

Statutory Audit of Bank Branches



**Western India Regional Council
of the Institute of Chartered Accountants of India
Jointly with
J.B.Nagar – CPE Study Circle
March 20, 2015**



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Audit of Advances



IMPORTANCE AND OBJECTIVES



- Compliance with:
 - BRA, RBI Guidelines, notifications & circulars
 - Accounting Standards & Standards on Auditing
 - ICAI Guidelines (incl. code of conduct)
- Sensitive Industry
- Public Accountability & responsibility
- Limited time
- Quality of work
- Reporting Effectiveness





KNOWLEDGE OF THE BUSINESS



Auditor should obtain knowledge of the business of the banks which enables him to identify transactions and practices which have a significant effect on the bank's financial statements.



INDIAN BANKING SECTOR AT GLANCE



Particulars	2012-2013 (Amount in Rs. Billion)	2013-2014 (Amount in Rs. Billion)	Growth (in %)
Loans & Advances	58,798	67,352	15%
Total Assets	95,900	1,09,635	14%
Gross Loans & Advances as a % of total Assets	61.31%	61.43%	-
NPA	1,941	2,642	36%
Gross NPA ratio (Gross NPAs as percentage of gross advances)	3.30%	3.92%	-



INDIAN BANKING SECTOR AT GLANCE

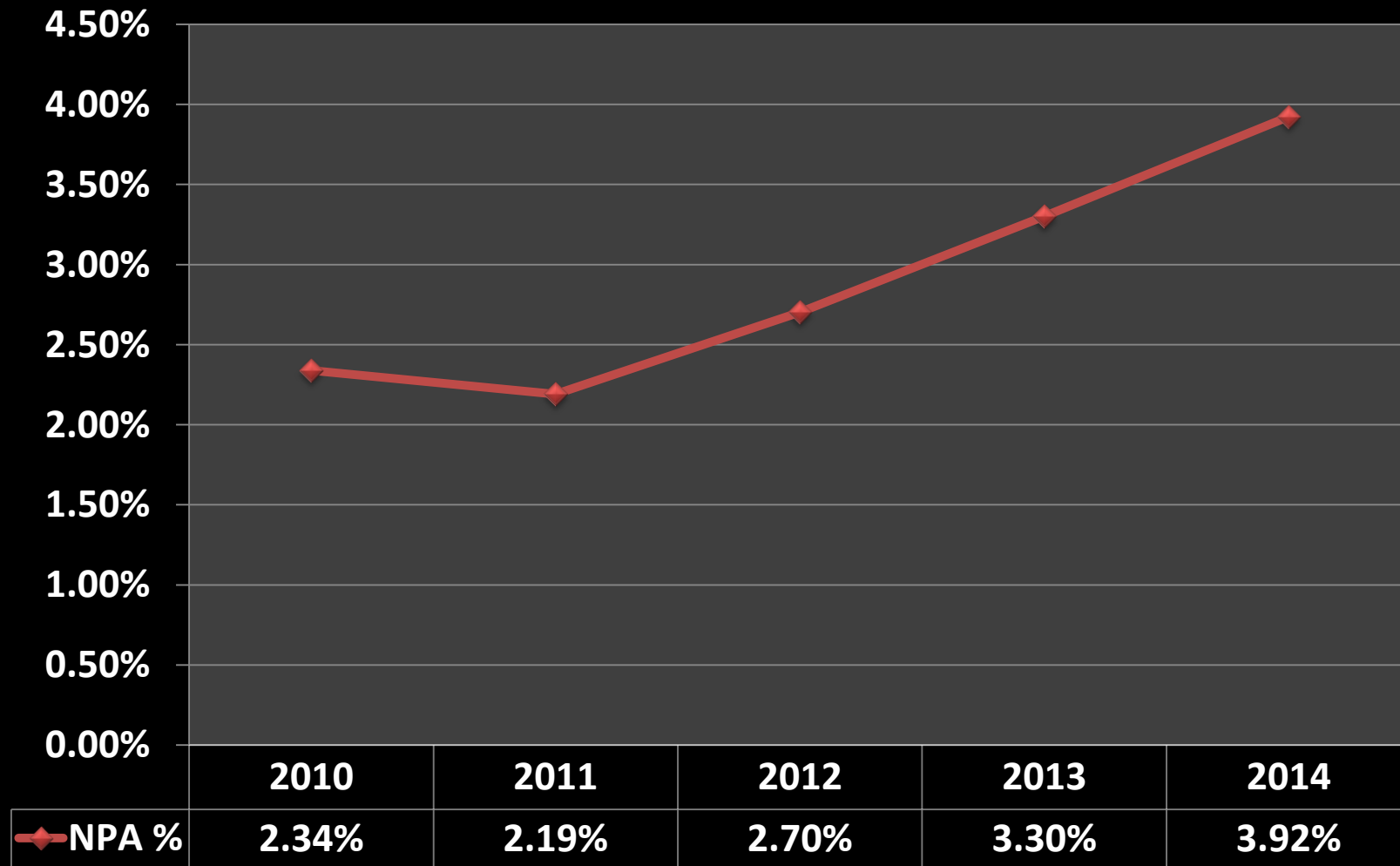


Sectorial Deployment of Bank Credit	2013 (Amount in Rs. Billion)	2014 (Amount in Rs. Billion)	Variation
Agriculture	5,899	6,694	13.48%
Industry	22,302	25,229	13.12%
Services	11,519	13,370	16.07%
Personal loans	8,976	10,367	15.49%
Others	10,102	11,692	15.74%





Non Performing Asset





CLASSIFICATION OF ADVANCES



Based On	Description	Examples
Funds	Fund and Non Fund based	Term loans, CC/OD, BG LOC etc.
Place of making Advance	Inland and Export	Domestic TL, Packing/Pre-shipment Credit, Post-shipment Credit
Security	Secured and Unsecured	Mortgage, Hypothecation, pledge, clean, credit card
Sector	Priority sector and Non-Priority Sector	Agricultural, Home loans, Educational, small & medium enterprises



FUND BASED ADVANCES



Type	Description
Demand	Repayable on demand in a single or pre-determined instalments generally upto 3 years
Term Loan	If demand loan's repayment exceeds 36 months, it is called Term Loan
Cash Credit (CC)	Credit Facility is generally granted against security of stock/book debts
Overdraft (OD)	Credit Facility similar to cash Credit but no security or other security like FD's, NSC receipts, Lien on LIC policies
Bill Purchased /Discounted	Advance against a sale bill (factoring etc.)



NON FUND BASED ADVANCES



Type	Description
Letter of credit	Undertaking by the bank to the payee(supplier of goods & services), on behalf of the buyer as per the terms of the LC
Bank Guarantee (Financial / performance)	To guarantee the performance of contractual obligations
Letter of comfort	Financial guarantee issued by bank to the beneficiary on behalf of borrower





SECURITY

➤ **Primary Security**

Refers to security acquired by the borrower with bank finance or the one against which credit facility has been sanctioned by the bank

➤ **Collateral security**

Collateral security is an additional security provided to bank in case of need. For eg, Insurance policy, FD's etc

➤ **Personal Guarantee**

It is a guarantee by a third party for payment of outstanding in the event of default by the borrower

➤ **Fixed & Floating charge**

Fixed charge is a charge on some specific and ascertained assets.

Floating charge is an equitable charge on the assets, present as well as future



SECTOR



➤ **Priority Sector**

Priority sector refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation.

Priority Sector includes the following categories

- ✓ Agriculture
- ✓ Micro & Small Enterprise
- ✓ Housing
- ✓ Export Credit

➤ **Non-Priority Sector**

Lending to other than priority sector is Non priority sector.



BANKING ARRANGEMENT



➤ **Sole Banking**

In this arrangement, borrower obtains credit from single bank. This is the simplest form of Tie-up.

➤ **Consortium Arrangement**

In this type of arrangement, the number of banks is more than one. The lending banks form a consortium.

➤ **Multiple Banking**

In this type of arrangement, there is no formal arrangement amongst the lending banks. Each of them has its set of loan documents, securities and mode of lending, independent of other lending banks



REVENUE FOR A BANK



Revenue

Interest from Loans/Advances

Processing charges on Loans

Penal Charges, commission, locker rent etc.

Investment/Treasury Income

Merchant Banking, Demat, Insurance & MF comm.

Other Fee based Service Charges





Verification of Advances



WHAT ARE WE LOOKING FOR.....?



IMPORTANT STANDARDS ON AUDITING



- **SA 230 – Audit Documentation**
- **SA 320 - Materiality**
- **SA 500 – Evidence**
- **SA 520 – Analytical Procedures**
- **SA 530 – Audit Sampling**
- **SQC 1 – Quality Control**





SIGNIFICANCE OF AUDITING

- **Value of Security & Quality of Security**
- **Recovery in case of default**
- **Provisioning also depends on this**



AUDIT APPROACH



- Verification of the Internal Control System in the branch
- Inspection, Observation and Inquiry
- Identify the risk areas
- More of Analytical procedures
- Materiality - Sample Checking to be done
- Full verification of certain advances
- Review of internal, concurrent, RBI inspections reports etc.



EVALUATION OF THE INTERNAL CONTROL SYSTEM



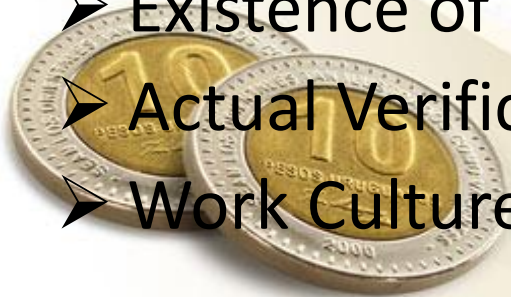
The auditor should examine the efficacy of various internal controls over sanctioning, disbursement and monitoring of advances to determine the nature, timing and extent of his **substantive procedures**.



EVALUATION OF THE INTERNAL CONTROL SYSTEM



- Discussion with management & any operating manuals
- Level of implementation of the IC system
- Sanctioning process in the Bank
 - Sanctioning Authority and Powers
 - Extent of computerization & Documentation
 - Internal Communication with RO/HO
 - Quality and trained Staff
- External Inspection
- Existence of IT systems and its effectiveness
- Actual Verification
- Work Culture and environment



EXTENT OF CHECKING AND MATERIALITY LEVELS



- New Sanctions
- Large Advances (5% of Advances or 2 crs)
- Adverse Remarks in
 - ✓ Concurrent Audit/IA Report
 - ✓ PY LFAR & Audit report
 - ✓ RBI Inspection
 - ✓ Internal Inspection
 - ✓ Special Audit
- Major movements (upgrades & down grades) in NPA / Restructured advances
- Type of Branch



LIST OF REQUIREMENTS @ COMMENCEMENT



- RBI Master Circulars
- ICAI Material
- Bank's Internal Policies (HO circulars etc.)
- Closing circular
- RBI inspection Report
- Internal Inspection and Concurrent audit Reports
- Other information about branch (NPA etc)
- Previous year's AR & LFAR
- Significant accounting policies of the bank



We Need:

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AREAS TO BE COVERED

- Pre Sanction Stage
- Post Sanction Stage
- Review, Monitoring & Renewal

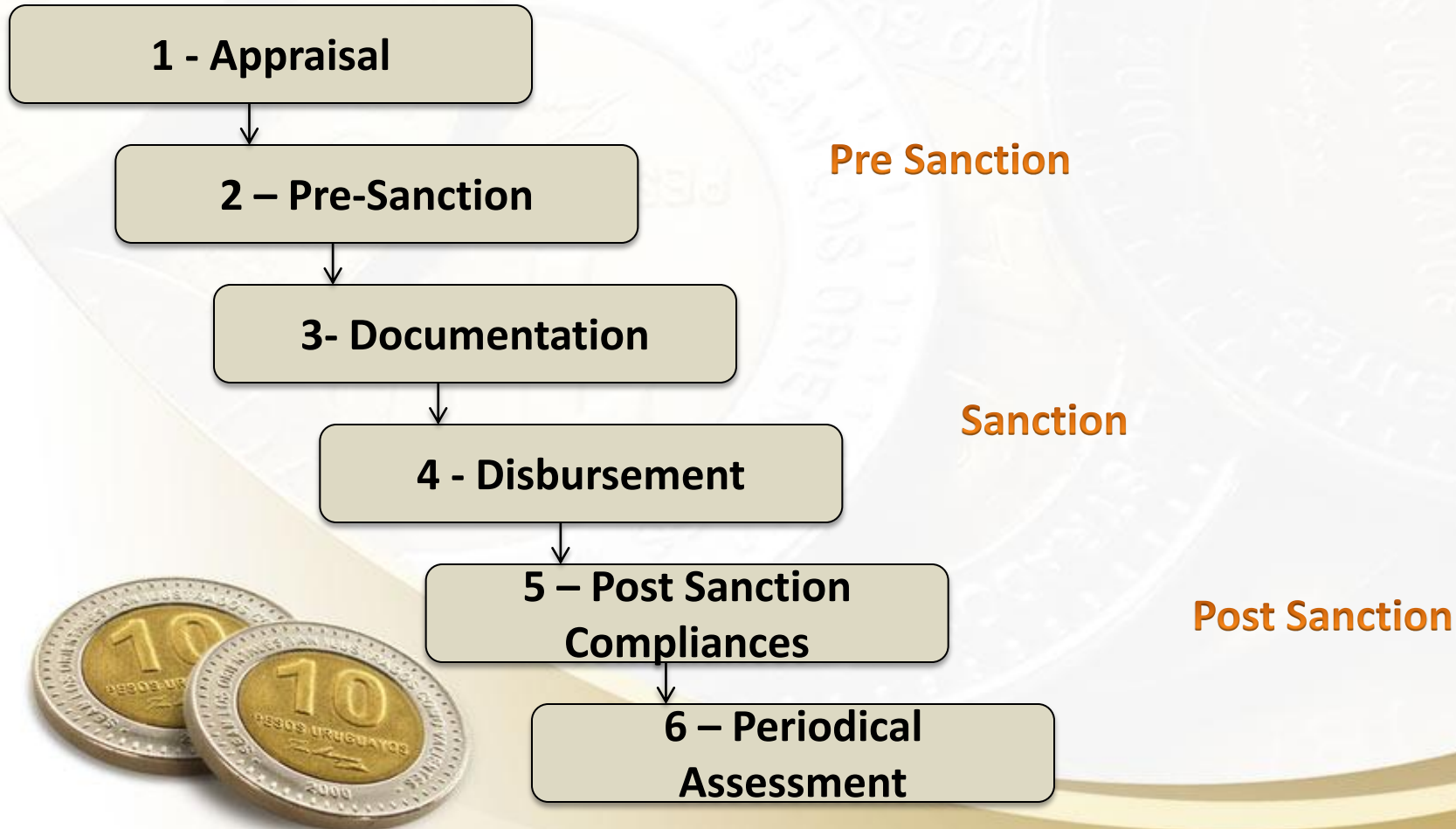


- Verification of Statement of advances





STAGES OF VERIFICATION



APPRAISAL



- Application / renewal in prescribed form
- Other documentations like project report, audited FS, cash flows etc
- Loan Application Scrutiny – competent authority
- KYC compliance
- Review of credit appraisal system
- Purpose of the loan- either business or personal
- Eligibility criteria & has the potential to repay specific loan
- Verify that sanction is within the power of authority
- Report any discrepancy noted during verification



PRE-SANCTION



- In this stage, the branch has the following functions:
 - ✓ Adequacy of Security & credit rating of borrower
 - ✓ Standing of promoters/ guarantors
 - ✓ Preliminary inspection of the business unit or residence of the borrower.
 - ✓ Inspecting the nature of the securities offered particularly Immovable properties.
 - ✓ Preparing report after such inspection stating specific reasons for either sanctioning/rejecting the loan.





PRE-SANCTION

- Verification of security – (title and valuation)
- Assessment of the latest audited financial statement of the borrower
- Review of the project report and projections – test for reasonableness
- Financial Ratios (Debt Equity & debt servicing)
- Credit appraisal
- NOC from previous banker
- Title clearance – search report – legal clearance
- Within sanctioning limits and exposure limits



DOCUMENTATION



- Adequate documentation – as per sanction note/bank's policy
- Regular updated
- Enforceable by law
- Any short comings observed
- Maintenance and safe custody



DOCUMENTATION



- Auditor should examine the loan documents obtained & compare with the list specified in the documentation manual.
- Auditor should verify whether:
 - ✓ All the particulars in the documents have been filled in.
 - ✓ All the particulars filled in are correct.
 - ✓ Signature and acceptance from the borrower has been obtained including the sanction letter.
 - ✓ Branch official concerned have verified & authorized that all the documents have been duly obtained.
 - ✓ Creation of charge – ROC site
 - ✓ Board resolutions – authorizing signatory
 - ✓ Borrower and Guarantors papers



ISSUES IN DOCUMENTATION



- Are all documents available for verification
- Additional requirements for consortium / multiple banking arrangements
- Original documents are not available at times
- Acceptance of borrower confirming terms of sanction
- Missing documents





DISBURSEMENT

- Sanction limit is within the powers of the sanctioning authority
- All the terms of sanction are complied (quotations / profroma invoices)
- Direct disbursements to vendor/third party
- Verification of own contribution
- Pre disbursement inspection
- In case of draw down facility – stage of completion to be verified
- Follow up with original documents, registration etc.





POST SANCTION COMPLIANCES

- After the disbursement of the loan, the branch should monitor and comply all the term and conditions specified in Loan sanction letter.
- This compliance includes the following:
 - ✓ Verification of end-use of the funds- *Whether they are utilized for intended purpose.*
 - ✓ In case of Immovable property offered as security:
 - ✓ *Mortgage has created & registered.*
 - ✓ *Valuation report, Legal opinion report, Latest encumbrance certificate has been obtained.*
 - ✓ *Creation of charge & lien*
 - ✓ *Insurance*



PERIODICAL ASSESSMENT



- Review & renewal as per policy
- Post disbursement & regular site visit
- Proper Inspection (stock/asset/unit) report (proof)
- Regular submission of stock / debtors statements
- Audited financial statements
- Regular MIS
- Performance and operations in the accounts
- Valuation of security
- Regular Insurance



PERIODICAL ASSESSMENT



- Periodic review and performance of irregular accounts (potential NPA)
- Review of fresh drawing power
- Compliance with adverse observation from audit/inspection (action taken report)
- Recovery of penal interest / commitment charges
- Verify & comment the recovery efforts done by the branch in case of NPA accounts and potential NPA accounts.



VERIFICATION OF STATEMENTS



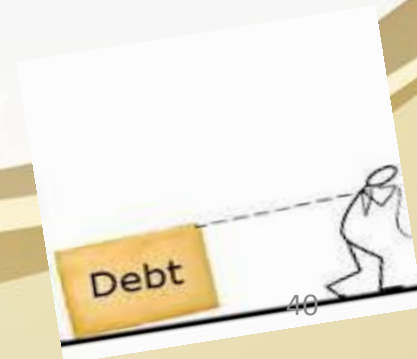
- Verification of various returns & statements from the CBS
- Classification of advances as per RBI guidelines
- Tallying with books of accounts & other statements
- Correctness wrt classification, security value etc.
- Priority classification
- Verification of Master Data

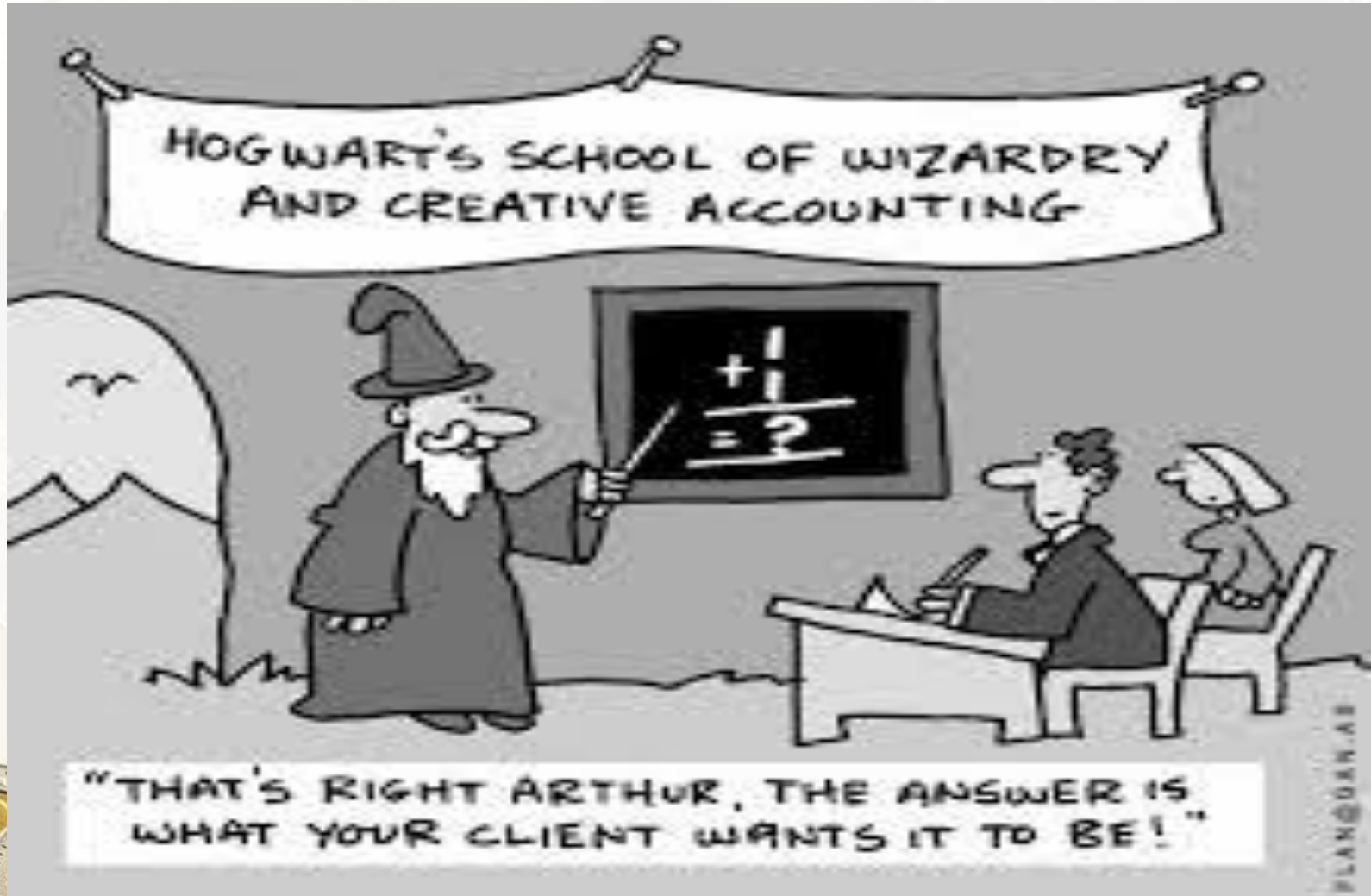


OTHER ASPECTS



- Systems driven identification of NPA
 - Non renewal of advances
 - Non/delay in submission of stock statements
 - Up gradation of NPA
- Reversal of Income
- Erosion in the value of security
- Fraudulent practice of advancing loan to ineligible persons, Advances without security
- Special monitoring of Special Mention Accounts (SMA)
- Post March Recovery
- Source of recovery







*Thank
You*

