exporter has filed claim with ECGC.
- To the extent payment has been received from the EXIM Bank, the advance may not be treated as a NPA for asset classification and provisioning purposes.

Credit Card Accounts

- A credit card account will be treated as NPA if the minimum amount due, mentioned in card statement, is not paid fully within 90 days from the payment due date mentioned in the statement.

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.

Loans and Advances - Early Warning Signals

- **Signals emanating from stock statements/audit report**
 - ❖ Delay in submission of monthly statements/stock audit
 - ❖ Non-provision of detailed stock statement in soft copy
 - ❖ Inability to verify the stock-by-stock auditor
 - ❖ Storage of stocks at third party warehouse
 - ❖ Database of different warehouses
 - ❖ Capacity of warehouses

- **Signals emanating from analysis of receivables/payables**
 - ❖ Limited due diligence of top 10 large receivables/payables
 - ❖ Concentration of receivables/payables with few parties
 - ❖ Wide variation in purchase/sale on month-to-month basis from/to such parties
 - ❖ Directors/KMPs of receivables/payables from public source (MCA, Zuaba Corp, Probe42, Insta financials etc.)
 - ❖ Director's association with other companies
 - ❖ Periodic validation of data submitted for sanction/review with actuals

Loans and Advances - Early Warning Signals

- **Signals emanating from analysis of CA/CC accounts**
 - ❖ Analysis of CA/CC statements exchanged amongst banks
 - ❖ On account payment from the debtor vis-a-vis bill to bill
 - ❖ Frequency of payments from debtors
 - ❖ Borrowings from high-cost providers (like NBFCs)
 - ❖ Lump sum payments to creditors
 - ❖ Long outstanding Bills for collections (inward/outward)

- **Signals emanating from LC issued/discounted**
 - ❖ Issue of LCs though there is no such trade practice
 - ❖ Time Gap between the LC opening and discounting
 - ❖ LC documents: Time gap between LR/RR date and acceptance of documents by the customer
 - ❖ Carrying capacity of mode of Transport
 - ❖ Co-relation of LR/RR with E-Way Bill
 - ❖ Transportation of goods by own vehicles

Loans and Advances - Early Warning Signals

- **Signals emanating from Financial Statements**
 - ❖ Significant movements in inventory, disproportionately higher than the growth in turnover.
 - ❖ Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet.
 - ❖ Return on assets
 - ❖ Review of contingent liabilities

- **Signals emanating from financial indiscipline**
 - ❖ Frequent instances of dishonor of Cheques
 - ❖ Frequent irregularity in the operating account
 - ❖ Frequent request for ad-hoc/ TOD
 - ❖ Delay in payment of statutory dues - CARO reporting
 - ❖ Devolvement of LCs
 - ❖ Invocation of BGs
 - ❖ Non payment of Income Tax - Income Tax Return
 - ❖ Non-routing of turnover through lending banks

Loans and Advances - Projects under Implementation

- DCCO should be clearly spelt out at the time of financial closure & should be formally documented.
- Two categories: Infrastructure Sector & Non-infrastructure Sector.
- Deferment of DCCO [where projects is delayed for legal and other extraneous reasons]

PHASE-I

Permitted [2 years or 1 year]

PHASE-II

Permitted + Restructure [2 years or 1 year]

<i>Infrastructure Projects involving court cases</i>	<i>Infrastructure Projects delayed for other reasons beyond the control of promoters</i>	<i><u>Project Loans for Non-Infrastructure Sector (other than Commercial Real Estate Exposure)</u></i>
<i>(2+2) = 4 years in case the reason for extension of date is arbitration proceedings or a court case.</i>	<i>(2+1) = 3 years other than Court Case</i>	<i>(1+1)=2 years</i>

- Project Loans for CRE exposure delayed for the reason beyond the control of promoter(s) - 1+1 = 2 years provided that the revised repayment schedule is extended only by a period equal to or shorter than the extension in DCCO and all provisions of the Real Estate (Regulation and Development) Act, 2016 are complied with.

Loans and Advances - Deemed DCCO

- A project with multiple independent units may be deemed to have commenced commercial operations from the date when the independent units representing 50 per cent (or higher) of the originally envisaged capacity have commenced commercial production of the final output as originally envisaged, subject to the following conditions:
 - The units representing remaining 50 per cent (or lower) of the originally envisaged capacity shall commence commercial operations within a maximum period of one year from the deemed date of commencement of commercial operations;
 - Commercial viability of the project is reassessed beyond doubt; and
 - Capitalisation of interest obligation in respect of project debt component attributable to the units of the plant which have commenced commercial operations has ceased and the interest expenditure is booked under revenue account.
 - In such cases, bank may, at their discretion, also effect a consequential shift in repayment schedule of the debt attributable to units which have not commenced commercial operations for equal or shorter duration (including the start date and end date of revised repayment schedule) i.e., one year, subject to no other changes being carried out.
- If the remaining units do not commence commercial operations within the stipulated time of one year, the account shall be treated as non-performing asset and the provisions shall be made accordingly.

NPA - Provisioning Norms

Asset Classification	Provision of Outstanding amount
Loss assets	100% (Loss assets should be written off)
Doubtful assets	100% of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis.
Up to 1 year	25%
1 to 3 years	40%
More than 3 years	100%
Substandard assets	<p>A general provision of 15 percent on total outstanding should be made without making any allowance for ECGC guarantee cover and securities available</p> <p>The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 25 per cent on the outstanding balance</p>
Standard assets	A general provision for standard assets at the rates for funded outstanding on global loan portfolio basis.

NPA - Early identification and reporting of Stress

Lenders shall recognise incipient stress in loan accounts, immediately on default, by classifying such assets as SMA as per the following categories:

SMA Sub-categories	Basis for classification - Principal or interest payment or any other amount wholly or partly overdue between
SMA - 0	Up to 30 days
SMA - 1	More than 30 days and up to 60 days
SMA - 2	More than 60 days and up to 90 days

In the case of revolving credit facilities like cash credit/overdraft

SMA Sub-categories	Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for a period of
SMA - 1	More than 30 days and up to 60 days
SMA - 2	More than 60 days and up to 90 days

If due date of a loan account is March 31, 2023, and full dues are not received before the bank runs the day-end process for this date, the date of overdue shall be March 31, 2023. SMA-1 on April 30, 2023 / SMA-2 on May 30, 2023 / NPA on June 29, 2023.

Fixed Assets

- Timeliness of recording of fixed assets in the system
- Correct recording of date of put to use in the system. Generally, branches record the date of payment as date for put to use.
- Treating the expense of capital nature as revenue nature
- Discarding the asset without recording in the system.
- Incorrect recording of estimated useful life of asset
- Not recording of movement of assets from one branch to another
- Delay in capitalisation of any CWIP.

Inter-branch/ Inter office balances

- In CBS, office accounts are bifurcated between accounts which mandatorily require the bank to enter a reference number while passing entry (pointing) and accounts which do not have such mandate (non-pointing).
- **Pointing accounts:** reconciliation is easier as the entries can be knocked off based on reference number and each outstanding entry constituting outstanding balance at reporting date can be identified.
- **Non-pointing accounts:** reconciliation require manual intervention and tracking due to non-availability of unique reference number.
- Non-reconciliation of transitory accounts, sundry/suspense accounts on timely basis.
- Manual entries passed in the GLs, without unique reference nos leading to mismatches in reconciliations.

Inter-branch/ Inter office balances

- System suspense BGL often contains a multitude of complex entries, including items such as unapplied funds, unidentified transactions, and reconciliation adjustments. These entries can be difficult to trace and reconcile, posing challenges for auditors in verifying their accuracy and completeness.
- Auditing system suspense BGL and provisions in the books of accounts pose several challenges for auditors, including complexity of entries, identification of material misstatements, provisioning for uncertain entries, documentation and audit trail issues, integration with core banking systems, regulatory compliance, substantive testing requirements, and effective communication with stakeholders. Addressing these challenges requires careful planning, thorough analysis, collaboration with relevant stakeholders, and adherence to professional standards and regulatory guidelines.

Reporting under Long Form Audit Report (LFAR)

- Whether there are any software/ systems (manual or otherwise) used at the branch which are not integrated with the CBS? If yes, give details thereof
- Whether the system of bank warrants expeditious compliance of daily exception reports and whether there are any major observations pending such compliance at the year end and reporting requirement and response system of such items to HO and review the system of closure of exception reports?
- Furnish your comments on data integrity (including data entry, checking correctness/ integrity of data, no back ended strategies etc.) which is used for MIS at HO/CO level.
- Whether the bank has laid down procedures for manual intervention to system generated data and proper authentication of the related transactions arising therefrom along with proper audit trail of manual intervention has been obtained?
- In case the branch has been subjected to Information Systems (IS) audit whether there are any adverse features reported and have a direct or indirect bearing on the branch accounts and are pending compliance?
- Whether branch is generating and verifying exception reports at the periodicity as prescribed by the bank?

Contingent Liability

- One of the primary challenges is identifying all contingent liabilities. These liabilities may not be recorded in the financial statements as they depend on future events. Auditors need to have a thorough understanding of the bank's operations and transactions to identify potential contingent liabilities, such as guarantees, letters of credit, or pending litigation.
- Auditing contingent liabilities in a bank branch involves navigating through various challenges, including identification, assessment, complexity of financial instruments, legal and regulatory compliance, estimation uncertainty, documentation, and subsequent events. Addressing these challenges requires specialized knowledge, careful planning, thorough testing procedures, and collaboration with relevant stakeholders

Internal Controls in bank branch

- Work of one staff member is invariably supervised / checked by another staff member, irrespective of the nature of work
- Banks have a system of job rotation among staff
- The financial and administrative powers of each official / each position are fixed and communicated to all persons concerned
- Branch managers have to send periodic confirmation to their controlling authority on compliance of the laid down systems and procedures.
- All branches of a bank have a unique code number which is circulated amongst all offices of the bank
- All books are to be balanced periodically. Balancing is to be confirmed by an official
- Particulars of lost security forms are immediately advised to controlling so that they can exercise caution
- Fraud prone items like currency, valuables, draft forms, term deposit receipts, traveler's cheques and other such security forms are in the custody of at least two officials of the branch

Internal Controls over Financial Reporting

- ❑ Entity Level Controls
- ❑ IT General Controls
- ❑ Process Level Controls applicable to Branches
 - Recording of Loans including
 - ✓ the rate of interest,
 - ✓ repayment schedule,
 - ✓ drawing power,
 - ✓ value of security etc.
 - Non-Fund based accounts, which are either opened at the Branch or being monitored by the Branch
 - Recording of restructuring and re-schedulement terms in respect of loans and advances.
 - Operations involving opening and closure of accounts
 - Updation of account wise specific details
 - Capital Adequacy Ratio

Internal Controls over Financial Reporting

- ❑ Process Level Controls applicable to Branches
 - Bank reconciliation
 - Cash Balance / Cash Transactions/Balance in the ATM
 - Forex transactions carried at Branches
 - Locker operations
 - Inventory management (debit card, cheque book, other valuable stationery etc.)
 - Inter office reconciliation
 - Suspense and Sundry accounts
 - Physical verification of fixed assets
 - Non-interest expenditure
 - Quantification of provisions required to be made against assets and contingent liabilities

Computer Assisted Audit Techniques (CAAT)

CAAT are computer programs and data that the auditor uses as part of the audit procedures to process data of audit significance, contained in an entity's information systems. CAAT may be used in performing various auditing procedures, including the following:

- Tests of details of transactions and balances, for example, the use of audit software for recalculating interest or the extraction of invoices over a certain value from computer records.
- Analytical procedures, for example, identifying inconsistencies or significant fluctuations
- Tests of general controls, for example, testing the set-up or configuration of the operating system or access procedures to the program libraries or by using code comparison software to check that the version of the program in use is the version approved by management ;
- Sampling programs to extract data for audit testing
- Reperforming calculations performed by the entity's accounting systems.

Enhancing Audit Focus in the Evolving Banking Landscape

- The following areas warrant heightened attention:
 - Probable NPA report
 - System suspense account and inter branch accounts
 - Contingent Liability
 - Fixed Assets
 - Technology changes
 - Internal Financial Control over Financial reporting at Branch level controls
 - Loans and advance including Sanction, documentation, disbursement and supervision
 - Deemed DCCO and Projects under Implementation
 - Financing of Cost Overruns for Projects under Implementation
 - Auditing in CBS environment



THANK YOU