

Bank Branch Statutory Audit Planning, Audit of Advances and Expectation of the Central Statutory Auditors Navi Mumbai Branch of WIRC - 26 March 2022



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Agenda

- Objectives of Audit Planning & Requirements
- Pre – Audit Planning
- Audit Acceptance
- Preliminary Work
- Evaluation of Internal Controls
- Audit Planning
- Execution of Work
- Documentation
- Auditing in Computerized Environment
- Types of advances
- Banking arrangement
- Extent of verification
- Reporting of verification
- Stages of verification
- Non-Fund Based Advances
- Report & Memorandum of Changes (MOC)
- Expectation of the Central Statutory Auditors



Objectives of Audit Planning & Requirements

- Effective Planning & Reporting
- Compliance with RBI/ ICAI Guidelines
- Compliance with Bank's Internal guidelines/ circulars (as mentioned in the annual closing guidelines/ manual of instructions).
- Compliance with the terms of appointment.
- Compliance with the Accounting Standards and the Standards on Auditing.
- Timely completion of the audit
- Certifying the Balance Sheet & P&L account along with the Annexures.



Objectives of Audit Planning & Requirements (Contd.)

- Simultaneous coverage of allied responsibilities including:
 - Responses to the LFAR
 - Requirements of Tax Audit Report under section 44AB of the Income Tax Act, 1961
 - Recommendations of Ghosh & Jilani Committee Reports
 - Other certification work indicated in the letter of appointment like
 - DICGC Claims, etc
 - PMRY Scheme, Provident Fund Scheme
 - Statutory Requirements (ICAI, Peer Review, Statutory Authorities)



Pre – Audit Planning

- Old Audit reports – Working papers, certifications, etc.– Refresh yourself with the way you had conducted earlier audits.
- Identify the staff – Experienced, specialized knowledge, train staff
- Visiting the branches – before year end, get acquainted etc.
- Standards on Auditing such as
 - ☐ Knowledge of Business (SA 310)
 - ☐ Terms of Audit Engagement (SA 210)
 - ☐ Audit Planning (SA 300)
 - ☐ Audit Sampling (SA 530)
 - ☐ Audit Documentation (SA 230)
 - ☐ Using the work of another auditor (SA 600)
 - ☐ Audit Evidence (SA 500)
 - ☐ Audit Materiality (SA 320)
 - ☐ Written Representations (SA 580)
 - ☐ Analytical Procedures (SA 520)



Audit Acceptance

- Appointment letter
- Acceptance, Engagement letter , Declarations, letter of fidelity and secrecy, not indebted to Bank etc. If unable to accept, state the reasons.
- NOC from previous auditors
- Requirement letter to Branch before commencement of audit
- Draft Management representation letter in advance
- Communicate with the Branch - time schedule, requirements, details of the staff attending the audit of that particular Branch etc.
- Visit the branch – before year end & meet the staff
 - Select the major advances to be verified.
 - Check the major advances files.
- Discuss with the Concurrent Auditors
- Liaison with Branch staff for access and other arrangements. Obtain the concurrent auditor's login and password. Inform the Branch about your late sittings and if you plan to work on Sundays.



Preliminary Work

- Obtaining knowledge of business of bank/branch - Advances, Deposits, Large borrowers, NPA A/cs, CBS, etc.
- Ascertain the Branch Profile viz; Housing Finance, Agricultural Finance, NRI, IFB, Overseas etc.
- Document the discussions/ minutes of meetings.
- Brief own staff and train them.
- Define the materiality to the audit team. Check guidelines for the minimum amount of MOC.
- Review of reports, viz:
 - ☐ Closing Guidelines issued by the bank
 - ☐ Circulars (interest & Service charges)
 - ☐ Delegation of Authority & Financial powers



Preliminary Work (Contd.)

- Branch Audit Report/ LFAR of previous year
- Latest Internal Inspection/ Concurrent Audit report/Stock Audit Report
- Branch's RBI Inspection Report, if any
- Revenue Audit Report, Special Audit Report (on accounts or any segment)
- *Status and level of compliance by the branch, on adverse features pointed out in reports*
- *MOC's passed by the previous auditor*



Evaluation of Internal Controls

- Evaluate the knowledge of accounting software, policies and strength of internal control systems existing at the branch. Gain knowledge of the various short cut keys and the different modules of the system, reports from the system.
- Internal Controls would include:
 - ☐ Accounting Controls
 - ☐ Administrative Controls
- Determine the effectiveness of control systems – segregation of duties, exception reports, financial powers, roles & responsibilities of staff, awareness of circulars and systems.



Evaluation of Internal Controls (Contd.)

- Executions of transactions are in accordance with the authorizations.
- Verify the controls in software being used at the Branch.
- Emphasize on Risk prone areas
- Control Weakness – Fraud areas
- Test Check or substantive checking
- Based on the internal controls, the substantive checking to be decided – focus more on the Balance Sheet and Revenue areas.



Audit Planning

- Ascertain the thrust of operations and nature of banking activities at the branch (deposits/advances)
- Audit Program to cover all heads like Liabilities, Asset, Income, Expenditure, Off Balance Sheet items, with special emphasis on verification of advances, deposits and Inter- Branch accounts
- Lay down the overall time schedule.
- Define the audit team with clearly defined scope of work for each team member.
- Decide the manpower requirement, Allocate the work (Deposits, Advances, Misc. items, etc.), decide who does what?, how many days, time constraints, outstation audits, other arrangements, etc. Document all these points properly in the working paper file.



Audit Planning (Contd.)

- Simultaneous compilation of data (checklist, etc)
- Analytical review – compare the current year's data with the previous year and calculate significant ratios to identify areas where there is a potential misstatement or substantial variances.
- Any issues in getting the information or non-cooperation may be referred to Controlling Authorities at the right time.
- Statutory Central Auditors – for clarification/ interpretation on any issue relating to the accounting treatment, disclosure etc.
- Areas generally not to be considered at the Branch level – provision for gratuity, taxation, audit fees, depreciation, pension, employee retirement benefits, transfer to reserves, dividends etc.



Execution of Work

- Staff to be adequately trained to carry out the assignment satisfactorily. Confirm that there is sufficient skill & competence for specialized areas.
- Execution must be done as per the audit programme
- Checks should be extended in areas of weaknesses, including those identified during the course of audit
- Modify the audit plan in certain areas depending on the inherent weaknesses existing in those areas. Keep the audit plan flexible.
- Obtaining Audit Evidence and Management Representations
- Audit working papers for each area to be placed in file.
- Timely discussion and rectification of queries, unsolved queries to be reported suitably.



Documentation

- Auditors should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles governing an audit.
- Address communication after accepting appointment for inquiring the readiness of financial statements & other statements and records requiring authentication as well as for carrying out certain year- end procedures.
- Auditor should address letters seeking information on matters where he desires to strengthen his procedures and substantiate his work.
- In case of non- readiness / partial readiness of branch records, non-co-operation of branch management, etc communicate and politely place on record, the facts of the case. Also communicate these facts to the Zonal office/ Inspection Department, since it might delay the audit.



Documentation (Contd.)

- Document 'Evaluation of Internal Control Systems' and its effectiveness
- Obtain copies of documents which have been relied upon, like internal/ concurrent/ revenue auditor's report, branch's RBI inspection report, etc.
- Document the *Extent of check* applied in all the areas and the names of audit team members who covered these areas of audit.
- Proper minutes should be made of important discussions held with the branch management on critical issues and how it was concluded. Obtain *management's representation* on critical areas of branch operations
- Well- documented queries and responses should be also placed on record
- Obtain a Management Representation Letter before signing the Balance Sheet.



Auditing in Computerized Environment

- No visible audit trail
- Walk through of the transactions – from start to end and document them
- Inadequate segregation of duties and risk to integrity of data
- Check rights of access – to staff members & its level
- Computer generated “Error Reports” to verify accuracy of interest rates, date of NPA, etc, if available
- System suspense entries
- Exceptional reports like overdrawn accounts, overdue bills, delayed submission of stock statements, accounts due for renewal but not renewed.
- Check whether the recurrence of such discrepancies is general or in respect of some specific clients.
- Auditor to go to root cause of the problems.



Advances - Verification

- Some of the Laws applicable to the Banks:
 - The Banking Regulation Act, 1949
 - The Companies Act, 2013 (registration of charges, resolutions, borrowing powers etc.)
 - The Reserve Bank of India Act, 1934
 - The Foreign Exchange Management Act
 - The Income Tax Act, 1961 (Tax Audit)
 - GST Act
 - The Stamp Act of the States/ The Indian Stamp Act
 - Negotiable Instrument Act
 - Law of Limitation



Important RBI Circulars

- RBI/2021-2022/104 DOR.No.STR.REC.55/21.04.048/2021-22 dated 1st October, 2021 on **Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances:**
 - i. **Para 4.2.2** – Appropriate internal systems for proper and timely NPA identification (Circular dated 14 September, 2020 on automation of IRAC and provisioning process)
 - ii. **Para 6.2.2** – Banks to extinguish all available means of recovery before writing off any account fully or partially.
 - iii. **Para 7** – NPA Management – Requirement of effective mechanism and granular data



Important RBI Circulars

- RBI/2021-2022/125.
DOR.STR.REC.68/21.04.048/2021-22 dated 12th November, 2021 on **Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarifications**
 - i. Specification of due date/ repayment date
 - ii. Classification of SMA and NPA – accounts to be flagged as part of the day end process.



Important RBI Circulars

- RBI/2021-2022/158

DOR.STR.REC.85/21.04.048/2021-22 dated 15th February, 2022 on **Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarifications**

- 90 days period for out of order status for CC/OD shall be inclusive of the day for which the day end process is being run.
- Account can be upgraded ONLY upon repayment of entire arrears of interest and principal pertaining to all the credit facilities availed by the borrower.



Types of Advances

- Fund based :
 - a) Cash Credit
 - b) Overdrafts
 - c) Demand/ Term Loan
 - d) Export credit – Packing Credit
 - e) Bills purchased/ discounted
- Non Fund based:
 - a) Guarantees – Performance/ Finance
 - b) Letter of credit (LC)



Types of Advances

a) Cash Credit

- This is a working capital facility granted to the borrower against the primary security of stock and receivables to fill the gap in working capital requirements.
- It is normally renewed each year and is repayable on demand.
- Borrower is sanctioned a limit based on his eligibility and his actual monthly drawing power is calculated based on the pledged/ hypothecated value of stock of goods, book debts after deducting the margins.



Types of Advances

b) Overdraft:

- This limit may be either secured or clean and does not generally carry a repayment schedule.
- Overdrafts are generally given against Property, FDR, Life Insurance Policies, NSCs etc.
- Several times the purpose of funds are not questioned to the borrower, but now a days many Banks are sanctioning this advance only for business purposes and several are converting it into short term loans with specified repayment periods.



Types of Advances

c) Demand/ Term Loans –

- Loans are repayable in installments over a period of time.
- TL are for acquisitions/creation of capital assets which become the security of the loan.
- Fixed repayment schedule and monthly interest charged on reducing balance method.
- Loans with repayment periods greater than 36 months usually are called Term Loans and of lesser period are known as Demand Loans.



Types of Advances

- The end use of the funds disbursed are fixed and for a pre specified purpose and are supposed to be used for the same purpose.
- The Bank directly pays the amounts to the suppliers of the borrower but in some instances lump sum payments are given to the borrower in their current accounts or CC accounts.
- CA certificates are obtained from the borrower confirming the usage of funds.



Types of Advances

d) Export Credit:

- It is disbursed in the modes of Pre Shipment & Post Shipment credit.

➤ Pre Shipment:

- Packing Credit - in Rupees/FC

Pre Shipment is granted for the production of the goods to be exported.

➤ Post Shipment:

- Export Bills purchased/Discounted

Post Shipment relates to the financing of the Bills raised on the overseas buyer upon shipment of goods.



Types of Advances

- Pre shipment credit has to be liquidated from the export proceeds only and cannot be adjusted out of rupee funds.
- Pre shipment credit can be granted at any branches but the export bills are handled only by authorized foreign dealer branches as foreign exchange is involved and there is reporting to RBI.
- Export proceeds have to be normally received within 180 days from the date of shipment. In genuine cases the Bank can extend the time limit as per the policy laid down or with the permission of RBI.



Types of Advances

e) Bills:

- Funding against the bills is meant to finance the actual sale transactions of the borrower.
- It includes
 - Purchase of Bills by the Bank if these are payable “On Demand”
 - Discounting of Bills by the Bank if these are usance bills
 - Advance against bills under collection from drawees.



Types of Advances

Non – Funded

A. Guarantees –

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

B. Letter of Credit –

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

C. Letter of Comforts / Buyers Credit –

- Undertaking by the bank to payee
- Nature / Purpose / Documentation



Types of Advances

a) Guarantees

- Financial, Performance & Deferred Payment guarantee
- Financial guarantee is issued in lieu of deposit mainly for tenders, bidding processes etc. The margins vary borrower –wise.
- Performance guarantee is issued for guaranteeing performance of any contractual obligations like delivery of machinery, goods etc. Mainly issued to contractors etc.



Types of Advances

- Deferred payment guarantee is issued to the equipment manufacturer on behalf of its client for payment. It could be for specific or multiple transactions.
- Upon invocation of the guarantee the facility becomes a Fund based and should be classified accordingly.



Types of Advances

b) Letter of Credit (LC):

- LC is a promise by a bank to honor the payments to be made by its customer (the buyer/importer) to the seller/exporter.
- The LC amounts are debited to the cash credit account of the borrower on the due date and if there is no limit available then sometimes the branch debits the amount to a separate account which becomes a devolved LC.



Banking arrangement

- Sole Banking – Borrower obtains credit from a single Bank.
- Multiple Banking – There is no formal arrangement between the lending Banks. Each Bank has its own set of loan documents, securities and mode of lending independent of other lending banks. The borrower has to deal with each of the banks separately.



Banking arrangement (Contd.)

- Consortium Arrangement – Number of lending banks is more than one. The lending banks form a formal consortium. Main features:
 - Bank with the largest exposure is the lead bank
 - Common set of loan documents, which is obtained by the lead bank on behalf of all the consortium member banks.
 - Lead bank is responsible for overall monitoring.
 - The securities are shared by the member banks in an agreed proportion based on their exposures.
 - Borrower maintains direct business relationship with all the member banks of consortium



Extent of verification

- Large advances which constitute individually more than 5% of the aggregate outstanding of that Branch or Rs. 2 crores, whichever is lower.
- Sampling will also depend on the existence of the internal control procedures and the reports given by the various auditors like the concurrent and stock auditors.
- If the NPA's are high or extensive problem is identified, samples selected should be more.



Reporting of verification

- Discrepancies noted in the advances have to be reported in 2 separate reports – one is the statutory audit report for “Major/Critical Discrepancies” and the other is a detailed report in the Long Form Audit Report.
- It is advisable that the auditors devise their format in which the queries can be noted down so that this helps them in compiling both the above reports. It should be kept in mind that material discrepancies which don't need a MOC are to be detailed in the LFAR.



Stages of Verification

- Credit appraisal and sanction:
 - Documents required
 - Sanction letter
 - RBI stipulations (Prudential Norms for Individuals and Group)
- Disbursement:
 - Documents by the Bank
 - Stamping
 - Documents to be obtained from the borrower
 - Insurance
 - Special terms and conditions



Stages of Verification (Contd.)

- Review of Operations:
 - Scrutiny of the accounts in the system.
 - Verification of the stock and books debts statement.
 - Drawing Power limits.
 - Accounts with other Banks.
 - Audit reports.
 - Direct reporting to RBI.



Stages of Verification (Contd.)

- Renewal/ Enhancement/ Reschedulement/ Balance Confirmation:
 - Limits are renewed at the end of each year, non renewal can make the account a NPA.
 - Ad hoc limits to be renewed within 180 days from the date of sanction.
 - Sufficient documents are required for any increase or re-alignment in the limits.
 - Reschedulement is done by Banks when a particular project gets delayed or there is a crisis faced by the borrower. It is permitted subject to the proper sanction and as per RBI rules.



Stages of Verification (Contd.)

- Physical inspection of securities & valuation
 - Physical inspection not usually possible due to shortage of time and hence have to rely on the report of the stock auditor/concurrent auditor/internal inspection department etc.
 - Obtaining stock auditors report is mandatory above a certain limit as prescribed by the Bank.
 - RBI states mandatory stock audit in cases of NPA accounts where the O/s is Rs. 5 crores and above.
 - Valuation to be done once in 3 years for all immovable properties



Stages of Verification (Contd.)

- Verification of the charges/income due on the advances
 - Following are some of the charges recoverable from the borrowers on various advances as prescribed by the Bank, which the auditors should at least test check:
 - Charges for processing of loan, stamping, insurance, valuation fees, stock auditor's fees, legal fees, postage and courier etc.
 - Interest levied : The auditor has to confirm that the rate as per the sanction is correctly updated in the client master in the system. Interest run reports can be generated from the system and verified. Also, penal interest in case of over drawings, late submission of the stock statements and the QIS, non-renewal of the limits need to be checked, to ascertain the revenue leakage.



Non Funded Advances

- Guarantees
 - Financial and Performance guarantee
 - Upon invocation of the guarantee the facility becomes a Fund based and should be classified accordingly.
 - Ghosh committee has recommended certain precautions to be taken by Banks while issuing guarantees.
 - For share and stock brokers RBI has advised to obtain minimum margin of 50% (with 25% being cash margin)



Non Funded Advances (Contd.)

- Letter of Credit (LC):
 - LC is a promise by a buyer to honor the payments to be made by its customer (the buyer/importer) to the seller/exporter. The LC amounts are debited to the cash credit account of the borrower and if there is no limit available then it results in a devolved LC.
 - Auditors should be careful in the accounts where there are frequent devolvment of LC.
 - The interest calculation on the LC based on the tenure should be checked.



Memorandum of Changes (MOC)

- All the rectifications in the financial statements should be necessarily done through MOC only.
- MOC are mostly of 3 kinds
 - Having effect on the Balance Sheet - Advances - NPA classification.
 - Having effect on the Profit & Loss account – increase or decrease in the revenue.
 - Having effect on the various statements of the final accounts set.
- MOC is prepared by the auditor and it not mandatory that the Branch Manager should sign it. His signature only denotes concurrence.
- It is advisable that the auditors attach a brief note with the MOC towards the reasons for classifying NPA accounts for the benefit of the Central Statutory Auditors.



Report & MOC

- Main Report should be a self contained document and should contain no reference of any point made in the LFAR
 - Audit Qualifications in the Main Report only and not in LFAR
- Report needs to be made out in the form and manner prescribed, subject to the qualifications being incorporated in the report and **duly quantified** in the Memorandum of Changes (MOC). In case of NIL MOC mention NIL in the main Audit Report and don't write 'subject to' which might create confusion to the CSA.
- For suggesting any changes
 - ☐ Quantify in MOC (qualification)- MOC – Auditors prerogative and need not take confirmations from the branch manager
 - ☐ Its an annexure to Main report



Report & MOC (Contd.)

- MOC to be given with explanations, justification and clarity.
- Discuss the draft reports – reservation, major observation, qualifications with the branch management prior to report finalization.
- Qualifications to be given in bold/italics
- Reports and the observations should be drafted in clear and unambiguous language.
- Changes to be done through MOC only.



Expectations of Central Statutory Auditors

- MOC to be properly prepared with detailed justification and reasoning.
- Check the SMA/ CIBIL/ CRILC reports.
- To take a stand and pass the MOC instead of referring it in the LFAR.
- LFAR to be elaborate instead of just stating YES/ NO.
- Main audit reports to be on the letter head of the Firm with UDIN and rubber stamp.



Expectations of Central Statutory Auditors

- Wherever Software packages are being used for audit reporting/ LFAR reporting - the same should be used and PDF copies should not be uploaded – as it becomes difficult for compiling the data at Zones and Head Office.
- Be objective while classifying the account as NPA should be based on the IRAC norms and don't use your subjectivity/ assumptions.
- Whenever in doubt the branch auditor should get in touch with the CSA/ F&A department.



Expectations of Central Statutory Auditors

- Understand the deadlines strictly since delay at the branch would delay the further process.
- Get properly updated on the restructuring RBI circulars since several accounts would have been restructured under the COVID era.
- Note to check the checklist provided by the Bank for signing the final sets along with the certificates.
- Check the effect of MOC passed by the previous auditor.



Expectations of Central Statutory Auditors

- Verify the date of NPA in the CBS – since several times RBI back dates the NPA and the classification changes from Sub-standard to Doubtful category.
- Check the restructuring files thoroughly as several times it is found that ineligible accounts are restructured, or the documentation is not proper in such cases.
- Get your DSC renewed/ prepared.
- Remember that you would be responsible for your Branch and not the SCA.



Thank you

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.