Procedure for bank branch audit

SOME IMPORTANT FACTS – CONCEPTS – AUDIT PROCEDURE IN BANKING

Executive Summary: Banking sector is the backbone of the economy. But now a days it is a major weak sector. What would be the probable reason for the same, i wanted to highlight the same. Since the weakness is in whole sector hence the responsibility of the auditor will automatic get increase, so i wanted to brief about the General Audit Procedure in case of Bank Branch Audit and important terms.

How is the Banking System In India?

The following types of banking institutions in India:

A. Commercial banks:
   1. Public Sector Banks (SBI & Associates, BOI, CBI, UBI, etc) and
   2. Private Sector Banks (Axis, ICICI, etc)

B. Regional Rural banks: RRB has a public sector bank as its ‘sponsor bank’. Capital in each such bank is contributed by the Central Government, the sponsor bank and the State Government concerned in proportion of 50, 35 and 15 per cent, respectively

C. Co-operative banks: Multi State Co-operative, Central Co-operative, State Co-operative, Urban, Semi Urban, etc.

D. Foreign Banks – DBS, BOA, HSBC, etc

E. Development banks (more commonly known as ‘term-lending institutions’); - IDFC, HDFC, etc
Authority for Appointment of Statutory Auditor of banks?

Generally Appointment of Statutory Auditor in all banks is in the hands of BOD-Members. In case of PSB and RRB, Reserve Bank of India publish’s the eligible firms list and thereafter BOD appoints the auditor. Earlier (2 years back) appointment of the Statutory Auditor was in the hands of RBI.

What would be the Probable reasons for huge NPA’s almost in all PSB?

In December quarter of 2015 the reasons for the huge losses or drastic change in the profit of the PSB’s is the increase in Non-Performing Assets (NPA). Why NPA’s has increased so drastically may be following reason:-

1. India is facing the Slow-down (Mandi).
2. Policy for Appointment of Auditor is changed from RBI to BOD-Members.
3. Change in the political environment.
4. RBI has needs to look into the NPA criteria according to world trend.

If we will check the list of NPA then we will find many big and renowned names. They are actually facing the problems or trying to benefit themselves?

What will be the impact of Large NPA’s for Common Man?

In all Public Sector Banks (PSB) more than 50% stake holding is of Government (Central/State/Both). Whenever needs government infusing the Capital via Equity, Debt and other capital market instruments to fulfill the Basel II/III norms.

Government is collecting the money from Public at large in form of Taxes, Duties, Royalties, etc.

If Government is infusing the Capital from the money collected from Public then ultimate burden of NPA’s on Common man.

If we will check the List of NPA’s then we will find many of them are listed on Stock Exchange. If Company is listed on Stock exchange then it has raised its part of capital from public/FII/Corporates, etc. Here also the common man’s money utilized.

If both ways Common man is funding the money then who is get benefited is a major question mark ????

Why NPA is not increased in case of Private Banks?

In Private Sector Banks NPA is not changed drastically like a Public Sector Bank. This is also the major question in front of us. If whole sector is in problem then it should be impacted to all not only one segment of the industry.

Regulatory Body, NPA norms, Basel norms, Circulars, etc. all RBI guidelines are applicable to both Public as well as Private then why only NPA increased in Public Sector?
Who are the top 50 corporate defaulters?

List of top 50 corporate defaulters in this country; (Source DRT India)

1. Kingfisher Airlines Rs.2673 Crore
2. Winsome Diamond & Jewellery Co. Ltd. Rs. 2660 Crore
3. Electrotherm India Limited Rs.2211 Crore
4. Zoom Developers Private Limited Rs.1810 Crore
5. Sterling Bio Tech Limited Rs.1732 Crore
6. S. Kumars Nationwide Limited Rs.1692 Crore
7. Surya Vinayak Industries Ltd. Rs.1446 Crore
8. Corporate Ispat Alloys Limited Rs.1360 Crore
9. Forever Precious Jewellery & Diamonds Rs.1254 Crore
10. Sterling Oil Resources Ltd. Rs.1197 Crore
11. Varun Industries Limited Rs.1129 Crore
12. Orchid Chemicals & Pharmaceutical Ltd. Rs.938 Crore
13. Kemrock Industries & Exports Ltd. Rs. 929 Crore
14. Murli Industries & Exports Limited Rs.884 Crore
15. National Agricultural Co-Operative Rs.862 Crore
16. STCL Limited Rs.860 Crore
17. Surya Pharma Pvt. Ltd. Rs. 726 Crore
18. Zylog Systems (India) Limited Rs.715 Crore
19. Pixion Media Pvt. Limited 712 Crore
20. Deccan Chronicle Holdings Limited Rs. 700 Crore
21. K.S. Oil Resources Ltd. Rs.678 Crore
22. ICSA (India) Ltd. Rs.646
23. Indian Technomac Co. Ltd. Rs.629 Crore
24. Century Communication Limited Rs.624 Crore
25. Moser Baer India Ltd. & Group Companies Rs.581 Crore
26. PSL Limited Rs.577 Crore
27. ICSA India Limited Rs.545 Crore
28. Lanco Hoskote Highway Limited Rs.533 Crore
29. Housing Development & Infra Ltd. Rs.526 Crore
30. MBS Jewellers Pvt. Ltd. Rs.524 Crore
31. European Projects And Aviation Ltd. Rs.510 Crore
32. Leo Meridian Infra Projects Rs.488 Crore
33. Pearl Studios Pvt. Ltd. Rs.483 Crore
34. Educomp Infrastructure & School Man Rs.477 Crore
35. Jain Infraprojects Limited Rs.472 Crore
36. Kmp Expressway Limited Rs.461 Crore
37. Pradip Overseas Limited Rs.437 Crore
38. Rajat Pharma/ Rajat Group Rs.434 Crore
39. Bengal India Global Infrastructure Ltd. Rs.428 Crore
40. Sterling Sez & Infrastructure Pvt. Ltd. Rs.408 Crore
41. Shah Alloys Ltd. Rs.408 Crore
42. Shiv Vani Oil And Gas Exploration Limited Rs.406 Crore
43. Andhra Pradesh Rajiv Swagruha Corp. Ltd. Rs.385 Crore
44. Progressive Constructions Ltd Rs.351 Crore
45. Delhi Airport Met Ex Ltd. Rs.346 Crore
46. Gwalior Jhansi Expressway Limited Rs. 346 Crore
47. Alps Industries Limited Rs.338 Crore
48. Sterling Port Limited Rs.334 Crore
49. Abhijeet Ferrotech Limited Rs. 333 Crore
50. Sujana Universal Industries Rs.330

Total Rs.40,528 Crore

**What would be the Audit Procedure (In Brief) in case of Bank Branch Statutory Audit?**

1. Preparation of Audit Plan
2. Work Allocation
3. Reading of Closing Circular, Bank policy, Delegation of Authority
4. Have a look on LFAR points, List of Certificates which requires to sign, Various system generated reports – Exception report, Exceeding report, SMA II report, etc.
5. Reading and noting the points from Concurrent Audit Report, Inspection Report, RBIA report, System Audit Report, Last year's financial statements.
6. Verification of GLA with FormA and FormB.
7. Selection of Advances according to Portfolio of Branch (Needs to ask for facility-wise jotting). It should be sample basis with coverage of all the products – While checking the advances go through the detail current file of communication, Latest Annual financials, Stock Audit Report, Credit Audit Report, Credit rating, CIBIL report, Valuation report of Collateral, Search Report, Mortgage papers, etc. Filling of Checklist is preferable according to facility.
8. Verification of KYC norms for the accounts opened during the audit period.
9. Stationery Verification – DD, Cheque books, FD, Lockers, Stamps ,etc.
10. Cash and ATM cash (if any) verification.
11. Form A - Form B head wise analysis with last year comparison and if variation is more than 5%-10% then reason for the same.
12. Form B – On Test basis vouchers-supporting of the expenses needs to verify.
13. Interest Verification – CC, OD, TL, RD, etc.
14. Commission Verification of DD, BG, LC, etc.
15. If AD Branch then foreign exchange related transactions needs to verify with proper supporting – Preferably checklist of the same needs to fill.
16. Based on the above audit needs to fill up the LFAR and verify the Certificates.
17. Verify the Provisioning on advances as per the RBI guidelines or not?
18. Verify the classification of advances – Priority, Others, Staff, etc.
19. Verify the Basel II – III report, Verify the Risk Weightage and cross tally the same with total advances.
20. Verify the transactions on test basis through black box testing.
21. Form A Verification – Long outstanding entries, age-wise break ups, subsequent clearance of parking entries (if any), grouping of advances, etc.

**What are the Category of Advances and Provisioning Norms for Advances?**

Classification of Advances –

i) Standard Assets  
ii) Sub- Standard Assets  
iii) Doubtful Assets  
iv) Loss Assets

Provisioning Norms (In General) – Provisioning are on the basis of Borrower wise and not on the facility wise:

**On Standard assets** - The provisioning requirements for all types of standard assets stand as below. Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis:

(a) Farm Credit to agricultural activities and Small and Micro Enterprises (SMEs) sectors at 0.25% (for medium enterprises 0.40%)

(b) Advances to Commercial Real Estate (CRE) Sector at 1.00 %;

(c) Advances to Commercial Real Estate – Residential Housing Sector (CRE - RH) at 0.75%

(d) Restructured Standard Assets – 5.00%

(e) All other loans and advances not included in (a) (b) and (c) above at 0.40 per cent.

**On Sub-Standard Assets** – In General 15% and on unsecured portion (if any) then additional provision of 10%
On Doubtful Assets – On Unsecured portion 100% and on secured portion as follows:

<table>
<thead>
<tr>
<th>Period for which the advance has remained in ‘doubtful’ category</th>
<th>Provision requirement (%)</th>
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<tbody>
<tr>
<td>Up to one year</td>
<td>25</td>
</tr>
<tr>
<td>One to three years</td>
<td>40</td>
</tr>
<tr>
<td>More than three years</td>
<td>100</td>
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On Loss Assets – 100%

What is the provision requirement for Restructured Advances?

Restructured advances is a weak advances but weakness is of for the temporary nature. And on the basis of probable inflow bank has restructured the facilities.

Provision for above type of advances is 5.00% but restructured advances turn into the Non-Performing Asset then the date of NPA should be original date of NPA before restructuring.

If any advances classified as NPA then non served interest from the date of NPA should be reversed by the bank.

What is the meaning of Statutory Liquidity Ratio (SLR), Cash Reserve Ratio (CRR), Repo Rate, Reverse Repo Rate, Bank Rate?

**SLR:** Statuary liquidity ratio means the amount of liquid assets such as precious metals (gold) or other approved securities that a financial institution must maintain as reserves other than cash.

Objectives of SLR is to restrict expansion of the bank credit:

i. To increase investment of banks in govt. securities.
ii. To ensure solvency of banks.

**CRR:** CRR refers to the funds that the banks have to keep with the RBI. If the central banks decide to increase the CRR, the available amount with the banks comes down.

The RBI uses the CRR to drain out the excessive money from the system.

**Repo Rate:** repo rate is the rate at which the central bank (RBI) lends the money to the commercial banks to meet the minimum statuary requirement of the day. Repo rate is charged on money lend by central banks to commercial banks for short term purposes.

A Reduction in repo rate helps the banks to get the funds at a lower rate from RBI.
**Reverse repo rate:** Reverse Repo Rate is the rate at which the commercial bank lends the money to the central bank (RBI). Banks are always happy to lend money to the RBI since their money is in safe & secure hands.

It is also a tool used by the RBI to drain out the excess money out of the Banking System.

**Bank Rate:** Bank Rate refers to the rate which the central bank charges on the loans & advances to the commercial banks. Whenever the banks have shortage of funds, they can typically borrow from the central banks based on the monetary policy of the country.

**Recommended Read**
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- GST Audit - An overview
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