

**BANK AUDIT SEMINAR  
SICASA  
HYDERABAD BRANCH OF SIRC of ICAI**

**Practical Issues in Bank Branch Audit**

**R SUNDARARAJAN  
Chartered Accountant**

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**Introduction**

- ▶ An annual Audit Process
- ▶ Empanelment by RBI through ICAI
- ▶ Appointment by Respective Banks from the list sent by RBI
- ▶ Governed by RBI Circulars
- ▶ Guided by ICAI through Guidance Note
- ▶ Audit under Banking Regulation Act

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## Reports & Certificates

- Regular Audit Report
- Long Form Audit Report
- Tax Audit Report
- Various Certificates such as IRAC Norms, Capital Adequacy, Ghosh & Jilani Committee

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## Statements to be signed

- Balance Sheet
- Profit & Loss account
- Memorandum of Changes
- Supplementary returns such as :
  - NPA statements
  - Movement of NPAs
  - Loans & Advances
  - Suit filed accounts
  - Restructured Accounts
  - Fixed Assets
  - Sundry Liabilities, Suspense, etc.

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## Salient Features

- Onerous task
- Huge responsibility
- Limited time available
- Shortage of trained manpower



Resultant Need  
Proper **Planning** & approach

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## PLAN FOR THE AUDIT

- ▶ Branch profiling
  - Obtain a facility wise break up of advance portfolio of the branch along with No. of accounts
  - Send a questionnaire calling for important details from the branch
- Carry out certain analytical review with data obtained
- Prepare a detailed audit checklist
- Timing – Start Date / End Date
- Manpower – Formation of team and training
- Working paper management

SA 300 - Plan for audit of FS  
SA 315 - Understanding the entity

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## Program

- Audit program should cover all the areas under liabilities, assets, income, expenditure including off Balance sheet items especially in the light of several fraud unearthed in recent times.
- Special emphasis on verification of advances, income recognition and provisions to be made
- Carry out a compliance test of internal controls
- Identify areas of weakness
- Prepare plans for substantive testing

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## Areas that require full check

- Verification of Balance Sheet and Profit & Loss account
- Verification of all closing returns with the ledgers and registers
- Verification of all large advances granted during the year
- Verification of all large NPA advances

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## NPA NORMS

- ▶ Uniform norm of 90 days for all advances including Government guaranteed Accounts
- ▶ Agricultural loans - Continues to be based on crop seasons

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## NPA NORMS- Term Loans

- ▶ Term Loan 1
- ▶ Instalments of principal remain overdue for a period of more than 90 days in respect of a term loan.
- ▶ In case of interest payments in respect of term loans, an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days

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## NPA NORMS- Term Loans

### ► Term Loan 2

- If **arrears** of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts. (Para 4.2.5 - RBI Master circular).
- Upgradation is allowed only if the account reaches "no overdues" status. This should not be misunderstood with "overdues brought within 90 days". (ICAI GN - Para 11.337 Page 413 & 414)

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## NPA NORMS- OD/CC

- The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC).
- An account should be treated as 'out of order' where
  - The balance o/s in the account remains continuously in excess of the limit/DP during a period of 90 days.
  - The balance o/s is within the limit/DP, but there are no credits continuously for 90 days ~~as on the date of the Balance sheet~~
  - or the credits are inadequate to cover the interest debited during the ~~same period~~ previous 90 days period.

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## NPA NORMS - Bills

- ▶ A bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

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## Agricultural Advances- NPA

- ▶ 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.
- ▶ “Long duration” crops would be crops with crop season longer than one year
- ▶ Crops, which are not “long duration” crops, would be treated as “short duration” crops.
- ▶ The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the **State Level Bankers’ Committee (SLBC)** in each State.

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## Crop Season- RBI clarification recd by Maharashtra SLBC

- ▶ Loan may be treated as NPA immediately on completion of two crop seasons / one crop season (as the case may be, depending on the duration of the crops) after the repayment due date.
- ▶ Two crop seasons after the due date should refer to only those two consecutive crop seasons in which the farmer usually undertakes crop production.

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## RBI clarification - Crop season

The crop season for each crop, means the period up to harvesting of the crops raised. The asset classification norms assume that there is normal crop yield during the season for which credit is extended.

Hence, immediately after consecutive two harvest seasons (as per the cultivation pattern followed by the farmer borrower) from repayment due date, the account is to be identified as NPA.

In case of natural calamities as declared by the SG, the loan should be restructured/ rescheduled

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## Agricultural Advances

- ▶ Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines contained in
- ▶ Master Direction - Reserve Bank of India (Relief Measures by Banks in Areas affected by Natural Calamities) Directions 2018 - SCBs dated October 17, 2018, as updated from time to time.

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## Significant factors for classifying an account as NPA in Working capital advances

- ▶ Stock statements should not be more than 3 months old.
- ▶ Regular and ad hoc limits should not be left lapsed without renewal for a period of more than 180 days
- ▶ Solitary or very few credits in the account before the balance sheet date.

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## Meaning of Restructured Account

- ▶ Reserve Bank of India has defined a restructured account as 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

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## Meaning of Restructured Account

- ▶ Restructuring means modification of terms of the advances including alteration
  - in repayment period, (including extension of moratorium period)
  - repayment amount,
  - amount of installments,
  - rate of interest.

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## Restructured Accounts- Key points

- ▶ **Specified Period** means a period of one year from the commencement of the first payment of interest or principal, **whichever is later**, on the credit facility with longest period of moratorium under the terms of restructuring package.
- ▶ Satisfactory performance during the specified period means adherence to the specified conditions during that period.

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## Restructured Accounts- Key points

Satisfactory performance

### Non-Agricultural Cash Credit Accounts

- ▶ In the case of non-agricultural cash credit accounts, the account should not be out of order any time during the specified period, for duration of more than 90 days and there should not be any overdues at the end of the specified period.

### Non-Agricultural Term Loan Accounts

- ▶ In the case of non-agricultural term loan accounts, no payment should remain overdue for a period of more than 90 days and there should not be any overdues at the end of the specified period.

### All Agricultural Accounts

- ▶ In the case of agricultural accounts, at the end of the specified period the account should be regular.

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## Resolution of Stressed Individual & small business

RBI/2021-22/31 DOR.STR.REC.11/21.04.048/2021-22 dated May 05, 2021

### Eligible Borrowers

- a. (a) Individuals (other than bank staff) who have availed of personal loans (as defined in the Circular DBR.No.BP.BC.99/08.13.100/2017-18 dated January 4, 2018).
- b. (b) Individuals who have availed of loans and advances for business purposes and to whom the lending institutions have aggregate exposure of not more than Rs50 crore as on March 31, 2021.
- c. (c ) Small businesses, including those engaged in retail and wholesale trade, other than those classified as micro, small and medium enterprises as on March 31, 2021, and to whom the lending institutions have aggregate exposure of not more than Rs.50 crore as on March 31, 2021

The aggregate exposure is both FB+NFB of banks & NBFCs<sup>23</sup>

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## Resolution of Stress in Individuals and Small Businesses

RBI/2021-22/31 DOR.STR.REC.11/21.04.048/2021-22 dated May 05, 2021

The RP implemented under this window may, based on an assessment of income streams of the borrower include

- rescheduling of payments,
- conversion of any interest accrued or to be accrued into another credit facility,
- revisions in working capital sanctions,
- granting of moratorium for a maximum period of 2 years which shall commence immediately on implementation of RP.

However, compromise settlements are not permitted as a resolution plan for this purpose.

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### Asset Classification

- a. Where a resolution plan is implemented as per the norms prescribed, the accounts classified as 'standard' may be retained.
- b. If an account has slipped into NPA between invocation & implementation, the same may be upgraded as 'standard' on the date of implementation.
- c. Additional finance sanctioned after invocation but before implementation may be classified as 'standard asset' till implementation disregarding actual performance.
- d. However, if the resolution plan is not implemented within the stipulated timelines, the classification of the additional finance sanctioned will be based on actual performance or the rest of the credit facilities, whichever is worse.

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### When is implementation complete?

- ▶ All related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are completed by all lenders; and
- ▶ The new capital structure and / or changes in the terms and conditions of the existing loans get duly reflected in the books of all the lenders and the borrower.

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## Project Loans

- ▶ **Project loans** is the long-term finance of infrastructure and industrial projects based upon the projected cash flows of the project rather than just the balance sheets of its sponsors.
- ▶ the '**Date of Completion**' and the '**Date of Commencement of Commercial Operations**' (**DCCO**), of the project should be clearly spelt out at the time of financial closure of the project and the same should be formally documented.

SHALL BE APPLICABLE IN LARGE ADVANCES BRANCHES

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## Project Loans

- ▶ In several instances, the completion of the projects is delayed due to extraneous reasons beyond the control of the promoters.
- ▶ The reasons for delay include legal disputes, delay in obtaining government approvals, etc.
- ▶ In such a situation Banks may restructure / reschedule
  - Project loans for infrastructure sector
  - Project loans for non infrastructure sector

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## Income Recognition

- ▶ Income is to be recognised based on recovery
- ▶ Not applicable to advances against Life Insurance Policies, NSCs, IVPs, KVPs etc, provided requisite margin is maintained.
- ▶ Critical area in respect of OD against deposits wherein Deposits with multiple Interest are taken as security
- ▶ Critical area in respect of loan against FD wherein interest is drawn periodically by the depositor but interest on loan is accumulated without payment

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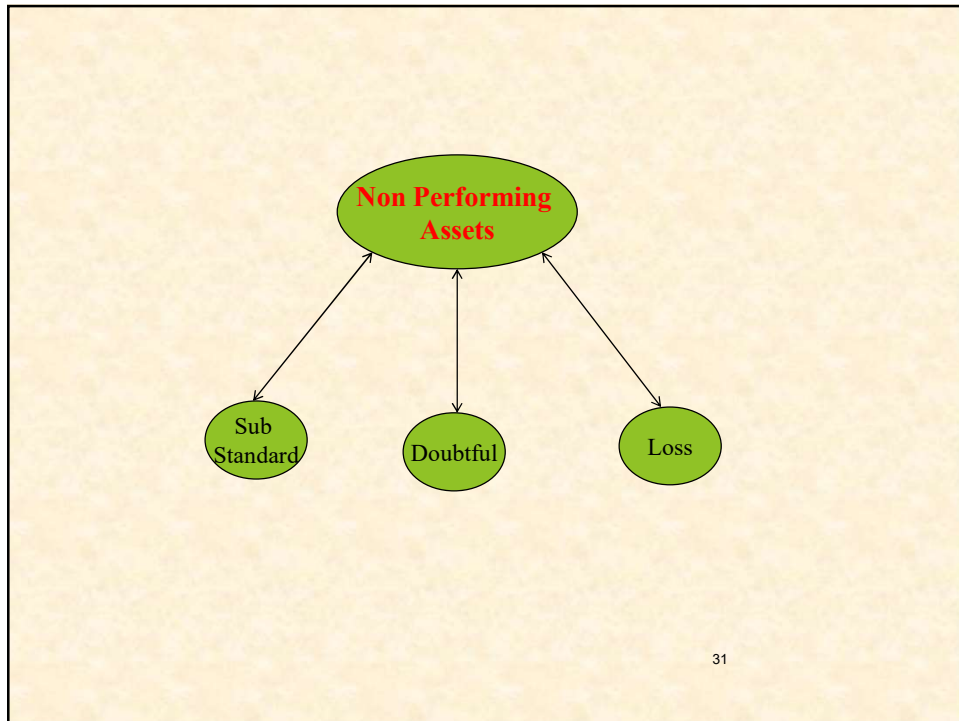
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## Reversal of Interest

- ▶ In respect of accounts classified as NPA for the first time, interest debited in the current year (2021-2022) and **previous years** which has not been realised should be reversed or provided.
- ▶ This will apply to Government guaranteed accounts also.

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## Sub Standard Assets & Doubtful assets

- ▶ An NPA which is less than 12 months old - SSA
- ▶ An NPA which is more than 12 months old - DA
- ▶ In case erosion in value of securities is more than 50%, classify as doubtful
- ▶ Critical point - Valuation has to be done once in three years for NPAs.

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## Loss Assets

- ▶ An asset considered uncollectible
- ▶ An asset where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly
- ▶ An asset whose security value has been eroded by more than 90 % of the advance value

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## Asset Classification

- ▶ Asset Classification to be borrower-wise and not facility-wise
- Exceptions
- ▶ Bills discounted under LC until default
  - ▶ Mark to market value of derivatives contract
  - ▶ Additional facility granted to a restructured NPA

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## Asset Classification

- ▶ Asset classification of **accounts under consortium** should be based on the record of recovery of the individual member banks
- ▶ In case of multi branch financing - The classification by the branch where main limit is availed has to be considered by all branches.
- ▶ **CRITICAL** - Certificate from Main branch is compulsory since the operations may be good in the branch where sublimit is availed.
- ▶ A NPA need not go through the various stages of classification in cases of serious credit impairment

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## Asset Classification

- ▶ **Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs.**
- ▶ Advances against gold ornaments, government securities and all other securities are not covered by the above exemption
- ▶ A sub-standard accounts which has been subjected to restructuring etc., would be eligible to be upgraded to the standard category only after the specified period of one year

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## **Asset Classification Govt. Guaranteed Accounts**

Accounts to be classified as NPA if guaranteed by

- Central Govt. when the guarantee is repudiated.
- State Govts. When the guarantee is invoked and remains in default for more than 90 days.

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## **Provisioning Whose responsibility**

- *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 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.*

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## Provisioning Norms

Standard assets(other than Restructured accounts)  
- on global loan portfolio

a) Direct advances to agricultural and SME	0.25%
b) Commercial Real Estate <sup>sectors</sup> (CRE) Exposures	1 %
c) Commercial Real Estate – Residential Housing Sector (CRE-RH)	0.75%

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## Provisioning Norms

- ▶ Standard assets (other than Restructured accounts) - on global loan portfolio
- ▶ d) Housing loans extended at teaser rates - 2%  
(The provisioning on these assets would revert to 0.40per cent after 1 year from the date on which the rates are reset at higher rates if the accounts remain 'standard'.)
- ▶ e) All other Standard advances - 0.40%

Accounts Restructured during the current year  
classified as standard - 5 %

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## Provisioning Norms

- ▶ Sub standard assets - 15 percent on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available

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## Substandard Assets

- ▶ In case of Substandard accounts, where security available abinitio at the time of sanction is less than 10% of both funded and non funded limits put together, then the provision to be made is 25 % (20% in case there is an escrow account in case of infrastructure lending, infrastructure loan accounts) of the Outstanding Value
- ▶ It is different from erosion of security to be classified as loss asset.

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## Provisioning Norms

- ▶ Doubtful assets - 100 % of the unsecured portion  
+  
25/40/100% (depending on age) of the secured portion
- ▶ Loss Asset - 100%

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## PROVISIONING – 2021-2022

Sl. No.	NPA Date	Status of Asset	Unsecured Portions	Secured Portion
I	Before 1.4.2018	D3 – Current year	100% of Outstanding irrespective of the availability of security as reduced by ECGC cover	

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### Provisioning Norms

II	1.4.2018-31.3.2020	D2 – Current year	100% as reduced by ECGC Cover	40%
III	1.4.2020-31.3.2021	D1 – Current year	100% as reduced by ECGC Cover	25%
IV	1.4.2021-31.3.2022	Substandar d current year	15% of the outstanding irrespective of security or ECGC Cover **	

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## Advances verification - LFAR

- Credit appraisal
- Sanctioning
- Documentation
- Disbursement
- Review & supervision

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## Advances verification - Procedural

- Delegated powers
- Banks advance manual, circulars, guidelines, etc.
- RBI Guidelines on lending
- Borrowers proposal and respective credit file
- RBI inspection report, concurrent audit report, inspection report & watch list (SMA)

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## Critical areas of awareness

The team members should be familiar with :

- RBI circulars relating to income recognition, asset classification and provisioning norms
- Guidelines issued to the auditors by the banks with reference to certificates to be issued by them.
- The accounting system of the bank and the related internal controls

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## Critical Areas of Awareness

- Salient features of the LFAR
- Salient features of the financial statements
- Salient features of Supplementary returns
- Memorandum of Changes
- Audit procedure to be adopted in a computerised environment.
- No tick marks / identification on the documents

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## Critical areas of advances

- Review of ALL large advances
- Review of other advances on sample basis
- Review of accounts already identified as NPA
- Review of previous year NPA statement & check current status.
- Review of RBI/ HO inspection commented advances
- Review quality of credit appraisal
- Study all accounts in the 'watch list' & SMA
- Check stock statements, insurance, CMA data, AFS, renewals.

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## Audit Techniques

- Review all exception reports
- Obtain an overall understanding of the CBS system in operation at the branch.
- Check whether the key controls are under dual operation

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## Audit Techniques

- Obtain the data files required for review in .txt or .sdf format or excel
- Account review can be done offsite by opening the data files with MS Excel
- Use SQL (Structured Query Language) to query the database and obtain the required reports
- Audit Module of CBS environment gives lot of audit features – explore and utilise

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## AUDIT DOCUMENTATION

- ▶ As per SA 230 audit documentation is a
  - record of audit procedures performed
  - relevant audit evidence obtained and
  - conclusions reached by the auditor
- ✓ Prepare Checklists for the audit process.

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### *Form, Content and Extent of Audit Documentation*

#### *Form of Documentation :*

Paper - Working papers – Borrowers statement of accounts, NPA computation sheets, supporting papers for certificates given, etc.

Electronic - System files – Exception reports, excel converted sheets, capital adequacy sheets, snap shots etc.

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## Examples of Bank Branch Audit Documentation

- ❖ Audit Plan
- ❖ Audit programmes
- ❖ Checklists for LFAR, Advances, NPA verification, Tax audit, Certifications, etc. ([www.casconline.org](http://www.casconline.org))
- ❖ Analysis done – ratio analysis, Interest variations, LFAR excess cash carrying, suspense items, etc.
- ❖ SA 580- Letter of Representation – TDS, Frauds, cont. Liab.
- ❖ Correspondence (including e-mails) regarding significant matters

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## Housekeeping - Working Papers

**It is necessary to prepare and keep adequate working papers to show precisely**

- **What work was done and by whom**
- **What explanations and information was given and by whom**
- **What decision on the various points was taken and by whom**

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## Housekeeping - Working Papers

- Aid in the planning and performance of the audit
- Aid in the supervision and review of the audit work
- Provide evidence of the audit work performed to support the auditors' opinion
- Become the basis for drafting the auditors report

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## Conclusion

- ▶ Plan you Audit
- ▶ Structure the activities
- ▶ Read through the guidance from the RBI and ICAI
- ▶ Exercise Due diligence
- ▶ Complete on a timely manner
- ▶ Regular audit and LFAR simultaneously
- ▶ Interact with the branch management
- ▶ Compile and submit the report
- ▶ Collect the working papers
- ▶ HAPPY AUDITING !!!!!

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THANK YOU

sundar@srbr.in

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