

PREPARATION AND PRECAUTIONS IN BANK AUDIT

 From Statutory Central Auditors/RBI angle

• About the Resource person

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Presently Independent Director and Audit Committee Chairman of Indbank Housing Ltd. Now practicing as a Chartered Accountant attending Statutory Central/Bank audits, Concurrent audits, Inspection audits, Stock audit, Credit Audit of Various banks and Audit of Insurance Companies and Merchant Banking Financial institutions.

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Classification of Advances and Income Recognition

- To complete the audit efficiently in the limited time frame, a few practical issues you may come across:
 1. What is the context of Statutory Branch Audit?
 2. What is intention of IRAC norms?
 3. What is auditor's responsibility?
 4. What is auditor's duty?
 5. How much time required for completed of Audit?

6. How one can hide NPA?
7. What are the advances that need not be verified for the purposed of classification and income recognition?
8. Where can one should start for verification of compliance of IRAC norms?
9. Where from the period of 90 days is calculated for classification of advances?
10. Where can CC/OD to be classified as NPA for temporary deficiency like excess drawings, insufficient credits, etc,.

11. Where regular adhoc credit limits need to be reviewed/ regularized?

12. How to deal with project under implementation?

13. Whether security cover and net worth of borrower is considered for classification?

14. Whether security cover guarantor or co-obligant is considered for classification?

15. Can security value for loans against except vehicle loans can be taken as NIL for NPA purpose?

16. Can the value of securities for loans against animals/ cattle be taken as NIL?

17. Can Crop agri loan be classified as secured?

18. For valuation of immovable property, whether forced sale value or market value be taken for NPA?

19. What valuation to be taken for fixed assets like Plant and Machinery etc., for NPA whether WDV or as per Valuation report?
20. What if such valuation is more than 3yrs old or such assets are obsolete?
21. Whether stock and debtors older than 6 months can be taken as NIL (Except Teak Wood, Sovereign Bond)?

22. Whether Plant & Machineries of units/ factories closed for more than 12 months can be taken as NIL for NPA?
23. Intangible assets as security in an NPA account how to consider?(Film rights, lease deed, Artificial Intelligence)
24. How the verification of Stock of Turmeric can be done by the Auditor?

25. An advance sanctioned as a “loan against property” and the same is used for payment of irregular portion of another advance, whether the new advance is NPA from day one as “ever greening”. What is the position if the entire facility is under “restructured” duly sanctioned by competent authority?
26. An advance is sanctioned to some other party against fresh security to clearing the irregularity of existing NPA advance

SYSTEM FAILURE

27. When the auditor finds that basic data, input like repayment schedule, date of stock statement, drawing limit etc., are not correctly filled up or wrongly filled up for some advances for which it affects classification, income recognition, provisioning etc., thereby affecting the true and fair view of final accounts.

- Can the auditor qualify?

28. When the system fails to classify advances/ recognizes income as per RBI norms, and auditor is not able to estimate the impact either at the Branch level or at the Bank level. Can the auditor qualify his report?
29. When the date of NPA of earlier years found changed, apart from correcting the date and relevant provisioning. What is the auditor's position?

30.Can funded interest on term loans (FITL), what is the provision required?

31.In case of advances guaranteed by ECGC, what provision to be made?

32.What a branch auditor can do when MOC is not agreed upon by the Branch Manager?

33. What is to be done in case LCs / LGs / LOCs (Letter of Creditworthiness)

- If it is not invoked?
- If it is invoked?

34. What if a CC/OD is regularized after balance sheet date?

35. How MOCs to be prepared?

ADVANCES

What types of Advances are prohibited by banks, to be availed by banks?

- Statutory Restrictions
- Regulatory Restrictions
- Restriction on other Loans & Advances

STATUTORY RESTRICTIONS

Advances against its own shares(Section 20(1) of Banking Regulations Act 1949)

Banks are prohibited from entering into any commitment for granting any loan or advance to or on behalf of:

1. Any of its directors
2. Any firm in which any of its directors is interested as partners, Manager, employee or guarantor.

Section 20A of the Banking Regulations Act 1949 stipulates No banking company shall, except with prior approval of RBI, remit in whole or part of any debt due to it by:

(a) Any of its Directors

(b) Any firm or company in which any of its directors is interested as partners, Manager, employee or guarantor.

REGULATORY RESTRICTIONS

- Without the approval of the Board, no loans and advances should be granted to the relatives of the bank's directors or directors of other banks and their relative, directors/relatives of subsidiaries or associated organizations

Restrictions on Loans and Advances to officers and relatives of senior officers of Bank.

[Exceptions are Loans & Advances as per rules and conditions of service applicable to officers or employees of Public Sector Banks, precaution to be observed while sanctioning.]

- Rule regarding sanction of Loans and Advances are equally applicable to relatives of Senior Officers of the bank will apply to the relatives of Senior Officers of all the participating banks.

- Advances against others bank's Fixed Deposit Receipts
- No loans and advances against gold bullion, primary gold etc., but not on gold Jewelry as securities.
- Caution on loans and advances to public against shares, debentures and bonds, caution to be exercised on margin, purpose, amount, policy of the bank.

- Stock statements certified by an auditor for bank purpose as on 31.03.XXXX must tally with closing stock shown as in relevant audited Balance sheet.
- Invariably the stocks shown in the Balance sheet does not tally with Stock statement given for the Bank.

- In case, Balance sheet stock value is less than the stock value given for the bank, the Drawing Power has to be reworked and penal interest to be collected if the outstanding balance exceeds the drawing limit.
- Secured and unsecured portion also be altered to that extent.
- The practice of getting different auditor's certificate for the same period to be avoided.

- Dealing of unpaid stock and margin on stock value, Auditor should peruse the stock statement submitted by the borrower and verify whether correct margin specified in the sanction ticket and unpaid stock are deducted for arriving at the drawing power.
- In case drawing power is less if the above exercise is done then penal interest to be collected for the short fall.

When the loans and advances will become NPA
by the mistake of the Bank's fault:

- (a) When the loans and advances has not been reviewed or renewed within the prescribed time.
- (b) When the stock statements obtained by the bank from the borrowers is older than 6 months

FRAUDS IN BANKS

- Frauds against the bank can be committed either internally by the employees, managers, officers, or owners of the bank or externally by customers, vendors, and other parties.
- RBI prescribes that the bank should conduct quarterly and annual review of frauds and apprise the Board regarding findings and action taken.

- What is the duty of the auditor when he finds a fraud during his audit?
- Reporting to the CMD of the bank if the amount of fraud exceeds Rs. 10 lakhs
- Reporting to RBI if the value of fraud exceeds Rs. 1 crore.
- Insists for provision of 100%

ANTI-MONEY LAUNDERING

- “Conversion of dirty money into clean money”. Money laundering is the practice of engaging transactions in order to conceal the identity, source, and/or destination of money and is a main operation of the underground economy.
- High risk, Less risk and No risk category of accounts – KYC Norms.

- RBI Expectations from the Statutory Central and Branch auditors
- Compliance in strict following laws, rules, regulations, bank's internal rules, policies and procedures, adherence to fair practice codes, statutory and regulatory compliance.

- The auditors will have to ensure that balance sheets not only disclose the difference between the RBI's observations for the previous financial year and the corresponding audited accounts, and also to ensure provision for it in the current year.
- Due to high NPAs and increase of willful defaulters, RBI expects the auditors to anticipate the inherent weakness in the advances.

- RBI in its release on framework for bank auditors has proposed for enforcement action on auditors if they were found lapsing in their duties.
- In instances of divergences, bank auditors too would be questioned, examined, and later penalized if found lapsing.
- When the divergence between AFI Team of RBI and the auditor exceeds 10% in NPAs, then the auditors will get love letter from RBI to explain about the difference.

- Profit and Loss account, Audit report.

- Qualification subject to:

(a) Provision for NPAs

(b) Provision for Frauds.

(c) Payment of GST, Income tax

(d) Provision for Depreciation

(e) Provision on Standard assets

(f) Provision for Bonus, Gratuity, PF, Pension.

Now your turn for raising questions on this topic.

THANK YOU

For your Patience and Participation.