



Expectation of Bank & Central Auditor's from Bank Branch Auditors

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HYDERABAD Branch of SIRC of ICAI

Organises Interactive 2 Hours CPE Seminar on Bank Audit



Special Session addressed by
CA Dr GOPAL KRISHNA RAJU, Chennai
*Topic: Expectations of Bank &
Central Auditor's from Bank Branch Auditors*



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Credit Monitoring and Restructuring Department

Credit Monitoring

- The department is responsible to monitor the credit portfolio independently and interact with the Zones/Regions and Branches for the followup. The overall overdue statement generated by the bank above certain limits is closely monitored.
- The auditors at respective branch, though take care of the credit portfolio, the department auditor may undertake certain tests independently at this department with a different perspective keeping in mind the overall materiality. Keeping in view the significance from the regulator perspective

Following transactions may be selected for checking at the HO level.

1. Any account in the bank having **exposure** (funded and non-funded) which is **more than 2000 crores** across banking sectors.
2. Accounts against whom **NCLT proceedings are initiated** either by Bank, any other financial creditors or the operational creditors.
3. List of **SMA accounts** having exposure **above 50 crore and above.**
4. **Red Flagged Accounts refer RBI circular dated May 7, 2015.** 
5. Cases under investigation for fraud. These are typically the ones not reported as fraud and hence not available with Fraud monitoring department.
6. List of upgraded accounts in the branch above ₹ 1 Crore.
7. **Test checking of CRILC reported accounts** for its classification with other banks.



Red Flagged Accounts



Red Flagged Accounts refer RBI circular dated May 7, 2015.

RBI Notification No RBI/2014-" 15/590 "DBS.CO.CFMC.BC.No.007 /23.04.001/2014-15

Early Warning Signals (EWS) and Red Flagged Accounts (RFA): The concept of a Red Flagged Account (RFA) is being introduced in the current framework as an important step in fraud risk control. A RFA is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the bank on alert regarding a weakness or wrong doing which may ultimately turn out to be fraudulent. A bank cannot afford to ignore such EWS but must instead use them as a trigger to launch a detailed investigation into a RFA

Role of Auditors: During the course of the audit, auditors may come across instances where the transactions in the account or the documents point to the possibility of fraudulent transactions in the account. In such a situation, the **auditor may immediately bring it to the notice of the top management and if necessary to the Audit Committee of the Board (ACB) for appropriate action**



Red Flagged Accounts



Red Flagged Accounts refer RBI circular dated May 7, 2015.

**RBI Notification No RBI/2014-15/590 DBS.CO.CFMC.BC.No.007
/23.04.001/2014-15**

Gist

1. The EWS so compiled by a bank would form the basis for classifying an account as a RFA
2. The threshold for EWS and **RFA** is an **exposure of Rs.500 million or more**
3. The initial decision to classify any standard or NPA account as RFA or Fraud will be at the individual bank level and it would be the responsibility of this bank to report the RFA or Fraud status of the account on the CRILC platform so that other banks are alerted. Thereafter, within 15 days, the bank which has red flagged the account or detected the fraud would ask the consortium leader or the largest lender under MBA to convene a meeting of the JLF to discuss the issue.
4. the account would be red flagged by all the banks and subjected to a forensic audit commissioned or initiated by the consortium leader or the largest lender under MBA.

Red Flagged Accounts

UNDER THE SCANNER

RBI to Check if Yes Bank Auditor BSR had Raised Red Flags

It wants to know whether the KPMG India group firm issued any warnings over the past 12 months

Sachin Dave & Saloni Shukla

Mumbai: The Reserve Bank of India (RBI) will check whether Yes Bank's statutory auditor had raised any red flags in the past year, two people aware of the development told ET. The banking regulator last week proposed a rescue of the private-sector lender that will be led by State Bank of India (SBI).

RBI will also likely question BSR on the health of the bank and if the SBI proposal will have 'any material impact'

The central bank has been in touch with auditor BSR & Co., which is a part of KPMG India, over the past few months. But the central bank will now specifically look at whether the auditor had issued any warnings over the past 12 months. Officials aware of the central bank's plans told ET that RBI officials had already held meetings with Yes Bank's new audit committee.

"The RBI wants to know whether the auditor had specified anything related to the bank's health or other issues as a going concern or raised any other red flags over the past year," said a person with direct

Areas of Concern

BSR came in as a new auditor in 2019 for Yes Bank after RBI penalised old auditor SR Batliboi & Co

BSR had raised red flags regarding whistleblower letter in September last year

The audit report states that the audit committee was looking into allegations made by whistleblower, including incorrect NPA classification

SBI's plan to infuse funds into Yes Bank can have a substantial impact on financials of the bank



knowledge of the matter.

The central bank will also likely question the auditor on the health of the bank and whether the SBI proposal will have "any material impact" on the private sector lender's existing accounts, said one of the persons.

The RBI could also look into the impact of the reconstruction scheme on Yes Bank's financial statements, the person added.

Bad Loans Under-reported >>> 4

PARTIAL WRITE-DOWN OF BONDS AND SHARES

Bond Investors Propose Settlement

i Many Yes Bank bondholders have come up with a settlement offer that would involve a partial write-down of bonds as well as shares. They have proposed conversion of ₹8,500 crore AT1 (or, additional tier 1) bonds into ₹1,700-crore equity with existing stockholders of Yes Bank, reports Sugata Ghosh. >>> 12

Large Corporate and Loan Syndication

Auditor of Lead Banker in case of Loan Syndication should verify:

1. Whether the Bank has Board Approved Policy for business of LoanSyndication?
2. Whether the Bank has put processes in place for loan syndicationbusiness?
3. Whether the Bank has underwritten any loan which it has syndicated, if yes whether the same has been considered as Contingent Liability?
4. Whether the Bank has collected fees in all cases of syndication?
5. Whether Loan Syndication Department is adequately staffed having different skill sets as required to carry out due diligence?

Large Corporate and Loan Syndication

Auditor of Other Bank (Member) should verify:

1. Whether the Bank has a Board Approved policy for participation in a Syndicate?
2. Whether the Bank has carried out its own due diligence on information provided by the Lead Bank and raise queries, if any to the Lead Bank and whether the same are resolved satisfactorily?
3. Whether share of the Bank is clearly mentioned in correspondence with Lead bank and other syndicate members?
4. Whether the Bank has put in place for loan system for Delivery of Bank Credit.

Bank Branch Audit and GST Compliance

Following parameters, can be adopted to characterize a transaction as supply:

1. Supply of goods or services. Supply of anything other than goods or services does not attract GST.
2. Supply should be made for a consideration.
3. Supply should be made in the course or furtherance of business.
4. Supply should be made by a taxable person.
5. Supply should be a taxable supply.

Bank Branch Audit and GST Compliance

1. Section 2(52) of the CGST Act defines **goods** as:

"goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply.

2. Section 2(102) of the CGST Act defines **Services** as:

"services" means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.

Bank Branch Audit and GST Compliance

As per Section 2(75) of the CGST Act:

"money" means the Indian legal tender or any foreign currency, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller cheque, money order, postal or electronic remittance or any other instrument recognised by the Reserve Bank of India when used as a consideration to settle an obligation or exchange with Indian legal tender of another denomination but shall not include any currency that is held for its numismatic value.

Section 2(101) of the CGST Act defines:

"securities" shall have the same meaning as assigned to it in clause (h)

of section 2 of the Securities Contracts (Regulation) Act, 1956.

Bank Branch Audit and GST Compliance

Where, section 2 of the Securities Contracts (Regulation) Act, 1956 defines

“securities” include—

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- (ia) derivative;
- (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
- (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- (id) units or any other such instrument issued to the investors under any mutual fund scheme;
- (ii) Government securities;
- (iia) such other instruments as may be declared by the Central Government to be securities; and
- (iii) rights or interest in securities;

Bank Branch Audit and GST Compliance

- From definition of securities, GST applicability on certain transactions can be analyzed: (No GST will be levied on activities and transactions covered in the definition of **money and securities**)

Sr. No.	Nature	Applicability of GST
1	Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;	Specifically covered in definition of Security, hence no GST.
2	units or any other instrument issued by any collective investment scheme to the investors in such schemes;	Specifically covered in definition of Security, hence no GST.
3	Security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;	Specifically covered in definition of Security, hence no GST.
4	Units or any other such instrument issued to the investors under any mutual fund scheme;	Specifically covered in definition of Security, hence no GST.
5	Government securities;	Specifically covered in definition of Security, hence no GST.

Bank Branch Audit and GST Compliance

6	Forward Contract in Currencies - Actual delivery of underlying currency	It is not covered in definition of securities, hence would be treated as normal supply of goods and liable to GST (Commission portion).
7	Forward Contract in Currencies - Where the settlement takes place by way of net settlement of differential of the forward rate over the prevailing market rate on the settlement date	These are derivative transaction and is covered in definition of securities, hence no GST
8	Future Contracts	It is financial derivative and falls within the definition of securities, hence not liable to GST. Commission and documentation charges will be liable for GST.

Bank Branch Audit and GST Compliance

24.	Services supplied by a recovery agent to a bank.	Taxable under RCM
25.	Services supplied by individual Direct Selling Agents (DSAs) other than a body corporate, partnership or limited liability partnership firm to bank.	Taxable under RCM
26.	Services provided by BF/BC to a banking company in compliance with RBI's CircularNo.DBOD.No.BL.BC.5 8/22.01.001/2005-2006dated 25.01.2006 and subsequent instructions on the issue.	Exempted in Entry no. 39 [Heading no. 9971] of Notification 12/2017

Bank Branch Audit and GST Compliance

27.	Services provided by a banking company to Basic Saving Bank Deposit (BSBD) account holders under Pradhan Mantri Jan Dhan Yojana (PMJDY).	Exempted by NN 28/2018 dated 31 st December 2018.
28.	business facilitator or a business correspondent to a banking company with respect to accounts in its rural area branch;	Exempted by Notification 12/2017
29.	any person as an intermediary to a business facilitator or a business correspondent with respect to services mentioned in Entry 28	Exempted by Notification 12/2017
30.	Penal interest in case of delay payment of EMI	Exempt in reference to Circular No. 102/21/2019- GST dated 28 th June 2019

Consolidation of LFARs for the Bank

Setting Reporting Materiality

overall objective is to design and carry out our audit procedures in order to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether due to fraud or error.

Consolidation of LFARs for the Bank

Specific Transaction Materiality

These transactions are selected for reporting irrespective of the materiality due to their sensitive nature such as:

1. Any standard account in the branch having exposure (funded and nonfunded) which is more than 50 crore across bank.
2. Accounts against whom NCLT proceedings are initiated either by Bank, any other financial creditors or the operational creditors
3. SMA accounts above 5 crore
4. Red Flagged Accounts.

Consolidation of LFARs for the Bank

The overall materiality limits

Hence as a part of setting up of overall materiality limits, any uncorrected observations affecting the financial statement above certain amount, that may be decided by the Statutory Central Auditors (all observations put together by individual auditor at unit level). The together impact needs to be assessed and reported in LFAR.

Consolidation of LFARs for the Bank

The illustrative list of annexures that may be required could be as under:

- i. Accounts where excess over sanctioned limits are allowed
- ii. Branches where limits were disbursed without complying with the terms and conditions of sanction
- iii. Branches with deficiencies in documentation/inadequate insurance cover
- iv. Branches where periodic balance confirmation / acknowledgement of debt not obtained

Consolidation of LFARs for the Bank

- v. Branches having accounts where review / renewal is pending
- vi. Branches where stock / book debt statements and other periodical operational & financial statements not obtained
- vii. Branches where audited accounts not on record for advances to noncorporate with limit over Rs. 10 lakh
- viii. Branches where stock audit report is not obtained at prescribed interval
- ix. Short reviewed for period beyond six months

Consolidation of LFARs for the Bank

- x. Accounts where credit card dues are not recovered promptly
- xi. Comments on major accounts (standard accounts having outstanding exceeding Rs. 5 crore)
- xii. Quarterly/half yearly statements not obtained
- xiii. Break up of outstanding entries in Nostro reconciliation as of 31.03.2018
- xiv. Rate of interest charged less than prescribed rate decided by the bank

Consolidation of LFARs for the Bank

- xv. Deficiencies noticed in appraisal, monitoring and supervision
- xvi. Details of accounts where the relevant controlling authority of the bank has authorised legal action for recovery of advances
- xvii. List of overdue / matured term deposits
- xviii. Major / adverse comments / issues not addressed by the branch arising out reports from previous auditors, concurrent auditors, stock or internal auditors or special audit or inspection report of RBI

Consolidation of LFARs for the Bank

xix. Whether identification and classification of advances as standard/substandard/ doubtful/ loss assets is as per RBI circular and instructions as per CO. If not, then details of accounts where there are deviations.

xx. Guarantees involved / expired but not adjusted / reversed

xxi. Outstanding amount of letter of credit / buyers credit

xxii. Cash holding/ cash held exceeds retention limit

xxiii. Details of cases where physical verification of securities not done as per laid down procedure

Consolidation of LFARs for the Bank

xxiv. Details of NPA accounts where valuation report is not obtained

xxv. Detail of items for more than three years in bills payable / sundry deposit etc.

xxvi. List of the accounts (with outstanding in excess of Rs.1.00 crore), which have been downgraded regarding their classification as non-performing asset or standard asset during the year

Consolidation of LFARs for the Bank

xxvii. List of the accounts (with outstanding in excess of Rs. 1.00 crore), which have been upgraded regarding their classification as non-performing asset or standard asset during the year

xxviii. List of recoveries and their appropriation against interest and principal accounts settled/ written off/ closed during the year

xxix. List of new borrower accounts transferred to the branch during the year.

Consolidation of LFARs for the Bank

Anti Money Laundering (AML), Combating the financing of terrorism (CFT). The bank shall file suspicious transactions report (STR) to Financial Intelligent unit (FIU-IND) for mobile banking and internet banking transactions.

Information Technology (IT)

The initiatives took by the banks are as follows:

- Core Banking Systems (CBS)
- Digital Payment System
- Credit / Debit Cards
- ATMs/ POS Terminals/CDMs
- Internet Banking like NEFT/RTGS
- Mobile Banking
- Branchless Banking
- Digital Wallet

Fraud Risk on CBS

The fraud on CBS occurs when SWIFT is not integrated with CBS and a perpetrator can easily send LOUs to overseas banks simply by bypassing the CBS.

The audit considerations for this aspect include:

- Examining whether currency wise **NOSTRO** reconciliation is performed on a day-to-day basis and check for long outstanding items.
- Checking whether there exists a policy of following up for outstanding reconciliation items with the counterparties or with the respective banks.
- Outstanding debit items over 90 days attract provisioning under RBI provisioning norms.

- Examining whether the statement of account is sent to the Vostro account holder and periodic confirmation is obtained and discrepancies, if any, is properly dealt in the books of accounts.
- To verify the bank submitted statement of Nostro / Vostro account balances on monthly basis to RBI.
- Verify if reconciliation is done by separate department and not by treasury department who operates Nostro accounts.
- Check for write off any un-reconciled item / number / amount and see if details are sent to RBI for approval.

Income Earned by Banks

Interest income

The income earned by way of grant of loans, deposits etc., is a taxable supply. However, by virtue of entry 27(a) of Notification No. 12/2017 and entry 28(a) of Notification No. 12/2017-ITR, no GST is payable on income earned by way of interest except interest income earned through credit card. The relevant extract of the said entry is as under:

<i>Sl No.</i>	<i>Chapter, Section, Heading, Group or Service Code (Tariff)</i>	<i>Description of services</i>	<i>Rate (%)</i>	<i>Condition</i>
27	Heading 9971	<i>(a) Services by way of— (a) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount <u>(other than interest involved in credit card services)</u>;</i>	NIL	NIL

Commission income – Such income is classified as a supply of service transaction and accordingly would be classified in terms of chapter heading as specified in the relevant notifications issued under GST. Commission earned (on accrual) is liable to GST. For e.g.: M/s. A Ltd. wants to invest in fixed securities / bonds which can be only routed through ICICI bank as they have exclusive rights for subscribing the same. ICICI bank gets 2% commission on the amounts so subscribed. For the period 2018-19, the bank earns ` 250 crores of commission from such subscription which is recorded as 'Other Income'.

Brokerage income: The instant income is classified as a supply of service transaction and accordingly would be classified in terms of chapter heading as specified in the relevant notifications issued under GST.

Agency charges: liable for payment of GST, 'enablement charge' or 'facilitation fee' or simple 'management fee'

Portfolio management service: GST is payable

Account maintenance charges: liable for payment of GST

Credit/Debit card charges: liable for payment of GST

Digital payment facilities : Chargeable under GST

Sale and purchase of foreign currency: Chargeable under GST, Inter bank Transaction exempted

Other income :

Income earned by banks by way of penalties, retention charges etc are liable for payment of GST.

Other income :

Realisation of payment (NPA) by way of disposal of NPA to an asset reconstruction company [ARC] or to any other buyer is a debatable issue. There is variant view to the aforesaid transaction and the taxability will depends upon the structuring of the transaction. One view is that this transaction may be considered as actionable claim and GST will also not apply as definition of supply [Clause 6 Schedule III read with Section 7] under CGST Act exclude actionable claim. Another view is that, this transaction may be an outright sale. And when there is outright sale, the GST applicability will depend on the nature of underlying asset sold and is to be paid by borrower. e.g. IVY Bank sells one of its NPA as a going concern to Company ABC then the instant transaction is taxable under GST but the same is classified as a supply of service and accordingly the rate of tax payable is NIL in terms of Entry 2 classified under Chapter 99 as specified under Notification No. 12/2017.

Page 656 - Further, that the Government may, by notification, on the recommendations of the Council, and subject to such conditions and restrictions as mentioned therein, specify that the tax invoice shall have Quick Response (QR) code. In this regard, w.e.f. 1st April 2020, Government have notified vide N/N- 72/2019 of CGST Act dated 13th December 2019, an invoice issued by a registered person, whose aggregate turnover in a financial year exceeds Rs. 500 crore, to an unregistered person (hereinafter referred to as B2C invoice), shall have Quick Response (QR) code. Where such registered person makes a Dynamic QR code available to the recipient through a digital display, such B2C invoice issued by such registered person containing cross-reference of the payment using a Dynamic QR code, shall be deemed to be having QR code.

Page 656 - Further, Notification No 68/2019-Central Tax dated 13th December 2019, inter alia insert Rule 48(4) of CGST Rules, 2017, which stipulates that the invoice shall be prepared by including particulars contained in Form GST INV-01 after obtaining an Invoice Reference Number by uploading information contained therein on the Common Goods and Services Tax Electronic Portal in such manner and subject to such conditions and restrictions as may be specified in the notification. In this regard, w.e.f.1st April 2020, vide Notification No. 70/2019 dated 13th December 2019, the Government have notified registered person, whose aggregate turnover in a financial year exceeds Rs. 100 crores, as a class of registered person who shall prepare invoice in terms of Rule 48(4) in respect of supply of goods or services or both to a registered person.



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