# Chapter 14A – "Audit of Banks"

## II. Verification Aspects:

### (i) Verification of Investments:

#### A. Audit Procedures:

For verification of investments, auditor is required to perform the following:

(1) Examination of Internal Control System w.r.t. Investments and Review of Investment Policy.

(2) Examine separation of investment function as:

(a) Own Investment account; and

(b) Client PMS Investment.

**Note:** As per RBI Guidelines, client PMS Investments requires separate audit by External auditors.

(3) Examination of reconciliation of Investment accounts.

(4) Examine the documents maintained w.r.t. Investments.

(5) Ensure Physical verification of Investments at year end.

(6) Examination of classification and Swifting.

Classification:
- Held for trading (HFT)
- Available for Sale (AFS)
- Held to Maturity (HTM)

Swifting: From AFS to HTM ↓ Requires approval of BoD.

(7) Examination of Valuation:

(a) Appropriateness of Accounting Policy / Method of Accounting

(b) Changes, if any in the method of valuation.

(c) Recognition of Income earned on Investments; Profit or loss arises on sale of investments.

(d) Compliance of RBI Guidelines, etc.

**B. Special Purpose Certificates:** Banks are required to obtain from their SCAs, the following:

(i) Certificate on Reconciliation of Securities on Own Investment account and PMS client A/c.

Note: Reconciliation is to be in specified format.

(ii) Certificate on Compliance by banks in Key Areas of Prudential and Other Guidelines relating to such transactions, issued by RBI.

**(C) Review of Investment Portfolio:** - Half yearly Review (as on 30.09. and 31.03) should be undertaken by banks of their investment portfolio.

- Review shall cover:
  (i) Operational aspects;
  (ii) Amendments made to Investment Policy;
  (iii) Adherence to Internal Policy and RBI Guidelines.



Note: Internal auditors are required to conduct concurrent audit of treasury operations and results of their report should be placed before CMD once every month.

**(D) Income Recognition Norms:**

(i) Performing Investments: Interest income is to be recognised on Accrual Basis provided interest rate is pre-determined.

(ii) Non performing Investments: Income to be recognised on realisation basis.

(iii) Dividend on shares: to be recognised on Accrual basis, if dividend declared in AGM and right to receive dividend is established.

(iv) Income on units of Mutual Fund: to be recognised on cash basis.

(ii) Verification of Important Ratios :

(A) Cash Reserve Ratio : - Minimum fraction of deposits, which banks have to hold as (4.5%) reserves, either in cash or as deposits with RBI.

- Requirements of CRR for Banking Companies → Banking Regulation Act
- " " " " Scheduled Banks. → RBI Act, 1934
- To Ensure compliance of CRR by banks, auditor should refer to the Master Circular issued by RBI in this regard.

(B) Statutory Liquidity Ratio (SLR) : - SLR Measures the liquidity aspects of a bank w.r.t. Demand and Time Liabilities (DTL)

- Can be Measured as :

$$\frac{\text{Liquid Assets}}{\text{Demand and Time Liabilities (DTL)}} \times 100$$

SCAs Role : · To verify the compliance of SLR on 12 odd dates in different Months of a financial year (not being Friday).

· Report to be sent to Mngt. of Bank and RBI.

Verification Points :

(a) Obtain understanding of RBI Circular so as to determine what is to be included and excluded in Composition of DTL.

(b) Request Branch Auditor's to verify the correctness of Trial Balance and Cash Balance at Branch for selected dates.

(c) Test check the Consolidation regarding DTL position prepared by H.O. (from related returns received from branches).

(d) Examine composition of DTL as per RBI Circular.

(e) Ensure that interest accrued, but not accounted is included in composition of DTL.

(f) No. of Unaudited branches to be specified.

**Note:** A Statement to be issued w.r.t. unaudited branches that reliance put on return received from branches.

Items to be included in DTL :
" " " excluded from DTL : | reading from book (H.W.)

(C) **Capital Adequacy Reserve Ratio (CARR):** 9% — CARR measures the adequacy of Capital resources w.r.t. risk associated with banking operations.

- CARR can be measured as : $\frac{\text{Capital Funds}}{\text{Risk weighted Assets and off B/S Items}} \times 100$

- Capital funds : Tier I Capital → Permanent Nature (Equity, Reserves)
  Tier II " → Relatively less stable (e.g. Hybrid debt Capital instruments)



(iii) **Verification of Advances:**

(A) **Audit Approach:** Learning + Noting — H.W.

(B) **General Audit Procedure:**
(i) Examination of I.C. System
(Performing Tests of Controls / Compliance Procedures)
(ii) Performing Substantive Audit Procedure
(iii) Examination of Recoverability.

Self Study

M. Imp.

(C) **Audit Procedure in Special Cases:**

(i) **Asset classification:**