

Chapter - 14 "Audit of Banks"

Topics Covered: (A) Introductory Topics

- (i) Introduction and legal framework
- (ii) Conducting Bank Audit
- (iii) Internal Control Procedures

(B) Verification

- (i) Investments
- (ii) Important Ratios (ERR, SLR, CARR)
- (iii) Advances



(A) Audit Approach

(B) General Audit Procedure

Evaluation-I.C.
Sub. Audit Proc.
Recoverability

(C) Audit Procedure in special cases



(i) classification of Advances →

(ii) Drawing Power calculation →

DP → C/c ; OD Limits
(Inventory)

Sanctioned limit = 10 Cr.

Drawing Power = (CA - CL)

• → BOD Guidelines

• → Creditors and stock-L/c

• → Stock Audit

• → working capital → construction business

Borrower → stock stn. - periodic ≤ sanctioned limit

NPA - A/c O/s Bal > D.P. - out of order - NPA
90 overdue.

(iii) Accounts with temporary deficiencies:

(iv) Limit not reviewed - 180 days from due date / date of Adhoc sanction.

Exception

A/c - inherently strong.

stock stn. not submitted

↓ D.P. - Nil

O/s Bal. - irregular amount.

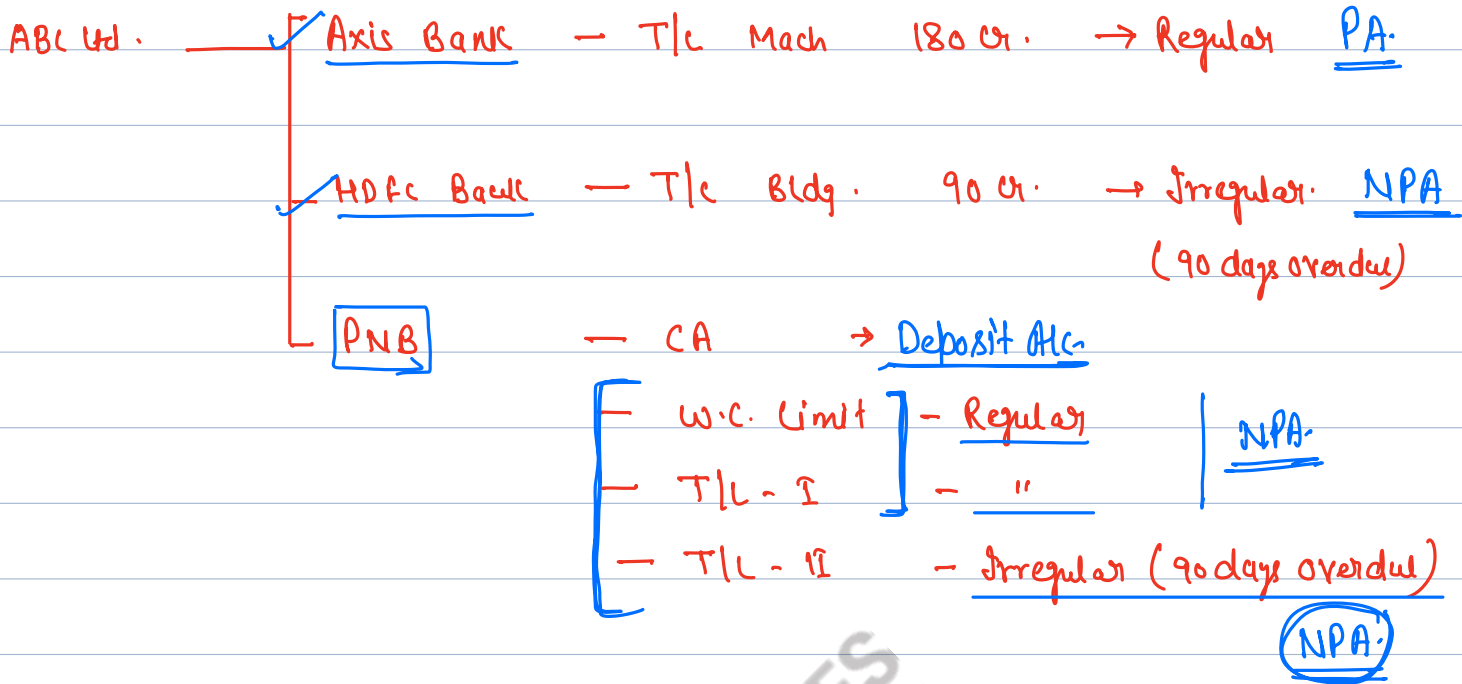


> 90 days overdue - NPA.

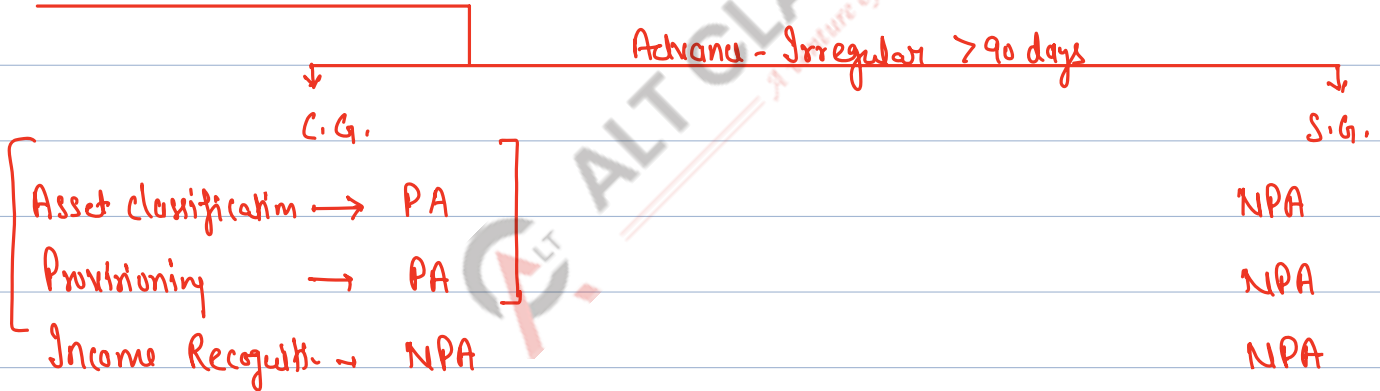
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D.P. stock stn. - > 7 month old.

(v) Asset classification - borrower-wise; not facility wise:



(vi) Govt. Guaranteed Advances:



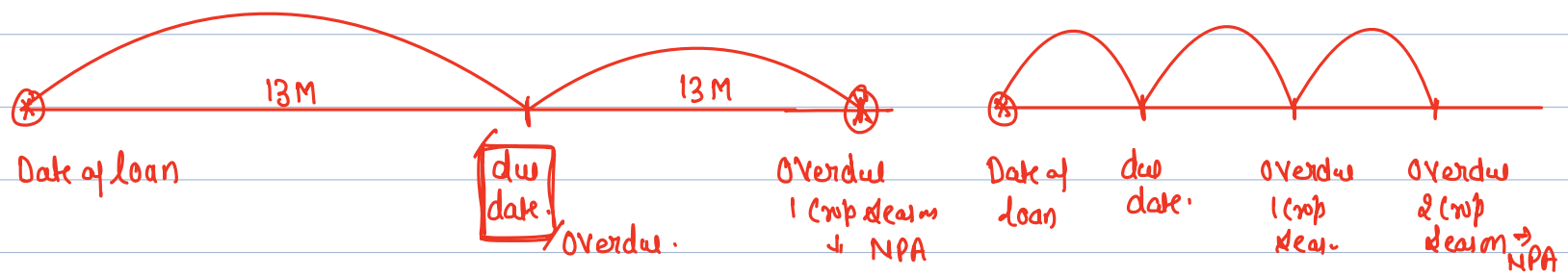
(vii) Agricultural Advances

Long duration crop

Overdue - One crop season (13M)

Short duration crop

Overdue - Two crop seasons (2M)

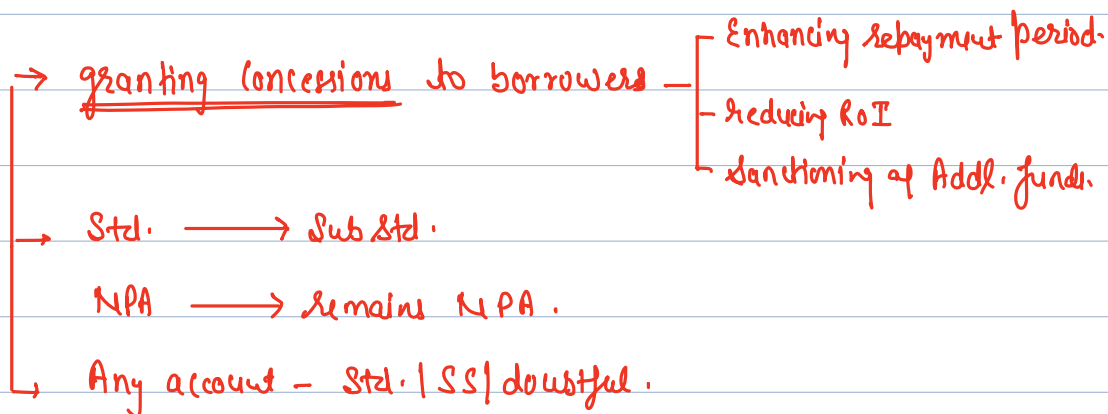


(viii) Provision towards standard assets: Master Circular

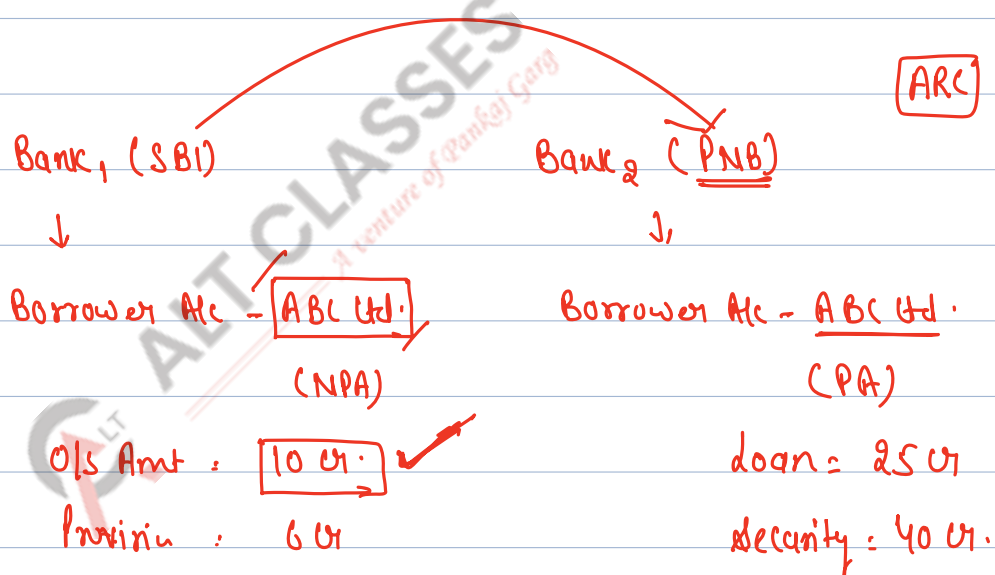
Provision - stn. of advances.

Bifurcation of Provisions.

(ix) Restructured Advances:



(x) Sale / Purchase of NPA:



NBY 4 Cr. ✓

Security: Approx - 6.50 Cr. ✓

PNB.

- Based on Circumstances.
- Provisioning.
- 100% Risk - CARR

- Selling Bank → 2 yrs. classification as NPA
- BOD Guidelines / Compliance
 - Without recourse
 - Cash basis / upfront.
 - Cannot purchase same NPA later

Chapter - 18 "Audit of Banks"

(vii) Verification of Capital and Liabilities:

✓(a) Capital and capital adequacy

✓(b) Reserves and Surplus

✓(c) Deposits (Current, Saving, Term deposits, Foreign Currency)

✓(d) Bills Payable

✓(e) ^{Inter}Contingent Liabilities

(a) Disclosure Requirements

(b) Audit Approach

(c) Verification aspects

(a) Capital:

Opening Balance
(Audited B/s of Py)

Addition during the
Year

Closing Balance

↓
Authorised Capital

↓
SR + MOA

↓
Subscribed and PUC

↓
- Prospectus/offer document

↓
- Bank statement, etc.

Capital Adequacy: Adequacy of capital resources in relation to risk of operational activities.

✓(A) Stress Testing



All Commercial Banks need to develop a "Stress Testing Framework" based on Individual Requirement of Bank designed to understand whether bank has enough capital to survive in

✓(B) BASEL III Framework



- It is a Global Regulatory Standard on Capital Adequacy of banks, stress testing as well as market liquidity risk.
- It is related with capital adequacy requirement, evolving methods of determining regulatory capital and

adverse economic conditions.

ensuring efficient use of capital.

(b) Reserves and Surplus:

- Opening Balance $\xrightarrow[\text{Addition | Reduction}]{\text{Changes during the year}}$ Closing Balance
↓
Supporting documents \rightarrow Board Resolution.
- Statutory Reserves \rightarrow Compliance of legal and regulatory requirements
- Statutory requirement of transfer of profits to reserves - Compliance | Exemption.

(c) Deposits:

(i) Current account and Saving account

- A/c opened - KYC Norms
- Balances verification
- Interest calculations
- Periodic balance confirmations
- Debit balances need to be shown as "advances"
- Inoperative accounts

(ii) Term deposits

- Issue of FD receipts
- S.No. of FD receipt
- Interest rate
- Foreclosure charges in case of pre-payment.
- Recurring deposits

(iii) Deposit in foreign currency

- RBI direction.
- Conversion at notified rate.
- Increase/Decrease should be chkd. to P&L A/c
- Intt - 360 days

- ✓ (D) Bills payable:
- (i) Evaluate EFC of J.C. (Std. printed forms, Custody, private codes, signatures, advice)
 - (ii) Examine O/S item/ entries
 - (iii) Examine correspondance with other branches.

(e) Contingent liabilities:

✓ (i) Disclosure Requirements.

✓ (ii) Audit Approach

(iii) Verification Aspects

✓ (a) claims against the bank not acknowledged.

Obtain Mngt. representation w.r.t.:

- Non funded facilities to be extended to regular

✓ (b) liability for partly paid investments

(a) Off-B/s items - Accounted in the books

constituents.

(b) Off-B/s items → accounted after compliance - If facilities extended to of due procedure.

✓ (c) liability for outstanding forward exchange contracts

(c) Off-B/s items → underlying documents

Other, ensure concurrence of existing bankers

✓ (d) Guarantees

(d) Disclosures → Completeness.

- Authorized / procedures

✓ (e) Acceptances, Endorsements and other obligations

(e) Disclosures → do not include any Crystallised liability

- L/C - Import of goods, payment should be on basis of shipping documents

(f) Other items

(f) Estimates of proposed obligations

- Accounting System → maintenance of adequate records

should be as per AS-29

(g) Guarantees - directors:

- J.C. → Identification, recorded

(h) liability - remote → Note.

- Test - completeness of all Contingent liabilities

- Reasonableness of year

end-balances