

BANK BRANCH STATUTORY AUDIT - CERTAIN ASPECTS

S.	Item	Important Audit Checks
1.	Deposit i. Term ii. Saving iii. Current iv. FCNR/ NRE/ NRNR	Verify transactions during the year relating to: <ul style="list-style-type: none"> ○ New Accounts opened; ○ Accounts closed; ○ Dormant Accounts; ○ Interest calculations; ○ Test check account statements for unusual/ large/ overdraft transactions; ○ Overdue Term deposits & banks policy for its renewal; ○ Accrual of interest; ○ RBI Norms for Non-resident deposits & its operations - with due importance to opening and operation of accounts like NRE, NRNR, FCNR, RFC, etc.; ○ Interest on various types of deposits; Tax Deducted at Source. ○ Large deposits placed at the end of the year (<i>probable window dressing</i>). ○ Examine unusual trend in account opening or account closing, dormant accounts that have suddenly been reactivated by heavy cash withdrawals or deposits, overdrawing, etc. ○ Examine interest trends as compared to average annual deposits (monthly average figures). ○ Review the Master Circular on Maintenance of Deposit Accounts issued by RBI dated March 1, 2004 attached hereto.
2.	Advances	<ul style="list-style-type: none"> ○ Review monitoring reports (irregularity reports) sent by the branch to the controlling authorities in respect of irregular advances. ○ Review appraisal system, Files of large as well as critical borrowers, sanctions, disbursement, renewals, documentation, systems, securities, etc. ○ Review on test check basis operations in the Advances Accounts. ○ Compliance of sanction terms and conditions in the case of new advances. ○ Whether the borrower is regular in submission of stock

		<p>statements, book debt statements, insurance policies, balance sheets, half yearly results, etc. and whether penal interest is charged in case of default/ delay in submission of such data.</p> <ul style="list-style-type: none"> ○ Charge of interest and recovery for each quarter or as applicable to be verified. ○ Review the monitoring system, i.e. monitoring end use of funds, analytical system prevalent for the advances, cash flow monitoring, branch follow-up, consortium meetings, inspection reports, stock audit reports, market intelligence (industry analysis), securities updation, etc. ○ Check classification of advances, income recognition and provisioning as per RBI Norms/ Circulars. ○ Examine interest trends as compared to average annual advances (monthly average figures). ○ Scrutinise the final advances statements with regard to assets classification, security value, documentation, drawing power, out standings, provisions, etc. ○ Check whether Non-Fund based (Letter of Credits/ Bank Guarantees) exposure of the borrowers is within the sanctioned limits. ○ Compare projected financial figures given at the time of project appraisal with actual figures from audited financial statements for relevant period and ascertain reasons for large variance. ○ Take into account the assessment of RBI if the regional office of RBI has forwarded a list of individual advances to the bank, where the variance in the provisioning requirements between the RBI and the bank is above certain cut off levels (<u>refer para 5.1.2 of the master circular</u>)
3.	Profit & Loss Account	Income/ Expenditure: Verify: <ul style="list-style-type: none"> ○ Short debit of interest/ commission on advances; ○ Excess credit of interest on deposits; ○ In case the discrepancies are existing in large number of cases, the auditor should consider the impact of the same on the accounts; ○ Determine whether the discrepancies noticed are intentional or by error; ○ Check whether the recurrence of such discrepancies are general or in respect of some specific clients; <ul style="list-style-type: none"> ○ Proper authority in sanction and disbursement of expenses as also the correctness of the accounting

		<p>treatment given as to revenue/ capital/ deferred expenses.</p> <ul style="list-style-type: none"> ○ Check accrual of income/ expenditure especially for the last month of the financial year. ○ Divergent Trends: <ul style="list-style-type: none"> ○ Divergent trends in income/ expenditure of the current year may be analysed with the figures of the previous year. ○ Wherever a divergent trend is observed, obtain an explanation along with supporting evidences like monthly average figures, composition of the income/ expenditure, etc.
4.	Balance Sheet	<p>Cash & Bank Balances:</p> <ul style="list-style-type: none"> ○ Physically verify the Cash Balance as on March 31, 2005 or reconcile the cash balance from the date of verification to March 31, 2005. ○ Confirm and reconcile the Balances with banks as on March 31, 2005. <p>Investments:</p> <ul style="list-style-type: none"> ○ Physically verify the Investments held by the branch on behalf of Head Office and issue certificate of physical verification of investments to bank's Investments Department. ○ Check receipt of interest and its subsequent credit to be given to Head Office. <p>Advances Provisioning:</p> <ul style="list-style-type: none"> ○ As per RBI norms, unrealised interest on NPA accounts should be reversed and not charged to "Advance Accounts". Reversal of unrealised interest of previous years in case of NPA accounts is required to be checked. ○ Partial Recovery in respect of NPA accounts should be generally appropriated against principal amount in respect of doubtful assets. <p>Fixed Assets:</p> <ul style="list-style-type: none"> ○ Check Inter-branch transfer memos relating to Fixed Assets and whether they have been correctly classified in the accounts and depreciation accounting thereof. <p>Inter Branch Reconciliation (IBR):</p> <ul style="list-style-type: none"> ○ Understand the IBR system and accordingly prepare an audit plan to review the IBR transactions. The large volume of Inter Branch Transactions and the large number of

unreconciled entries in the banking system makes the area fraud-prone.

- Check up head office inward communication to branch to ascertain date upto which statements relating to inter-branch reconciliation have been sent.

Check and report:

- Reversal of any large/ old/ unexplained entries, which had remained outstanding in IBR.
- Items of revenue nature, cash-in-transit (for example, cash meant for deposit into currency chest) which remains pending for more than a reasonable period.
- Double responses to the entries in the Accounts.
- Test Check accuracy and correctness of "Daily statements" which are prepared by the branch and sent to IOR department.

The auditor should duly consider the extent of non-reconciliation in forming his opinion on the financial statements. Where the amounts involved are material, the auditor should suitably qualify his audit report. Attention is drawn on the paper on "Certain Significant Aspect of Statutory Audit of banks" issued by the Council of ICAI in March, 1994, published in the C. A. journal. Further, vide its circular no. DBOD No. BP.BC. 73 /21.04.018/2002-03 dated February 26, 2003, the Reserve Bank (RBI) advised the banks to maintain category-wise (head-wise) accounts for various types of transactions put through inter-branch accounts so that the netting can be done category-wise. Further, RBI advised banks to make 100 percent provision (category-wise) for net debit position in their inter-branch accounts arising out of the unreconciled entries, both debit and credit, outstanding for more than six months (Refer to the master circular).

Suspense Accounts, Sundry Deposits, etc.:

Suspense accounts are adjustment accounts in which certain debit transactions are temporarily posted whose authorisation is pending for approval. Sundry Deposit accounts are adjustment accounts in which certain credit transactions are temporarily posted whose authorisation is pending for approval. As and when the transactions are duly authorised by the concerned officials they are posted to the respective accounts and the Suspense account/ Sundry Deposit account is credited/ debited respectively.

- Ask for and analyse their year-wise break-up.
- Check the nature of entries parked in such Accounts.
- Check any movement in such old balances and whether

		<p>the same is genuine and has been properly authorised by the competent authority.</p> <ul style="list-style-type: none"> ○ Check for any revenue items lying in such accounts and whether proper treatment has been given for the same.
5.	Auditors Report & Memorandum of Changes	<ul style="list-style-type: none"> ○ The Auditors Report should be a self contained document and should contain no reference of any point made in any other report including the LFAR; ○ Include Audit Qualifications in the Auditors Report and not in the LFAR; ○ Quantify the Audit Qualifications for a better appreciation of the point made to the reader; ○ For suggesting any changes in the financial statements of the branch, quantify the same in the Memorandum of Changes (MOC) and make it a subject matter of qualification and annex it to the Auditors Report.
6.	Long Form Audit Report (LFAR)	<ul style="list-style-type: none"> ○ RBI has revised the LFAR w.e.f. F.Y. 2002-2003 and it has now been made more comprehensive. ○ Study the LFAR Questionnaire thoroughly; ○ Plan the LFAR work along with the statutory audit right from day one; ○ The LFAR questionnaire is a useful tool for planning the statutory audit of a branch; ○ Complete & submit the Auditors Audit Report as well as the LFAR simultaneously; ○ Be specific while replying the LFAR; ○ Give instances of shortcomings/ weaknesses existing in the respective areas of the branch functioning in the LFAR; ○ The LFAR should be sufficiently detailed and quantified so that they can be expeditiously consolidated by the bank.
7.	General	<ul style="list-style-type: none"> ○ Send a Letter of your Requirements to the Branch before commencing the audit [<u>Draft Letter enclosed herewith</u>]. ○ Obtain the latest status of cases involving fraud, vigilance and matters under investigation having effect on the accounts and its reporting requirement. Review the Master circular on FRAUDS - CLASSIFICATION AND REPORTING issued by RBI dated 19 September 2003 enclosed herewith ○ Obtain a Management Representation Letter (MRL) [<u>Draft MRL enclosed herewith</u>].

INCOME RECOGNITION and ASSET CLASSIFICATION NORMS - AT A GLANCE

Credit Facility	Basis for treating a Credit Facility as NPA	Remarks
Term Loans	<p>Interest or installment remains overdue for a period of more than 90 days from end of the quarter w.e.f. March 31, 2004</p> <p>Agricultural Advances: In respect of advances granted for agricultural purposes where interest and/ or installment of principal remains overdue for a period of more than two harvest seasons but for a period not exceeding two half years, the advance should be treated as NPA.</p>	<p>Overdue: An amount due to the bank under any credit facility is 'Overdue' if it is not paid on the due date fixed by the bank.</p>
Cash Credits & Overdrafts	<p>The account remains continuously "out of order" for a period of more than 90 days i.e. Outstanding balance remains continuously in excess of the sanctioned limit/ drawing power or there are no credits continuously for a period of 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period.</p>	<p>Banks may not classify an account merely due to existence of some deficiencies, which are of temporary nature such as non-availability of adequate drawing power, balance outstanding exceeding the limit, non-submission of stock statements and non-renewal of the limits on the due date, etc.</p> <p>However, stock statements older than three months should not be considered for drawing power and the working capital borrower 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.</p> <p>Further, an account where the regular/ ad-hoc credit limits have not been reviewed/ renewed within 90 days from the due date/ date of ad-hoc sanction respectively, will be treated as NPA.</p>
Bills Purchased and Discounted	<p>The bills purchased/ discounted remains overdue for a period of more than 90 days.</p>	<p>Overdue interest should not be charged and taken to income account in respect of overdue bills unless it is realised.</p>
Other Accounts	<p>Any amount to be received in respect of that facility remains overdue for a period of more than 90 days.</p>	
Government	<p>State Government guaranteed</p>	<p>The credit facilities backed by guarantee of</p>

guaranteed advances	advances in respect of which guarantee has been invoked and has remained in default for more than 90 days.	Central Government though overdue may be treated as NPA only when the government repudiates its guarantee when invoked. However, income shall not be recognised if the interest or installment has remained overdue or the account has remained continuously out of order or the bills or any other facility has remained overdue for a period of more than 90 days.
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Notes:

1. For Copy of Master Circular on Prudential Norms on Income recognition, Asset Classification and Provisioning pertaining to the Advances Portfolio issued by Reserve Bank of India vide DBOD No. BP. BC. 15/ 21.04.048/ 2003- 2004 dated August 22, 2003.
2. Once an account has been classified as NPA, all the facilities granted to the borrower will be treated as NPA except in respect of Primary Agricultural Credit Societies (PACS)/ Farmers Service Societies (FSS). Also, in respect of additional facilities sanctioned as per package finalised by BIFR and/ or term lending institutions, provision may be made after a period of one year from the date of disbursement in respect of additional facilities sanctioned under the rehabilitation package. The original facilities granted would however continue to be classified as sub-standard/ doubtful, as the case may be.
3. Interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.
4. Till the time the account is identified as NPA, income is recognised irrespective of whether realized or not. Where an account is identified as NPA during the year, unrealised income should not be recognised for the year. Also, interest accrued and credited to income account in the previous year should be reversed or provided for if the same is not realized.
5. If the accounts of the borrowers have been regularized before the balance sheet date by repayment of overdue amounts, the same 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. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/ Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.
6. If the debits arising out of devolvement of letters of credit or 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.
7. In case of restructured accounts, the classification of advances should be done as per para 4.2.15 of the aforesaid master circular.
8. In cases of substantial time overrun in the projects under implementation, the asset classification, income recognition and provisioning should be done as per para 4.2.16 of the aforesaid master circular and as per RBI circular No. DBOD. BP. BC.74/ 21.04.048/ 2002-03 dated February 27, 2003.

DBOD No. BP.BC. 73 /21.04.018/2002-03

All Scheduled Commercial banks
(excluding RRBs and LABs)

Dear Sir,

Inter-branch Accounts-Provisioning for net debit balance

Please refer to our circular DBOD No. BP.BC.22/21.04.018/99 dated March 24, 1999 wherein banks were advised that from the year ended March 31, 1999, they should make 100 per cent provision for the net debit position in their Inter-branch Accounts, arising out of the un-reconciled entries (both debit and credit) outstanding for more than three years as on March 31 every year. To expedite the process of reconciliation, the period allowed for making provision against the net debit balance in the inter-branch accounts was brought down from three years to two years from the year ended March 31, 2001 vide our circular DBOD No. BP.BC. 133/21.04.018/2000 dated January 10, 2000 and further to one year from the year ended March 31, 2002 vides our circular DBOD No. BP.BC.17/21.04.018/201-02 dated August 24, 2001. While reviewing the progress made by banks in a recent meeting the Board for Financial Supervision noted that a large number of banks were able to reconcile the entries in time and hence the banking system in general needed to be complimented. It was also decided that the guidelines for making provisions should be revised.

2. In this connection, banks' attention is invited to paragraph 3 of our circular DBOD No. Fol. BC.114/16.01.001-93 dated April 28, 1993, in terms of which banks are required to reconcile the entries outstanding in their inter branch accounts within a period of six months. With this end in view and in keeping with the best banking practices, it has been decided to further reduce the time period allowed to banks for making provision against the net debit balance in the inter-branch account **from one year to six months from the year ending March 31, 2004.**
3. Accordingly, banks should arrive at the category-wise position of unrecognized entries outstanding in the inter-branch accounts for more than six months as on March 31, 2004 and make provision equivalent to 100 per cent of the aggregate net debit under all categories. While doing so, it maybe ensured that:
 - i. Credit balance in the Blocked Account created in terms of our instructions contained in our circular DBOD No. _____ dated _____ is also taken into account; and
 - ii. The net debit in one category is not set-off against net credit in another category.
4. Please acknowledge receipt.

Yours faithfully,

(Name & designation)