

WT 7 (Ch. 14 and 15 – Audit of Banks, NBFC and PSU)

Marks: 25

Time: 45 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

A. Subhadra is conducting statutory audit of a branch of FNB Bank. The branch is having deposits of ₹ 450 crore and advances of ₹ 300 crore respectively reflected in its financial statements as on 31st March 2024. While performing audit procedures, she noticed the following:

1. While reviewing advances of the branch, she came across the following particulars of two cash credit accounts:

| (₹ in crore) | | | | | |
|------------------|------------------|---------------------------|------------------------------|-----------------------|-------------------------|
| Name of borrower | Sanctioned Limit | Value of primary security | Value of collateral security | Net worth of borrower | Net worth of guarantors |
| KT Fab | 10.00 | 20.00 | 15.00 | 5.00 | 3.00 |
| PM Decor | 15.00 | 25.00 | 12.00 | 7.50 | 5.00 |

Following further information is also available in respect of above noted accounts:

Information pertaining to KT Fab

| (₹ in crore) | | |
|--------------|---------------|----------------------|
| As on | Drawing power | Outstanding balances |
| 31.12.2023 | 9.00 | 9.61 |
| 31.01.2024 | 9.25 | 9.55 |
| 28.02.2024 | 9.50 | 9.60 |
| 31.03.2024 | 9.50 | 9.75 |

The outstanding balance in the account has remained more than ₹ 9.50 crore beginning from 31st December, 2023 till 31st March, 2024 on all days.

Information pertaining to PM Décor

| (₹ in crore) | | |
|--------------|---------------|----------------------|
| As on | Drawing power | Outstanding balances |
| 31.12.2023 | 12.00 | 12.50 |
| 31.01.2024 | 12.50 | 12.25 |
| 28.02.2024 | 12.50 | 12.40 |
| 31.03.2024 | 12.50 | 12.50 |

Both units are working and their financial position is satisfactory. The branch has classified both accounts as Standard Assets.

2. On reviewing “Statement of Accounts classified as NPA” as on 31.03.24, she finds that an education loan was granted to son of Mr. X, a customer of bank, for pursuing short duration technical higher studies abroad for ₹ 50.00 lakh sometime back repayable in 5 years. The loan was granted against security of residential house of Mr. X, valuing ₹ 60.00 lakh assessed by bank’s empanelled valuer. However, the name of bank’s empanelled valuer has now been removed due to certain irregularities. Later, value of residential house got reassessed from another valuer and he gave a report reflecting realisable value of residential house for ₹ 20.00 lakh. Meanwhile, the instalments in education loan account are overdue for 110 days as on 31st March, 2024. The account was classified as standard asset till last year i.e., 31st March, 2023.
3. While verifying deposits of the branch, she noticed that inoperative accounts for less than 10 years are to the tune of ₹ 5 crore reflected in the balance sheet of the branch. She plans to focus her audit procedures on this segment too. One of her team members has suggested the following audit procedures in this regard:
 - Verifying whether there exists a system of informing customers on accounts turning inoperative.
 - Identification of cases where there is significant reduction in balances as compared to last year.
 - Testing debits in inoperative accounts.
 - Verifying auto activation of inoperative accounts.
4. While gathering information to be included in LFAR, she comes across some cases of advance accounts which became non-performing within a relatively short span of time. The details of few such identified accounts are as under:

| Account name | Sanctioned amount (₹ in crore) | Nature of facility | Date of first sanction | Date of renewal |
|----------------|--------------------------------|--------------------|------------------------|-----------------|
| ABC Industries | 1.00 | Cash credit | 15/05/23 | Not applicable |
| XY Pvt. Ltd. | 0.50 | Cash credit | 01/07/23 | Not applicable |
| SK & Sons | 1.50 | Cash credit | 04/04/22 | 04/04/23 |
| DK Creations | 0.75 | Term loan | 01/10/23 | Not applicable |

On the basis of the abovementioned facts, you are required to answer the following MCQs:

- Q.1 Keeping in view information stated in respect of two borrower accounts at para (1) of case scenario, which of the following statement is correct? 2**
- (a) The classification made by branch is not proper. Both accounts should be classified as non-performing assets.
- (b) The classification made by branch is not proper. Borrower account of KT Fab should be classified as Standard asset. However, borrower account of PM Décor should be classified as non-performing asset.
- (c) The classification made by branch is not proper. Borrower account of KT Fab should be classified as non-performing asset. However, borrower account of PM Décor should be classified as Standard asset.
- (d) The classification made by branch is proper.
- Q.2 Considering issue relating to education loan described in para (2) of case scenario, how should it be classified in books of branch as on 31st March, 2024? 1**
- (a) Sub-standard asset.
- (b) Doubtful asset.
- (c) SMA.
- (d) Loss asset.
- Q.3 As discussed in para (3) of case scenario, one of team members has suggested certain audit procedures described in case scenario for verification of inoperative accounts. Which of audit procedure(s)/ combination of procedures are relevant in such a situation? 2**
- (a) Identification of cases where there is significant reduction in balances as compared to last year, testing debits in inoperative accounts and verifying auto-activation of inoperative accounts.
- (b) Verifying whether there exists a system of informing customers on account turning inoperative, identification of cases where there is significant reduction in balances as compared to last year and verifying auto activation of inoperative accounts.
- (c) Verifying whether there exists a system of informing customers on account turning inoperative, testing debits in inoperative accounts and verifying auto activation of inoperative accounts.
- (d) Verifying whether there exists a system of informing customers on account turning inoperative, identification of cases where there is significant reduction in balances as compared to last year and testing debits in inoperative accounts.
- Q.4 Quick mortality cases are required to be stated in LFAR by statutory branch auditor. With reference to the particulars in para (4) above, which of the following statement is correct? 2**
- (a) All the four cases reflected in the table in para (4) are quick mortality cases. Quick mortality cases are indicative of shortcomings in credit appraisal.
- (b) Only the case of DK creations is in nature of quick mortality case. Quick mortality cases are indicative of shortcomings in credit appraisal.

- (c) Cases of ABC Industries, XY Pvt Ltd and DK creations are in nature of quick mortality cases. Quick mortality cases are indicative of shortcomings in credit appraisal.
- (d) Cases of XY Pvt Ltd and DK creations are in nature of quick mortality cases. Quick mortality cases are indicative of shortcomings in credit disbursement.

Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt Any two from the rest.

- Q.1 (a) Super Non-Bank Limited, a “Systemically Important Non-Deposit Taking Non-Banking Financial Company”, was operating appropriately till the start of COVID-19 Pandemic. Due to unforeseen conditions during the Pandemic and after that, the operating revenue of the NBFC started decreasing. Following were the position of Net Owned Funds of the company during the last 4 financial years:**

| Financial Year | Net Owned Funds |
|----------------|-----------------|
| FY 20-21 | ₹ 15 Crore |
| FY 21-22 | ₹ 6 Crore |
| FY 22-23 | ₹ 4 Crore |
| FY 23-24 | ₹ 1.5 Crore |

Super Non-Bank Limited appointed Mr Shyam as their statutory auditor for the FY 23-24. Mr Shyam identified that the Net Owned Funds of the company have been less than ₹ 2 Crore since June 2023. Kindly guide Mr Shyam with respect to his reporting requirements as per relevant NBFC provisions.

- (b) CA Smita had joined Indian Audit and Accounts Service after qualifying as a Chartered Accountant. Her initial appointment was in Mumbai office. She was part of team conducting performance audit of a government owned steel company. The said company had undertaken modernization and expansion of its steel plants and the performance audit of company was carried out.**
- Audit team has not yet decided audit approach to be followed for carrying out the performance audit. Guide audit team as to the methods which could be used in conducting performance audits.**

- Q.2 Advances generally constitute the major part of the assets of the bank. There are substantial number of borrowers to whom a variety of advances are granted. The audit of advances requires major attention from the auditors. As an expert in bank audit, you are required to briefly discuss the area of focus and suggested audit procedures regarding the evaluation of internal controls over advances, substantive audit procedures and recoverability of advances.**

- Q.3** Sudhir and Associates, a firm of Chartered Accountants, was appointed as auditor of an NBFC. The audit work has been completed. The audit team which was involved in the fieldwork came across various observations during the course of audit of this NBFC and have also a limited understanding about the exceptions which are required to be reported in the audit report. They would like to understand in detail regarding the obligations on the part of an auditor in respect of exceptions in his report so that they can conclude their work. Please explain. **5**
- Q.4** The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees. In view of above, you are required to list down role of C&AG. **5**

Instructions for submission of answer sheet

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