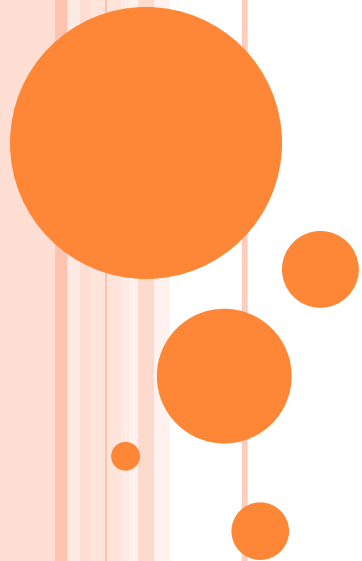


**BANK BRANCH AUDIT**  
**MARCH 19, 2022**  
**NUANCES**



# THE PREREQUISITES

The bank branch audit necessitates reading and knowledge of following basic three things:

- **Master circulars issued by RBI:** As all of us are aware RBI issues various master circulars every year on July 1. This circular could be construed to be compilation of all the circulars and current relevant guideline on the subject. It is advisable to visit RBI site and download relevant circulars for the type of branch one is auditing.
- **Closing circular issued internally by the bank:** Every bank issues the closing circular. Generally it outlines all the aspects expected at the branch level closing in details. Strict adherence to this circular helps closure of financial statement smoothly.
- **Guidance note on Bank audits:** ICAI has prepared (and keeps updating every year) a detailed guidance note on the bank audits. It is very useful as a ready reckoner. It also educates the members on legal and accounting framework, accounting system, internal controls etc of the bank and guides on how to conduct audit of various assets and liabilities and income & expenses heads of the bank.



# RBI CONCERNS THAT NEED TO BE ADDRESSED

## **Role of Statutory Auditors in Identification of Non-Performing Assets (NPAs)**

Expectations from Statutory Auditors to display a greater degree of skepticism and independence in assessing asset classification, especially large-value accounts

## **System-based asset classification**

Scrutinizing the internal controls in the bank in both manual and system driven identification of assets, including the controls in place in the Internal Audit Department of the bank



## RBI CONCERNS CONTD...

1. Non Compliance of SA 505 External Confirmations in respect of not receiving confirmation requests directly by the audit firm.
2. Non compliance of SA 530 Audit Sampling in respect of not clearly documenting application of sampling procedures.



# RBI CONCERNS CONTD...

## **Audit Working Papers – Preparation and maintenance**

- i. IMF-World Bank recommendation to RBI on RBI having explicit authority to access working papers of auditors
  
- ii. RBI is examining multiple methods to review the work of auditors, including having access to working papers



# NUANCES OF LFAR

a)List of accounts examined for audit  
(Advances having exposure of ₹ 10 Cr or 10% of the Branch exposure)

	Account No.	Account Name	Balance as at year end – Funded	Balance as at year end – Non-funded	Total
	XXXXXX				
	XXXXXX				
	Total		A	B	$C = A + B$
	T o t a l Outstanding of the Branch		X	Y	$Z = X + Y$
	Percentage examined		A as % of X	B as % of Y	C as % of Z



# NUANCES – CREDIT APPRAISAL

Have you come across cases of quick mortality in accounts, where the advance became Non-performing within a period of 12 months from the date of first sanction? Details of such accounts may be provided in following manner:

- Account No.
- Account Name
- Balance as at year end

Whether in borrowal accounts the applicable interest rate is correctly fed into the system?

Whether the interest rate is reviewed periodically as per the guidelines applicable to floating rate loans linked to MCLR / EBLR (External Benchmark Lending Rate)?

Have you come across cases of frequent renewal / rollover of short-term loans? If yes, give the details of such accounts.

Whether correct and valid credit rating, if available, of the credit facilities of bank's borrowers from RBI accredited Credit Rating Agencies has been fed into the system?

**The credit rating is essential for all the exposures above 5 Cr. This determines the risk weight for the purpose of CRAR calculations. Non availability of credit rating would attract higher risk. In case the rating is not available, auditor should find out the earlier rating. Further banks many times confuse between Govt. Corporations and Government undertaking. Unless there is specific sanction term for not taking rating (only in case of Govt. undertaking, others have to be rated) valid rating certificate should be verified.**



# NUANCES – SANCTIONING & DISBURSEMENT

In the cases examined by you, have you come across instances of:
(a) credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch? (b) Are such cases promptly reported to higher authorities?
Whether advances have been disbursed without complying with the terms and conditions of the sanction? If so, give details of such cases .
Did the bank provide loans to companies for buy-back of shares/securities? <b>It is suggested that the management representation to this clause should be obtained as it is difficult for an auditor to find out unless specifically mentioned (which is very unlikely)</b>





# NUANCES – REVIEW & MONITORING

Is the procedure laid down by the controlling authorities of the bank, for periodic review of advances, including periodic balance confirmation / acknowledgement of debts, followed by the Branch? Provide analysis of the accounts overdue for review/ renewal. What, in your opinion, are major shortcomings in monitoring, etc.

- a) between 3 to 6 months, and
- b) over 6 months

- a) Are the stock/book debt statements and other periodic operational data and financial statements, etc., received regularly from the borrowers and duly scrutinized? Is suitable action taken on the basis of such scrutiny in appropriate cases?
- b) Is the DP properly computed?
- c) Whether the latest audited financial statements are obtained for accounts reviewed / renewed during the year?

- a) Whether there exists a system of obtaining reports on stock audits periodically?
- b) If so, whether the branch has complied with such system?
- c) Details of:
  - cases where stock audit was required but was not conducted
  - where stock audit was conducted but no action was taken on adverse features



# NUANCES – REVIEW & MONITORING

Indicate the cases of advances to non-corporate entities with limits beyond that set by the bank where the Branch has not obtained the duly audited accounts of borrowers

Does the branch have on its record, a due diligence Report in the form and manner required by the Reserve Bank of India in respect of advances under consortium and multiple banking. Give the list of accounts where such certificate/report is not obtained, or on record.  
(In case the branch is not the lead bank, copy of certificate/ report should be obtained from lead bank for review and record)

Has the inspection or physical verification of securities charged to the bank been carried out by the branch as per the procedure laid down by the controlling authorities of the bank?

Whether there is a substantial deterioration in value of security during financial year as per latest valuation report in comparison with earlier valuation report on record?

In respect of advances examined by you, have you come across cases of deficiencies, including in value of securities and inspection thereof or any other adverse features such as frequent/ unauthorized overdrawing beyond limits, inadequate insurance coverage, etc.?



# NUANCES – REVIEW & MONITORING

Whether the branch has any red-flagged account? If yes, whether any deviations were observed related to compliance of bank's policy related with Red Flag Accounts?

Comment on adverse features considered significant in top 5 standard large advances and which need management's attention

In respect of leasing finance activities, has the branch complied with the guidelines issued by the controlling authorities of the bank relating to security creation, asset inspection, insurance, etc.? Has the branch complied with the accounting norms prescribed by the controlling authorities of the bank relating to such leasing activities?

**RBI has issued Master circular on Lending to NBFCs (RBI /2004-05/14/ DBOD / IECS.No. 7 /08.12.01/2004-2005). Further the Exposure Norms also suggest the cap on lending of such activity. It is necessary at the branch to understand the correct categorization of advances and whether such instructions from the controlling office of the bank are adhered to. Please note that the error of categorization has impact on disclosure of Exposure norms as well as risk parameters change due to such change.**



# NUANCES – IRAC

- a) Has the branch identified and classified advances into standard/ substandard/doubtful/loss assets through the computer system, without manual intervention?
- b) Is this identification & classification in line with the norms prescribed by the Reserve Bank of India
- c) Whether the branch is following the system of classifying the account into SMA-0, SMA-1, and SMA-2. Whether the auditor disagrees with the branch classification of advances into standard (Including SMA- 0, SMA-1, SMA-2) / substandard / doubtful / loss assets, the details of such advances with reasons should be given.

d) Also indicate whether required changes have been incorporated/ suggested in the Memorandum of Changes.

e) List the accounts (with outstanding in excess of Rs. 10.00 crore) which have either been downgraded or upgraded with regard to their classification as Non-Performing Asset or Standard Asset during the year and the reason thereof.

**This question expects auditor to select all the accounts having exposure of 10 Cr and above who have any classification movement from & to Standard accounts during the year. The upgrading, especially would need greater audit check for its accuracy.**

f) Whether RBI guidelines on income recognition and provisioning have been followed.

**This is overreaching question would for part of our opinion.**



# NUANCES – IRAC (RECOVERY)

In respect of non-performing assets, has the branch obtained valuation reports from approved valuers for the immovables charged to the bank, once in three years, unless the circumstances warrant a shorter duration?

In the cases examined by you has the branch complied with the Recovery Policy prescribed by the controlling authorities of the bank with respect to compromise/settlement and write-off cases? Details of the cases of compromise/settlement and write-off cases involving write-offs/waivers in excess of Rs. 50.00 lakhs may be given.

Is the Branch prompt in ensuring execution of decrees obtained for recovery from the defaulting borrowers? Give Age-wise analysis of decrees obtained and pending execution.

Whether in the cases concluded the recoveries have been properly appropriated against the principal / interest as per the policy of the Bank?

In cases where documents are held at centralized processing centers / office, whether the auditor has received the relevant documents as asked by them on test check basis and satisfied themselves. Report the exceptions, if any



# NUANCES – NON-FUND EXPOSURES

(i)	List of borrowers where the LCs have been devolved or guarantees have been invoked				
Sr. No.	Invocation Date	Party Name	Beneficiary Name	Amt	Reason for non-payment



# NUANCES – NON FUND EXPOSURES

(ii)	List of borrowers where the LCs have been devolved or guarantees have been invoked but not paid with amount thereof				
Sr. No.	Invocation Date	Party Name	Beneficiary Name	Amt	Reason for non-payment
(iii)	List of instances where interchangeability between fund based and non-fund based facilities was allowed subsequent to devolvement of LC / invocation of BG				



# NUANCES - DEPOSITS

Is the branch complying with the regulations on minimum balance requirement and levy of charges on non- maintenance of minimum balance in individual savings accounts?

- RBI specifically has mandated Certification for penalty levied by banks for non-maintenance of minimum balance (DBR, no. Leg, BC.21/09.07.006/ 2015/16 dated July 1, 2015)
- Although the general answer given at the branch is that the calculations are automated through system, it is expected that the auditor takes at least 5 samples and calculates whether the levy of these charges is fair and as per the policy.





# NUANCES – BILLS PAYABLE, SUNDRY DEPOSITS

a)	The number of items and the aggregate amount of old outstanding items pending for one years or more be obtained from the Branch and reported under appropriate heads. Give details thereof		
Year	Number of Items	Amounts	Remarks
b)	Does your test check indicate any unusual items or material withdrawals or debits in these accounts? If so, give details thereof.		



# NUANCES – PROFIT & LOSS ACCOUNT

Has the test checking of interest/discount/ commission/ fees etc. revealed excess/short credit of a material amount? If so, give details thereof.

Has the branch complied with the Income Recognition norms prescribed by R.B.I.? (The Auditor may refer to the instructions of the controlling authorities of the bank regarding charging of interest on non-performing assets).

Has the test check of interest on deposits revealed any excess/ short debit of material amount? If so, give details thereof.

Does the bank have a system of estimating and providing interest accrued on overdue/matured/ unpaid/ unclaimed term deposits including in respect of deceased depositors?

Are there any divergent trends in major items of income and expenditure, in comparison with corresponding previous year, which are not satisfactorily explained by the branch? If so, the same may be reported.



# NUANCES – BOOKS & RECORDS

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.

i) In case the branch has been subjected to IS Audit whether there are any adverse features reported and have a direct or indirect bearing on the branch accounts and are pending compliance? If yes give details.

ii) Whether branch is generating, and verifying exception reports at the periodicity as prescribed by the bank

iii) 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.

iv) Whether the bank has laid down procedures for manual intervention to system generated data and proper authentication of the related transactions arising there from along with proper audit trail of manual intervention has been obtained.

v) 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.



## NUANCES - MIS

- Whether the branch has the proper systems and procedures to ensure data integrity relating to all data inputs which are to be used for MIS at corporate office level and for supervisory reporting purposes. Have you come across any instances where data integrity was compromised?



# NUANCES - MIS

Typically, the MIS reports generated at the branch would include:

1. **Account Information:** The terminology used by each bank is different. However, every bank would have one report under MIS that gives complete details of a borrowal account. The report not only include the basic information but the transaction summary, securities, DP, repayment schedule dates, outstanding and the outstanding should have been based on the original sanction. There may be many more details regarding the account. Any account selected as sample for audit must be verified also through this report to get the correct perspective.
2. **Exception reports such as:**
  - Review/ Renewal not done.
  - Stock statements not received.
  - DP violations
  - Modification done without proper authority.
  - Guarantees expired.
  - Deposits matured.
  - Mismatch, if any between the rates charged etc
  - There may be many more reports based on the requirements of the bank reporting matrix.
3. **Stressed Borrower related MIS such as**
  - SMA 0, SMA 1, SMA 2 borrowers
  - Early warning signals related transactions taken place at the branch.



## NUANCES - FRAUD

Furnish particulars of:

(i) Frauds detected/classified but confirmation of reporting to RBI not available on record at branch

(ii) Whether any suspected or likely fraud cases are reported by branch to higher office during the year? If yes, provide the details thereof related to status of investigation.

(iv) Whether the system of Early Warning Framework is working effectively and, as required, the early warning signals form the basis for classifying an account as RFA.



# NUANCES - FRAUD

(iii) In respect of fraud, based on your overall observation, please provide your comments on the potential risk areas which might lead to perpetuation of fraud (e.g. falsification of accounts/false representation by the borrower; misappropriation of funds especially through related party/ shell company transactions; forgery and fabrication of financial documents like invoices, debtor lists, stock statements, trade credit documents, shipping bills, work orders and encumbrance certificates and avail credit; Use of current accounts outside consortium where Trust and Retention Account (TRA) is maintained, to divert funds; List of Debtors/ Creditors were being fabricated and receivables were not followed up/ write off of debt of related parties; Fake export/shipping bill, etc.; Over statement of invoice amounts, stock statements, shipping bills, turnover; fly by night operations -including the cases where vendors, related/ associate parties, manufacturing units etc. aren't available on the registered addresses; Round Tripping of funds, etc.)



# SUPERVISORY POINT OF VIEW

**Supervisory process has revealed that following aspects are generally misinterpreted that lead to Divergences**

- Accounts closed to open new accounts to **camouflage rollover of accounts**-mainly in cases of STL which are not permitted beyond two times rollover
- Accounts which were already NPA but **camouflaged through ever greening** before the date of reference for restructuring
- Round tripping of funds from other banks
- Funds given to parent coming back to SPV to regularize the account
- Funds under devolved BG/LC not considered together with CC over-drawn
- Debt Service Reserve Account created from own disbursal and utilised to service interest/installment
- Enhancing FB limit repeatedly without assessment
- Change of DP multiple times in a month
- Converting NFB limit into FB limit without justification
- Sanction of ad-hoc limit to regularize an account
- Transfer of funds between intra-group companies





# FRAUD CONCERNS

- SA 240- The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- Audit risk assessment & planning would be inconclusive in Banking without giving due weightages to Fraud reporting.
- RBI has specific directions and expectations with regard to fraud reporting.
- It is therefore integral part of the audit planning and developing audit procedures well ahead of time.
- Refer RBI circular in May 2015 on Framework for dealing with Loan Frauds advising the banks to Red flag the accounts based on early warning signals.



## SUMMARY STATISTICS - FRAUDS (OF RS 1 LAKH AND ABOVE) REPORTED DURING THE LAST 5 FYs

Year	All banks	
	No. of Frauds	Amount Involved (Rs. in Crore)
2013-14	4306	10170.8
2014-15	4639	19455.1
2015-16	4693	18698.8
2016-17	5076	23933.8
2017-18	5916	41167.0



# OBSERVATION ON FRAUDS

- About 90 percent of the frauds, in terms of the amount involved, are happening in the credit portfolio of the banks.
- During 2017-18, large value frauds involving Rs. 50 Cr and above constituted 80 percent of all frauds.
- Factors facilitating large value frauds are
  - Opening current account with banks outside consortium without the No Objection Certificate from lenders
  - Deficient and fraudulent services/certificates by Third Party Entities (TPEs)
  - Diversion of funds by the borrowers through various means including through associated/shell companies
  - Lapses in credit underwriting standards
  - Failing to identify the Early Warning Signals (EWS) of incipient frauds.



# FRAUD CONCERNS BY REGULATOR

- **Delayed Recognition and Reporting of Frauds**
  - Advances related frauds often seasoned for 3 to 4 years as NPAs
  - Time between first bank and last bank in consortium reporting fraud
  - Ideally within six months from date first entity reports the account as fraud
  - Complicity of bank officials and third parties with the borrower
  - Reluctance to conduct the meeting of the lenders
- Delay in reporting in CRILC



# FRAUD CONCERNS BY REGULATOR

- Delay in filing complaint with CBI/Police
- Very poor credit and fraud risk governance
- **Professional Service Providers**
  - Advocates, chartered accountants, valuers, independent engineers
  - Reporting and dissemination of names of such third party professionals by IBA

(RBI had advised IBA to put in place an enhanced web-enabled TPEs-reporting and disseminating system. IBA has implemented the same w.e.f. December 1, 2018).



# FRAUD CONCERNS BY REGULATOR

- Opening of current accounts by banks outside the consortium without obtaining NOC and thus facilitating diversion of funds lent by consortium
- Deficiency in implementation of the Early Warning Signals (EWS) and Red Flagging of Accounts (RFA) Mechanism by banks
  - ❖ Banks have not adopted any or all of the indicative list of EWSs provided by RBI
  - ❖ Non-integration of the mechanism into banks' credit monitoring software
  - ❖ Not concluding investigation after RFA within the stipulated 6 month timeline
  - ❖ Inconclusive forensic audits due to non-cooperation by the borrowers
- Some banks in a consortium sell some accounts to ARCs just before their recognition as a fraud by the consortium.
- Slow progress in investigations and prosecution of fraudsters.



# SOME EARLY WARNING SIGNALS (EWS)

- Critical issues highlighted in the stock audit report
- Poor disclosure of materially adverse information
- Frequent change in the scope of the project
- Liabilities appearing in ROC search report, not in annual report
- Not routing sales through consortium member bank
- LCs issued for related parties without underlying trade transaction
- Raid by Income tax /sales tax/ central excise duty officials
- Significant reduction in the stake of promoters or pledging of shares



## NUANCES - ICFR

- The ICFR technical guide available on ICAI website talks about ICFR certification from Branch Auditors in respect of critical branches
- There is no regulatory guideline to implement ICFR by PSUs
- However, RBI in the appointment letter issued to CSAs has specified to certify the effectivity of the controls
- Many banks have decided that they will take certification from all branch auditors





THANK YOU

