CHAPTER 12

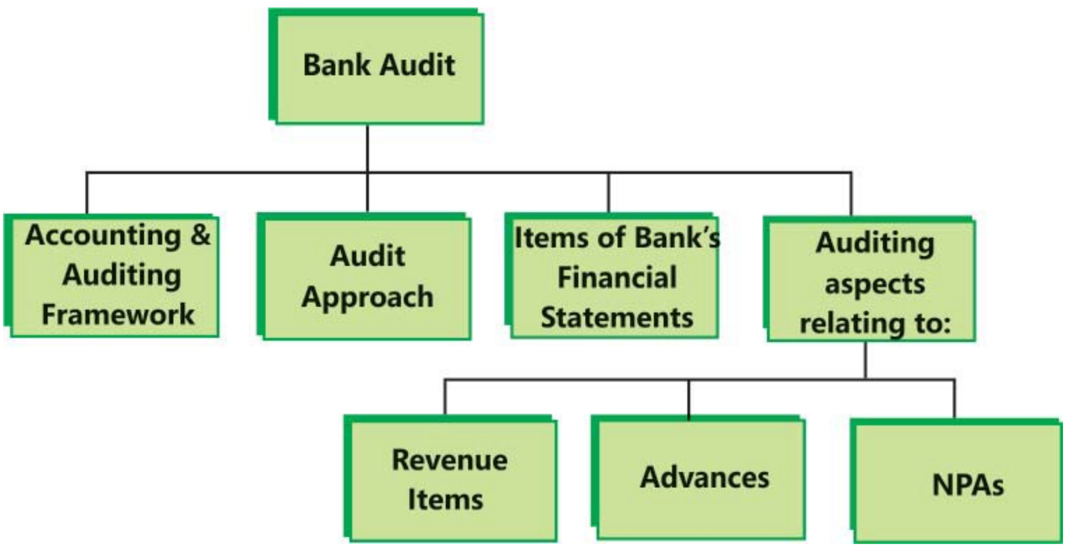
AUDIT OF BANKS

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ❑ Understand the legal framework for the bank audit.
- ❑ Gain the knowledge of financial statements of the banks in brief.
- ❑ Understand the audit approach for items of profit and loss in case of banks.
- ❑ Learn the important items such as Advances, NPAs etc. and related audit

CHAPTER OVERVIEW



INTRODUCTION

After having read the basics of audit and all related concepts in previous chapters, now is time to apply all that knowledge gained to conduct the audit of banks.

Source of image: busy buddie

You might have done Online Shopping or purchased a Flight or Rail or Bus ticket online. You must have definitely booked a Hotel room for yourself or your family online. Gone are those days when you used to stand up in queue to pay your Electricity Bills , Telephone or Mobile Bills , etc. Because of the advent of modern technology of making payments and to make these payments , we use money held in our Bank accounts. There are some online facilities which are available 24x7.

A number of peculiarities are associated with the banking work and one always wonders how are such complex transactions performed , regulated and monitored . Regulation and Monitoring of Banks is a very important task in any economy because of the strategic importance associated with this sector.

Banking sector is the backbone of any economy as it is essential for sustainable socio-economic growth and financial stability in the economy. The banking sector is also crucial as it deals with mammoth amounts of public monies and is highly sensitive to reputational risk. Like all economic activities, the banking sector is also exposed to various risks in its operations. It is of utmost importance to ensure that banking sector stays healthy, safe and sound. For safe and sound banking sector, one of the most important factors is reliable financial information supported by quality bank audits.

Types of Banks

There are different types of banking institutions prevailing in India which are as follows:

Commercial Banks.	**Regional Rural Banks.**
Co-operative Banks.	Payment Banks.
Development Banks (more commonly known as 'Term-Lending Institutions').	Small Finance Banks.

1. Commercial banks are the most wide spread banking institutions in India, that provide a number of products and services to general public and other segments of economy. Two of its main functions are:-

(a) accepting deposits and

(b) granting advances.

2. Regional Rural Banks known as ***RRBs*** are the banks that have been set up in rural areas in different states of the country to cater to the basic banking and financial needs of the rural communities. **Examples are** :- *Punjab Gramin Bank , Tripura Gramin Bank , Allahabad UP Gramin Bank , Andhra Pradesh Grameen Vikas Bank, etc.*

3. Co-operative Banks function like Commercial Banks only but are set up on the basis of Cooperative Principles and registered under the Cooperative Societies Act of the respective state or the Multistate Cooperative Societies Act and usually cater to the needs of the agricultural and rural sectors. **Examples are** :- *The Gujarat State Co-operative Bank Ltd. , Chhatisgarh Rajya Sahakari Bank Maryadit , etc.*

4. Payments Banks are a new type of banks which have been recently introduced by RBI. They are allowed to accept restricted deposits but they cannot issue loans and credit cards. However , customers can open Current & Savings accounts and also avail the facility of ATM cum Debit cards , Internet-banking & Mobilebanking. **Examples are** :- *Airtel Payments Bank , India Post Payments Bank, Paytm Payments Bank , etc.*

5. Development Banks had been conceptualized to provide funds for infrastructural facilities important for the economic growth of the country. **Examples are**:- *Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI) , etc.*

6. Small Finance Banks have been set up by RBI to make available basic financial and banking facilities to the unserved and **unorganised** sectors like small marginal farmers, small & micro business units, etc. **Examples are**:- *Equitas Small Finance Bank , AU Small Finance Bank , etc.*

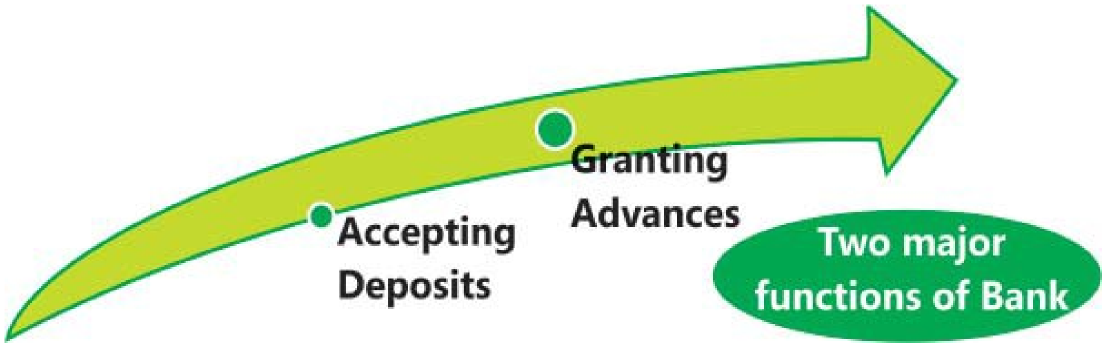


Diagram showing Two Major Functions of Banks

Source :- twitter.com

Reserve Bank of India: Regulating Body

The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country.

RBI is responsible for :-

- development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions)
- determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour.
- regulating the activities of commercial and other banks

Important functions of RBI are :-

- issuance of currency;
- regulation of currency issue;

- acting as banker to the central and state governments; and
- acting as banker to commercial and other types of banks including term-lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks.

No bank can commence the business of banking or open new branches without obtaining license from RBI. The RBI also has the power to inspect any bank.

Independent audit of financial statement of banks is important for a healthy, safe and sound banking system.

Banking Operations - Conducted only at Branches

Banking operations are conducted only at the branches, while other offices act as controlling authorities or administrative offices that lay down policies, systems and internal control procedures for conduct of business, in compliance with the statutory/ regulatory impositions and in compliance of accepted accounting principles and practices that cover all transactions and economic events. These controlling/ administrative offices also stipulate the delegation of powers and fix responsibilities and accountability and these are involved generally in effective supervision, monitoring and control over the business activities and operations, including seeking faithful compliance of the bank's laid down policies/ procedures /controls and deal with deviations therefrom.

Regulatory Framework

Banking Regulation Act, 1949.	State Bank of India Act, 1955.
Companies Act, 2013.	State Bank of India (Subsidiary Banks) Act 1959.
Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.	
Regional Rural Banks Act, 1976.	
Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.	
Information Technology Act, 2000.	Prevention of Money Laundering Act, 2002.
Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.	
Credit Information Companies Regulation Act, 2005.	
Payment and Settlement Systems Act, 2007.	

Besides, the above enactments, the provisions of the Reserve Bank of India Act, 1934, (RBI Act) also affect the functioning of banks. The RBI Act gives wide powers to the RBI to give directions to banks which also have considerable effect on the functioning of banks.

Peculiarities involved:

- Huge volumes and complexity of transactions;
- Wide geographical spread of banks' network;
- Large range of products and services offered;
- Extensive use of technology;
- Strict vigilance by the banking regulator etc.

Types of Bank Audit Reports to be issued (generally):

Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

(a) Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.

(b) Long Form Audit Report. (LFAR)

(c) Report on compliance with SLR requirements.

(d) Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.

(e) Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.

(f) Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.

(g) Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.

(h) Report on instances of adverse credit-deposit ratio in the rural areas.

1. UNDERSTANDING OF ACCOUNTING SYSTEM IN BANKS

From the time that customers had to physically visit and deal with a bank, there is a sea change in banking as use of technology and its continuous evolution has enabled banks to reach their customers in providing them the convenience and comfort of *anytime-anywhere-banking* by letting them access their information/data on real time basis, as stored in a safe and secure environment on the bank's servers. With many customers having access to Internet and mobile connectivity, monetary transactions from inception to finish have become expeditious through E-banking; but for Core banking technology and extensive advancement therein and the availability and extensive use of technology tools, banks could not have achieved such phenomenal and accelerated growth, and could not have ventured into and offered a wide range of innovative products and services to their customers. The transactions in banks have become voluminous and it needs to be ensured that in the system of recording, transmission and storage of information/ data, integrity thereof is optimally maintained and control systems ensure that the same is free of errors, omissions, irregularities and frauds. Considering the challenges of technology, bank managements continuously endeavor to make their internal control systems robust, safe and secure as well as convenient and expeditious for the customers.

Banks may be divided into three board categorises based on the level of computerisation:

- ***Non-computerised banks*** :- Transactions can be done only at bank branches during working hours using paper and pen.
- ***Partially computerised banks*** :- Some transactions are computerised while major are non-computerised.
- ***Fully computerised banks***:- Core banking *allows inter-connectivity between branches of the same* bank and with CBS , customers can operate their accounts as well as avail banking services from any branch of the bank over the network

In the computerized environment, it is imperative that the auditor is familiar with and satisfied that all the norms/parameters as per the latest applicable RBI guidelines are incorporated and built into the system that generates information/data having a bearing on the classification/ provisions and income recognition. The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on the required parameters. He should use Professional Skepticism and Prudence wherever he feels that something manually needs to be performed to check the authenticity and consistency of the information obtained from the systems and document the results of such activities performed.

BANKING SYSTEM

Computerized	Non- Computerized
All banking activities are done using computer system	Banking system done manually
Transaction- anywhere, anytime	Transaction only made during working hours
Banking process – shorten times	Takes long time for any banking process
More productive	Less productive

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Source :- slideshare.net

2. BANK AUDIT APPROACH

1. Drawing an Audit Plan :- An audit plan should be drawn up based on :-

♦ the nature and level of operations,

♦ nature of adverse features,

♦ level of compliance based on previous reports and

♦ audit risks based on inadequacy in or breach of internal controls and the familiarization exercise carried out,

2. Control Environment at the Bank :- A bank should have appropriate controls to mitigate its risks, including effective segregation of duties (particularly, between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.

The following are certain common questions /steps, which have to be kept in mind while undertaking/ performing control activities:

Nature of Questions	Questions to be considered / answered
Who	• Who performs the control? • Does the above person have requisite knowledge and authority to perform the control?
What	• What evidence is available to demonstrate /prove that the control is performed?
When	• When and with what frequency is the control performed? • Is the frequency enough to prevent, detect and correct
Where	• Where is the evidence of performance of the control retained? • For how long is the evidence retained? • Is the evidence accessible/ available for audit?
Why	• Why is the control being performed? • What type of errors are prevented or detected through the performance of the control?
How	• How is the control performed? • What are the control activities? • Can these activities be bypassed? • Can the bypass, if any, be detected? • How are exceptions / deviations resolved on identification? • What is the time frame for resolving the exceptions /

3. Engagement Team Discussions : All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement are known to be the " Engagement Team". The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference. The discussion between the members of the engagement team and the audit engagement partner should be done on the susceptibility of the bank's branch financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

The engagement team discussion ordinarily includes a discussion of the following matters:

(a) Errors that may be more likely to occur;

(b) Errors which have been identified in prior years;

(c) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;

(d) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;

(e) Need to maintain professional skepticism throughout the audit engagement;

(f) Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

Advantages of such a discussion :-

- Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
- Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

3. INCOME RECOGNITION POLICY

The policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Income from non-performing assets (NPA) is not recognized on accrual basis but is booked as income only when it is actually received. *(Dealt in detail later on)*

4. FORM AND CONTENT OF FINANCIAL STATEMENTS

Sub-sections (1) and (2) of Section 29 of the Banking Regulations Act, 1949 deal with the form and content of financial statements of a banking company and their authentication. These sub-sections are also applicable to nationalised banks, State Bank of India, subsidiaries of the State Bank of India, and Regional Rural Banks.

Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit. Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.

Every banking company needs to comply with the disclosure requirements under the various Accounting Standards, as specified under section 133 of the Companies Act, 2013, read with Rule 7 of the Companies (Accounts) Rules 2014, in so far as they apply to banking companies or the Accounting Standards issued by the ICAI.

5. AUDIT OF ACCOUNTS

Sub-section (1) of section 30 of the Banking Regulations Act, 1949 requires that the balance sheet and profit and loss account of a banking company should be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

6. ELIGIBILITY, QUALIFICATIONS AND DISQUALIFICATIONS OF AUDITOR

Refer Section 141 of the Companies Act, 2013 discussed in the "Chapter-10 The Company Audit".

7. APPOINTMENT OF AUDITOR

As per the provisions of the relevant enactments:-

- The auditor of a banking company is to be appointed at the annual general meeting of the shareholders,
- The auditor of a nationalised bank is to be appointed by the bank concerned acting through its Board of Directors.

  (In either case, approval of the Reserve Bank of India is required before the appointment is made.)

- The auditors of the State Bank of India are to be appointed by the Comptroller and Auditor General of India in consultation with the Central Government.
- The auditors of the subsidiaries of the State Bank of India are to be appointed by the State Bank of India.
- The auditors of regional rural banks are to be appointed by the bank concerned with the approval of the Central Government.

8. REMUNERATION OF AUDITOR

(a) The remuneration of auditor of a banking company is to be fixed in accordance with the provisions of Section 142 of the Companies Act, 2013 (i.e., by the company in general meeting or in such manner as the company in general meeting may determine).

(b) The remuneration of auditors of nationalised banks and State Bank of India is to be fixed by the Reserve Bank of India in consultation with the Central Government.

9. POWERS OF AUDITOR

The auditor of a banking company, nationalised bank, State Bank of India, subsidiary of State Bank of India or regional rural bank has the same powers as those of a company's auditor in the matter of access to the books, accounts, documents and vouchers.

10. AUDITOR'S REPORT

In the case of a nationalised bank, the auditor is required to make a report to the Central Government in which he has to state the following:

(a) whether, in his opinion, the financial statements present a true and fair view of the affairs of the bank and in case he had called for any explanation or information, whether it has been given and whether it is satisfactory;

(b) whether or not the transactions of the bank, which have come to his notice, have been within the powers of that bank;

(c) whether or not the returns received from the offices and branches of the bank have been found adequate for the purpose of his audit; and

(d) any other matter which he considers should be brought to the notice of the Central Government.

The report of auditors of State Bank of India is also to be made to the Central Government and is almost identical to the auditor's report in the case of a nationalised bank.

10.1 Format of Report

The auditors, central as well as branch, should also ensure that the audit report issued by them complies with the requirements of Standards on Auditing discussed in Chapter 11 on Audit Report. The auditor should ensure that not only information relating to number of unaudited branches is given but quantification of advances, deposits, interest income and interest expense for such unaudited branches has also been disclosed in the audit report. Such disclosure in the audit report is not only in accordance with the best international trends but also provides useful information to users of financial statements.

It may be noted that, in addition to the aforesaid, the auditor of a banking company is also required to state in his report the matters covered by Section 143 of the Companies Act, 2013. **However, it is pertinent to mention that the reporting requirements relating to the Companies (Auditor's Report) Order, 2016 is not applicable to a banking company, as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949.**

10.2 Long Form Audit Report

Besides the audit report as per the statutory requirements discussed above, the terms of appointment of auditors of public sector banks, private sector banks and foreign banks (as well as their branches), require the auditors to also furnish a long form audit report (LFAR). The matters which the banks require their auditors to deal with in the long form audit report have been specified by the Reserve Bank of India.

The LFAR is to be submitted before 30th June every year. To ensure timely submission of LFAR, proper planning for completion of the LFAR is required. While the format of LFAR does not require an executive summary to be given, members may consider providing the same to bring out the key observations from the whole document.

10.3 Reporting to RBI

1. The RBI issued a Circular relating to implementation of recommendations of Committee on Legal Aspects of Bank Frauds applicable to all scheduled commercial banks (excluding Regional Rural Banks). Regarding liability of

accounting and auditing profession, the said circular provided as under:

"**If an accounting professional, whether in the course of internal or external audit or in the process of institutional audit finds anything susceptible to be fraud or fraudulent activity or act of excess power or smell any foul play in any transaction, he should refer the matter to the regulator. Any deliberate failure on the part of the auditor should render himself liable for action".**

As per the above requirement, the member shall be required to report the kind of matters stated in the circular to RBI.

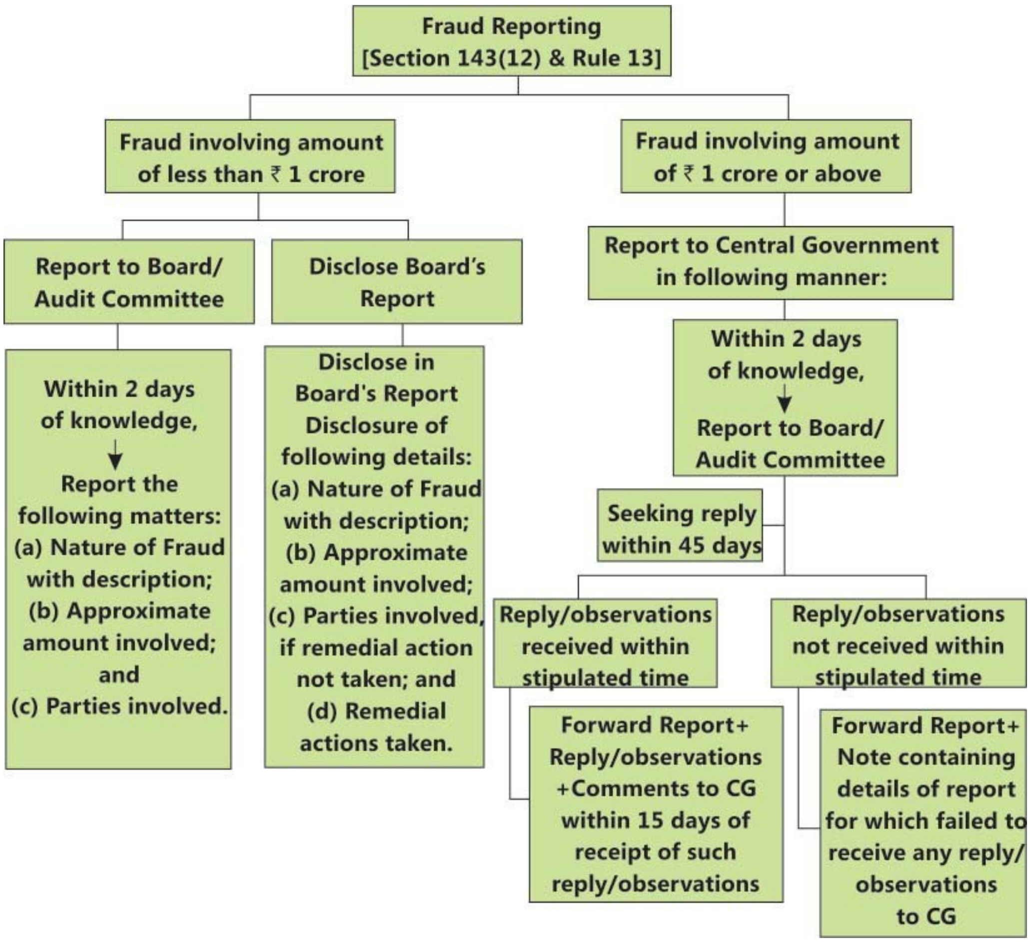
2. Auditor should also consider the provisions of **SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements"**. The said Standard explains that the duty of confidentiality is over-ridden by statute, law or courts.

3. SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" states that an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

It must be noted that auditor is not expected to look into each and every transaction but to evaluate the system as a whole. Therefore, if the auditor while performing his normal duties comes across any instance, he should report the matter to the RBI in addition to Chairman/Managing Director/Chief Executive of the concerned bank.

10.4 Duty to report on Frauds under the Companies Act, 2013

As per sub-section 12 of section 143 of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed. Students may refer Chapter 5 - Fraud and Responsibilities of the Auditor in this regard for a detailed understanding , however , a summary is being reproduced below as follows :-



11. CONDUCTING AN AUDIT

The audit of banks or their branches involves the following stages –

1. Initial consideration by the statutory auditor

(i) Declaration of Indebtedness: The RBI has advised that the banks, before appointing their statutory central/branch auditors, should obtain a declaration of indebtedness. Indebtedness refers to the situation of owing money to the bank in any case , whatsoever.

(ii) Internal Assignments in Banks by Statutory Auditors: The RBI decided that the audit firms should not undertake statutory audit assignment while they are associated with internal assignments in the bank during the same year , like Concurrent audits (Internal Audit of Banks conducted monthly during the year)

(iii) Planning: Standard on Auditing **(SA) 300, "Planning an Audit of Financial Statements"** requires that the auditor shall undertake the following activities prior to starting an initial audit:

(a) Performing procedures required by SA 220, "Quality Control for Audit Work" regarding the acceptance of the client relationship and the specific audit engagement; and

(b) Establish understanding of terms of engagement as per **SA 210, "Agreeing the Terms of Audit Engagements".**

(iv) Communication with Previous Auditor: As per Clause (8) of the Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice cannot accept position as auditor previously held by another chartered accountant without first communicating with him in writing. He should get a NO Objection Certificate (NOC) from the previous auditor through this communication as to know whether he has any objections to such an appointment made, for any valid reasons.

(v) Terms of Audit Engagements: **SA 210, "Terms of Audit Engagements"** requires that for each period to be audited, the auditor should agree on the terms of the audit engagement with the bank before beginning significant portions of fieldwork. It is imperative that the terms of the engagement are documented, in order to prevent any confusion as to the terms that have been agreed in relation to the audit and the respective responsibilities of the management and the auditor, at the beginning of an audit assignment.

(vi) Initial Engagements: The auditor needs to perform the audit procedures as mentioned in **SA 510 "Initial Audit Engagements-Opening Balances"** and if after performing that procedures, the auditor concludes that the opening balances contain misstatements which materially affect the financial statements for the current period and the effect of the same is not properly accounted for and adequately disclosed, the auditor should express a qualified opinion or an adverse opinion, as appropriate.

(vii) Assessment of Engagement Risk: The assessment of engagement risk is a critical part of the audit process and should be done prior to the acceptance of an audit engagement since it affects the decision of accepting the engagement and also in planning decisions if the audit is accepted.

(viii) Establish the Engagement Team: The assignment of qualified and experienced professionals is an important component of managing engagement risk. The size and composition of the engagement team would depend on the size, nature and complexity of the bank's operations.

(ix) **Understanding the Bank and its Environment: SA 315 "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"** lays down that the auditor should obtain an understanding of the entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error and sufficient to design and perform further audit procedures.

2. **Identifying and Assessing the Risks of Material Misstatements:** SA 315 requires the auditor to identify and assess the risks of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances and disclosures to provide a basis for designing and performing further audit procedures.

3. **Understanding the Bank and Its Environment including Internal Control:** An understanding of the bank and its environment, including its internal control, enables the auditor:

- to identify and assess risk;
- to develop an audit plan so as to determine the operating effectiveness of the controls and to address the specific risks.

4. **Understanding the Bank's Accounting Process:** The accounting process produces financial and operational information for management's use and it also contributes to the bank's internal control. Thus, understanding of the accounting process is necessary to identify and assess the risks of material misstatement whether due to fraud or not and to design and perform further audit procedures.

5. **Understanding the Risk Management Process:** Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

(a) **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (Board of Directors/Managing Director) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.

(b) **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.

(c) **Control activities:** A bank should have appropriate controls to mitigate its risks including effective segregation of duties (particularly between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.

(d) **Monitoring activities:** Risk management models, methodologies and assumptions used to measure and mitigate risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.

(e) **Reliable information systems:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

source – educba.com

6. **Engagement Team Discussions:** The engagement team should hold discussions to gain better understanding of banks and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements.

7. **Establish the Overall Audit Strategy: SA 300 "Planning an Audit of financial Statements"** states that the objective of the auditor is to plan the audit so that it will be performed in an effective manner. For this purpose, the audit engagement partner should:

- establish the overall audit strategy, prior to the commencement of an audit; and
- involve key engagement team members and other appropriate specialists while establishing the overall audit strategy, which depends on the characteristics of the audit engagement.

8. **Develop the Audit Plan**: **SA 300** deals with the auditor's responsibility to plan an audit of financial statements in an effective manner. It requires the involvement of all the key members of the engagement team while planning an audit.

9. **Audit Planning Memorandum**: The auditor should summarise the audit plan by preparing an audit planning memorandum in order to:

- Describe the expected scope and extent of the audit procedures to be performed by the auditor.
- Highlight all significant issues and risks identified during their planning and risk assessment activities, as well as the decisions concerning reliance on controls.
- Provide evidence that they have planned the audit engagement appropriately and have responded to engagement risk, pervasive risks, specific risks, and other matters affecting the audit engagement.

10. **Determine Audit Materiality:** The auditor should consider the relationship between the audit materiality and audit risk when conducting an audit. The determination of audit materiality is a matter of professional judgment and depends upon the knowledge of the bank, assessment of engagement risk and the reporting requirements for the financial statements.

11. **Consider Going Concern:** While obtaining an understanding of the bank, the auditor should consider whether there are events and conditions which may cast significant doubt on the bank's ability to continue as a going concern.

12. **Assess the Risk of Fraud including Money Laundering**: As per **SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"**, the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. The RBI has from time to time issued guidelines ("Know Your Customer Guidelines – Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

13. Assess Specific Risks: The auditors should identify and assess the risks of material misstatement at the financial statement level which refers to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions.

14. Risk Associated with Outsourcing of Activities: The modern day banks make extensive use of outsourcing as a means of both reducing costs as well as making use of services of an expert not available internally. There are, however, a number of risks associated with outsourcing of activities by banks and therefore, it is quintessential for the banks to effectively manage those risks.

15. Response to the Assessed Risks: **SA 330 "The Auditor's Responses to Assessed Risks"** requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. The auditor should design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

16. BASEL III framework: Basel norms or accords are the International Banking regulations issued by the BCBS. The Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) has undertaken an extensive review of the regulatory framework in the wake of the sub-prime crisis. In the document titled 'Basel III: A global regulatory framework for more resilient banks and banking systems', released by the BCBS in December 2010, it has inter alia proposed certain minimum set of criteria for inclusion of instruments in the new definition of regulatory capital. The set of agreement by the BCBS, which mainly focuses on risks to banks and the financial system are called Basel accord.

17. Reliance on / review of other reports: The auditor should take into account the adverse comments, if any, on advances appearing in the following-

- Previous year's audit reports.
- Latest internal inspection reports of bank officials.
- Reserve Bank's latest inspection report.
- Concurrent / Internal audit report.

- Report on verification of security.
- Any other internal reports specially related to particular accounts.
- Manager's charge-handing-over report when incumbent is changed.

The above reports should be reviewed in detail. The Statutory Central Auditors must review the Annual Financial Inspection report of RBI relating to the bank and ensure that the variations in provisions, etc. reported by RBI have been properly considered by the bank management.

In carrying out his substantive procedures, the auditor should examine all large advances while other advances may be examined on a sampling basis. The accounts identified to be problem accounts, however, need to be examined in detail unless the amount involved is insignificant. The extent of sample checking would also depend on the auditor's assessment of efficacy of internal controls. What constitutes a 'large advance' would need to be determined in the context of volume of operations of the branch e.g. an advance may be considered to be a large advance if the year-end balance is in excess of 2 crore or 5% of the aggregate year-end advances of the branch, whichever is less.

12. ADVANCES

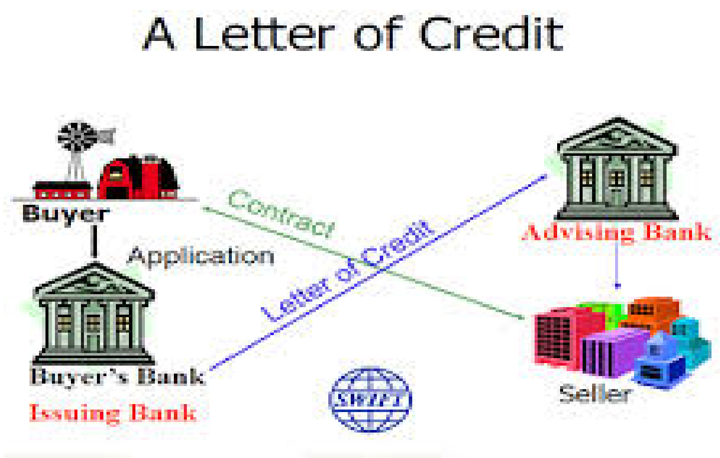
Lending constitutes a major activity of a bank besides the investment function. The core business of banks is accepting deposits for onward lending.

Advances are amount of money or credit, given as a loan from a bank to another party with an agreement that the money will be repaid. All Bank Loans are made at interest which is a compensation for borrowing. Advances, generally, constitute the largest item on the assets side of the balance sheet of a bank and are major source of its income. Audit of advances is one of the most important areas covered by auditors in bank audit. It is necessary that auditors should have adequate knowledge of the banking industry and the regulations governing the banks. Auditors must be aware of the various functional areas of the bank/branches, its processes, procedures, systems and prevailing internal controls with regard to advances.

Types of Advances :- *Funded Loans & Non-Funded Loans*

- **Funded** loans are those loans where there is an actual transfer of funds from the bank to the borrower. **Examples of funded loans** are Term loans, Cash credits, Overdrafts, Demand Loans, Bills Discounted and Purchased, Participation on Risk Sharing basis, Interest-bearing Staff Loans.

♦ **<u>Non-funded</u>** facilities are those which do not involve such transfer. **<u>Examples of non-funded loans are</u>** Letters of credit, Bank guarantees, etc.



source :- opentoexport.com

12.1 What do ADVANCES comprise:

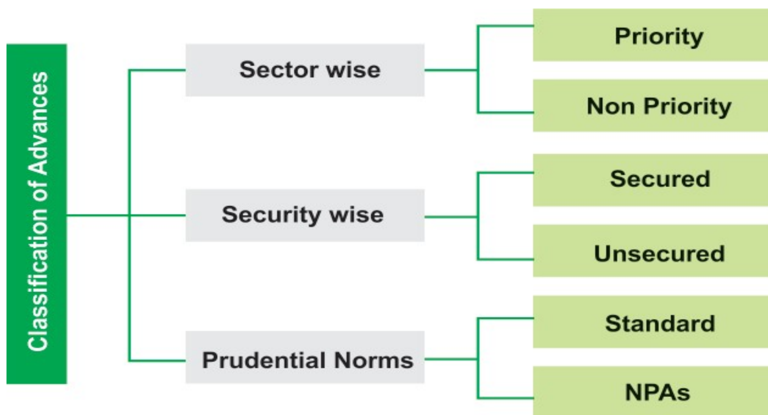
Advances comprise of funded amounts by way of:

- Term loans :-
- Cash credits, Overdrafts, Demand Loans
- Bills Discounted and Purchased
- Participation on Risk Sharing basis
- Interest-bearing Staff Loans

12.2 Legal requirements of Disclosure in the Balance Sheet:

A.	(i)	Bills purchased and discounted
	(ii)	Cash credits, Overdrafts and loans repayable on demand
	(iii)	Term Loans
B.	(i)	Secured by tangible assets
	(ii)	Covered by Bank/Government guarantees
	(iii)	Unsecured

C. I. Advances in India:	C. II. Advances outside India:
(i) Priority sectors	(i) Due from Banks
(ii) Public sector	(ii) Due from Others:
(iii) Banks	(a) Bills Purchased and discounted
(iv) Others	(b) Syndicated loans
	(c) Others



12.3 Classification of Advances

12.3.1 SECTOR WISE

RBI issues common guidelines for lending to Priority Sector which banks are required to follow. These guidelines cover rate of interest; service charges, receipt, sanction, rejection, disbursement Register; issue of Loan Application Acknowledgement. RBI also issues targets for banks for lending to Priority Sector.

Examples of Priority Sectors are Agriculture , MSME , Education , Housing , etc.

source:-neoioscape.com

12.4 SECURITY WISE

Banks ask Security or Collateral while lending to assure that the Borrower will return the money to bank in prescribed time else the Banks have legal authority to sell the collateral to recover its money.

Nature of Security

A. **Primary security** refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.

B. **Collateral security** is an additional security. Security can be in any form i.e. tangible or intangible asset, movable or immovable asset.

Examples of most common types of securities accepted by banks are the following:

- Personal Security of Guarantor
- Goods/Stocks/Debtors/Trade Receivables
- Gold Ornaments and Bullion
- Immovable Property
- Plantations (For Agricultural Advances)
- Third Party Guarantees
- Banker's General Lien
- Life Insurance Policies
- Stock Exchange Securities and Other Instruments

12.5 Mode of Creation of Security

Depending on the nature of the item concerned, creation of security may take the form of a mortgage, pledge, hypothecation, assignment, set-off or lien.

(i) Mortgage: Mortgage are of several kinds but the most important are the Registered Mortgage and the Equitable Mortgage.

source :- forbes.com

- **Registered Mortgage** can be affected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security.

- **Equitable mortgage**, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

(ii) Pledge: A pledge thus involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.

(iii) Hypothecation: The hypothecation is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower.

source :- 91wheels.com

Neither ownership nor possession is transferred to the bank. However, the borrower holds the physical possession of the goods as an agent/trustee of the bank.

The borrower periodically submits statements regarding quantity and value of hypothecated assets (stocks, debtors, etc.) to the lending banker on the basis of which the drawing power of the borrower is fixed.

source :- indiamart.com

(iv) Assignment: Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favor of another person. Only actionable claims (i.e., claim to any debt other than a debt secured by a mortgage of immovable property or by hypothecation or pledge of moveable property) such as book debts and life insurance policies are accepted by banks as security by way of assignment.

An assignment gives the assignee absolute right over the moneys/debts assigned to him.

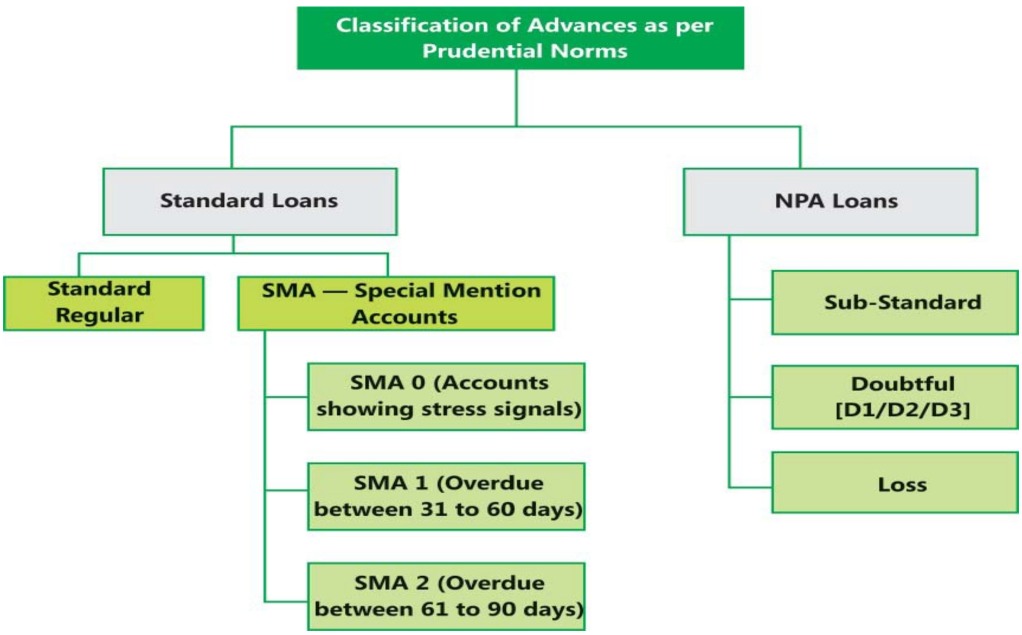
(v) Set-off: Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set-off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right (i.e., the capacity of the account holder in both the accounts should be the same).

For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.

(vi) Lien: Lien is creation of a legal charge with consent of the owner, which gives lender a legal right to seize and dispose / liquidate the asset under lien.

12.6 Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances:

Classification of Advances as per RBI Prudential Norms



(i) Non-performing Assets: An asset becomes NPA when it ceases to generate income for the Bank.

A non-performing asset (NPA) is a loan or an advance where -:

- interest and/ or installment of principal remain overdue for a period of more than 90 days in respect of a term loan;
- the account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/ CC);
- the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

(ii) Out of Order: An account should be treated as 'out of order' if:-

- ♦ the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- ♦ In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet ; or
- ♦ credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

<u>Example</u> :- A Ltd. has been sanctioned a Cash Credit Facility by ADB Bank Ltd. for INR 50 lacs but as per the Stock Statements furnished for the last quarter , the Bank has calculated the Drawing power to be INR 42 Lakhs. In this case, the account would be termed as OUT OF ORDER if :-

- ♦ the outstanding balance remains continuously in excess of the INR 50 lacs/42 lacs whatever the case may be ; or
- ♦ The outstanding balance in the account is less than INR 42 lacs but there are no credits or any payments deposited into this account continuously for 90 days as on the date of Balance Sheet ; or
- ♦ credits are there upto say INR 2 lakhs but are not enough to cover the interest debited during the same period which is around INR 5 lakhs.

(iii) Overdue: Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Source :- inventiva.co.in

REPORT CARD

Standalone data (₹ crore)

Quarter ended	Mar,'19	% Chg*
Net interest income	5,066.96	**26.6**
Total income	15,284.59	**20.0**
Provisions & contingencies	5,399.29	**-19.1**
Taxes	-547.13	**-**
Net profit	-991.37	**Loss**
Gross non-performing assets	48,232.77	**-14.6**
Net non-performing assets	15,609.5	**-33.5**

* Change over YoY; Compiled by *BS* Research Bureau
Source: Press release

Source :- business-standard.com

Categories of Non-Performing Assets:	Provision required
• **Substandard Assets:** Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
• **Doubtful Assets:** Would be one, which has remained in the substandard category for a period of 12 months.	(Secured + Unsecured)
Sub-categories:	
Doubtful up to 1 Year (D1)	25% + 100%
Doubtful 1 to 3 Years (D2)	40% + 100%
Doubtful more than 3 Years (D3)	100% + 100%
• **Loss Assets:** Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%

Note :-

1. **Classification as NPA** should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise.

2. Asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

   For Example :- Mr. Raman has availed two Loan facilities - a Car Loan as well as a Housing Loan from XYZ Bank Ltd. He is regular in depositing the Housing loan EMI but has not deposited the last 4 EMI's of the Car Loan due to paucity of funds. Hence , in this case , not only the Car loan but the Housing Loan would also be treated as an NPA, although it is going good and there are no irregularities because the NPA classification is Borrower wise (Mr. Raman) and not Facility wise (Car & Housing Loan individually).

(iv) Accounts regularized near the Balance Sheet Date: The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as NPA.

(v) Government Guaranteed advances :-

- Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.
- The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

(vi) Advances under Consortium:

Consortium advances *mean advancing loans to a borrower by two or more Banks jointly by forming a* ***Consortium****. Joint appraisal, control and monitoring will facilitate for exchange of valuable information among the Banks. Usually, a Bank with a higher share will* ***lead*** *the* ***consortium****.*

Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

source :- marketbusinessnews.com

Note:- ***Drawing Power Allocation in case of Consortium Cash Credit Account*****:** The Lead Bank would be responsible for computing the drawing power (DP) of the borrower and allocate the same to member banks. In certain special circumstances, at the request of the Borrower, the Lead Bank may allot a higher or lower share of drawing power to the member bank, as against their share of advances. The proforma DP Allocation Letter is presented hereunder for reference:

ILLUSTRATIVE DRAWING POWER FOR DECEMBER 2019
AS PER STOCK STATEMENT NOVEMBER, 2019

(₹ in Crores)

Description of Stocks	Market Value	Margin	Advance Value
Raw Materials	636.27	25	477.20
Finished Goods	372.75	25	279.56
Stock in process	659.35	25	494.51
Stores and Spares	124.51	25	93.38
Book Debts (Upto 120/180 days)	37379.90	35	24296.94
Stock in Transit	52.31	25	39.23
Total	**39225.09**		**25680.82**
Less: Unpaid Stocks under LC	0.00	100	0.00
Total	**39225.09**		**25680.82**

(₹ in Crores)

BANKS	Share %	LIMIT/D.P.
State Bank of India	32.25	500.00
Bank of Baroda	2.58	40.00
Bank of India	6.45	100.00
Canara Bank	5.16	80.00
Standard Chartered Bank	9.03	140.00
Union Bank of India	6.45	100.00
HSBC	13.87	215.00
Citi Bank	6.45	100.00
Bank of America	1.29	20.00
BNP Paribas	1.94	30.00

Punjab National Bank	6.45	100.00
ICICI Bank	4.84	75.00
IDBI Bank	3.23	50.00
Unallocated		
TOTAL	**100.00**	**1550.00**

12.7 Accounts where there is erosion in the value of security / frauds committed by borrowers

Erosion means ***the gradual destruction or diminution of something*** not prudent to follow stages of asset classification. It should be straight-away classified as doubtful or loss asset as appropriate as follows :-

(i) Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straight-away classified under **doubtful category** and provisioning should be made as applicable to doubtful assets.

(ii) If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straight-away classified as **loss asset**. It may be either written off or fully provided for by the bank.

12.8 Advances Against Term Deposits, NSCs, KVPs/ IVPs, etc.

Advances against Term Deposits, NSCs eligible for surrender, KVP/IVP and life policies need not be treated as NPAs, provided **adequate margin** is available in the accounts.

12.9 Agricultural Advances Affected by Natural Calamities

Master Circular issued by the RBI deals elaborately with the classification and income recognition issues due to impairment caused by natural calamities. Banks may decide on their own relief measures, viz., conversion of the short term production loan into a term loan or re-schedulement of the repayment period and the sanctioning of fresh short term loan, subject to the guidelines contained in RBI's latest Master Circular on Prudential Norms on Income Recognition, Asset Classification and provisioning pertaining to Advances. In such cases, the NPA classification would be governed by such rescheduled terms.

12.10 Advances to Staff

Interest-bearing staff advances as a banker should be included as part of advances portfolio of the bank. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets.

12.11 Agricultural Advances

As per the guidelines, Agricultural Advances are of two types:

(1) Agricultural Advances for "long duration" crops; and

(2) Agricultural Advances for "short duration" crops.

The "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State.

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons; and
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

13. COMPUTATION OF DRAWING POWER

1. **Meaning** :- **Drawing Power** generally addressed as **"DP"** is an important concept for ***Cash Credit (CC)*** facility availed from banks and financial institutions. **Drawing power** is the limit up to which a firm or company can withdraw from the working capital limit sanctioned.

2 **<u>Different from Sanctioned Limit</u>** :- The **Sanctioned limit** is the total exposure that a bank can take on a particular client for facilities like cash credit, overdraft, export packing credit, non-funded exposures etc. On the other hand, **Drawing Power** refers to the amount calculated based on primary security less margin as on a particular date.

3. **<u>Considerations:</u>**- All accounts should be kept within both the drawing power and the sanctioned limit at all times. The accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.

4. **<u>Bank's Duties:-</u>** Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets. Drawing power is required to be arrived at based on current stock statement. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular.

5. **<u>Auditor's Concern:-</u>** The stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail. The audited Annual Report submitted by the borrower should be scrutinized properly. The monthly stock statement of the month for which the audited accounts are prepared and submitted should be compared and the reasons for deviations, if any, should be ascertained.

6. **<u>Computation of DP:</u>**- It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

7. **<u>Stock Audit:</u>**- The stock audit should be carried out by the bank for all accounts having funded exposure of more than 5 crores. Auditors can also advise for stock audit in other cases if the situation warrants the same. Branches should obtain the stock audit reports from lead bank in the cases where the Bank is not leader of the consortium of working capital. The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.

Particulars of current assets			DP
(A) Stocks:			
Stocks at realizable value		1000	
Less: Unpaid stocks:			
- Sundry creditors	300		
- Acceptances/LCs etc.	300	600	
Paid for stocks		400	
Margin @ 25%		100	300
(B) Debtors:			
Total Debtors		1000	
Less: Ineligible debtors		200	
Eligible debtors		800	
Margin @ 40%		320	480
Total DP			780

14 AUDIT OF ADVANCES

Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

(a) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.

(b) Advances represent amount due to the bank.

(c) Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.

(d) There are no unrecorded advances.

(e) The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.

(f) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.

(g) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by:

- examining the validity of the recorded amounts;
- examining loan documentation;
- reviewing the operation of the accounts;
- examining the existence, enforceability and valuation of the security;
- checking compliance with RBI norms including appropriate classification and provisioning; and
- carrying out appropriate analytical procedures.

In carrying out his substantive procedures, the auditor should examine all large advances while other advances may be examined on a sampling basis. The accounts identified to be problem accounts, however, need to be examined in detail unless the amount involved is insignificant.

Advances which are sanctioned during the year or which are adversely commented by RBI inspection team, concurrent auditors, bank's internal inspection, etc. should generally be included in the auditor's review.

Source :- maillie.com

Evaluation of Internal Controls over Advances: The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, *inter alia*, the following:

- The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
- All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
- The compliance with the terms of sanction and end use of funds should be ensured.
- Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
- If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
- All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
- In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
- Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
- The accounts should be kept within both the drawing power and the sanctioned limit.
- All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
- The operation of each advance account should be reviewed at least once a year and at more frequent intervals in the case of large advances.

15. AUDIT OF REVENUE ITEMS

PROFIT AND LOSS ACCOUNT: Sub–section (1) of Section 29 of the Banking Regulation Act, 1949, requires the preparation of Profit and Loss Account in Form B of Third Schedule to the Act or as near thereto as the circumstances admit.

यथा 31 मार्च, 2016 को समाप्त वर्ष का लाभ व हानि खाता

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH 20

	अनुसूची Schedule	यथा 31.03.2016 को समाप्त वर्ष For the Year ended 31.03.201 (₹ '000)	यथा 31.03.2015 को समाप्त वर्ष For the Year ended 31.03.201 (₹ '000)
I. आय / INCOME			
अर्जित ब्याज / INTEREST EARNED	13		
अन्य आय / OTHER INCOME	14		
जोड़ / TOTAL			
II. व्यय / EXPENDITURE			
व्यय किया गया ब्याज / INTEREST EXPENDED	15		
परिचालन व्यय / OPERATING EXPENSES	16		
प्रावधान और आकस्मिक व्यय / PROVISIONS AND CONTINGENCIES			
जोड़ / TOTAL			
III. वर्ष का निवल लाभ / NET PROFIT FOR THE YEAR			
IV. विनियोजन / APPROPRIATIONS			
निम्नांकित को अंतरण / TRANSFERS TO			
सांविधिक आरक्षित निधियाँ / STATUTORY RESERVES		-	
पूँजी आरक्षित निधियाँ / CAPITAL RESERVES		-	
निवेश आरक्षित निधि खाता / INVESTMENT RESERVE ACCOUNT		-	
राजस्व आरक्षित निधि / REVENUE RESERVE		-	
विशेष आरक्षित निधियाँ / SPECIAL RESERVE		-	
अंतरिम लाभांश / INTERIM DIVIDEND		-	
प्रस्तावित लाभांश / PROPOSED DIVIDEND		-	
लाभांश कर / DIVIDEND TAX		-	
जोड़ / TOTAL		-	
लेखांकन नीतियाँ / ACCOUNTING POLICIES	17		
लेखा संबंधी टिप्पणियाँ / NOTES ON ACCOUNTS	18		
प्रति शेयर अर्जन (मूल व तनुकृत) / EARNINGS PER SHARE (BASIC AND DILUTED) (₹ में / in ₹)			

15.1 Income

The following items are included under this head:

Interest Earned	Other Income
• Interest/ Discount on Advances/ Bills: • Interest Income on Investments: • Interest on Balances with RBI and Other Inter–bank Funds: • Others: This includes any other interest/discount income not included in the above heads	• Commission, Exchange and Brokerage: This item comprises of the following: (a) Commission on bills for collection. (b) Commission/exchange on remittances and transfers, e.g. demand drafts, NEFT, RTGS, etc. (c) Commission on letters of credit and guarantees, letter of comforts. (d) Loan processing, arranger and syndication fees. (e) Mobile banking fees. (f) Credit/Debit card fee income including annual fee income, merchant acquiring income, interchange fees, etc. (g) Rent from letting out of lockers (h) Commission on Government business. (i) Commission on other permitted agency business including consultancy and other services. (j) Brokerage on securities. (k) Fee on insurance referral. (l) Commission on referral of mutual fund clients. (m) Service/transaction banking charges including charges levied for transaction at other branches. (n) Income from rendering other services like custodian, demat,

	investment advisory, cash management and other fee based services. ● Profit on Sale of Investments ● Profit/Loss on Revaluation of Investments ● Profit on sale of Land, Buildings and Other Assets: ● Profit/Loss on Revaluation of Fixed Assets ● Profit on exchange transactions: This includes revaluation gains/losses on forward exchange contracts and other derivative contracts, premium income/expenses on options, etc. ● Income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India. ● Miscellaneous income.

15.1.1 Audit Approach and Procedures

- **Auditor's Concern :-** In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount.
- **RBI's Directions:-**RBI has advised that in respect of any income which exceeds one percent of the total income of the bank if the income is reckoned on a gross basis or one percent of the net profit before taxes if the income is reckoned net of costs, should be considered on accrual as per Accounting Standard 9.
- **Materiality:-**If any item of income is not considered to be material as per the above norms, it may be recognised when received and the auditors need not qualify their report in that situation.
- **Revenue Certainty:-**Banks recognise income (such as interest, fees and commission) on accrual basis, i.e., as it is earned. It is an essential condition for accrual of income that it should not be unreasonable to expect its

ultimate collection. In modern day banking, the entries for interest income on advances are automatically generated through a batch process in the CBS system.

- **Revenue Uncertainty:-** In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also.

- **Advances against Securities :-** Interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

- **Bills Purchased :-** In the case of bills purchased outstanding at the close of the year the discount received thereon should be properly apportioned between the two years. [The Unexpired discount/ rebate on bills discounted i.e., where part of receipt comprising discount charges on bills purchased relate to the period beyond the year-end, should be recorded as "Other Liabilities"]. Interest (discount) component paid by Bank/Branch on rediscount of bills from other financial institutions, is not to be netted off from the discount earned on bills discounted.

- **Bills for Collection :-**In the case of bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected. The procedure is usually such that the customer's account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents, etc. This procedure is in consonance with the nature of obligations of the bank in respect of bills for collection. The commission of the branch becomes due only when the bill has been collected.

- **Renegotiations :-**Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit. Test check the interest earned by the banks for the sample selected. Test check the fees and commissions earned by the banks made for commission on bills for collection, letters of credit and bank guarantees.

Customer Code 28XXXXXXX Customer Name ABCD Account No 015XXXXXX1367

Date From	Date To	No Of Days	Rate Of Interest	Amount Base	Total Product	Interest Amount	Applied On
02-06-20XX	03-06-20XX	2	6.86	39,96,21,376	79,92,42,751	1,50,214	02-07-2015
04-06-20XX	29-06-20XX	26	6.86	39,96,23,192	10,39,02,02,983	19,52,789	02-07-2015
30-06-20XX	01-07-20XX	2	6.86	39,94,70,852	79,89,41,705	1,50,157	02-07-2015
						22,53,160	02-07-2015
02-07-20XX	06-07-20XX	5	6.86	39,96,21,010	1,99,81,05,048	3,75,534	02-08-2015
07-07-20XX	30-07-20XX	24	6.86	39,96,23,192	9,59,09,56,600	18,02,574	02-08-2015
31-07-20XX	01-08-20XX	2	6.86	40,18,01,300	80,36,02,600	1,51,033	02-08-2015
						23,29,142	02-08-2015
02-08-20XX	02-08-20XX	1	6.86	40,19,52,334	40,19,52,334	75,545	02-09-2015
03-08-20XX	05-08-20XX	3	6.86	39,96,21,813	1,19,88,65,438	2,25,321	02-09-2015
06-08-20XX	30-08-20XX	25	6.86	39,96,23,192	9,99,05,79,791	18,77,682	02-09-2015
31-08-20XX	31-08-20XX	1	6.86	40,18,01,739	40,18,01,739	75,517	02-09-2015
01-09-20XX	01-09-20XX	1	6.86	39,94,70,343	39,94,70,343	75,079	02-09-2015
						23,29,143	02-09-2015
02-09-20XX	06-09-20XX	5	6.86	39,96,20,939	1,99,81,04,693	3,75,534	02-10-2015
07-09-20XX	29-09-20XX	23	6.86	39,96,22,317	9,19,13,13,283	17,27,463	02-10-2015
30-09-20XX	30-09-20XX	1	6.86	40,17,25,314	40,17,25,314	75,502	02-10-2015
01-10-20XX	01-10-20XX	1	6.86	39,94,69,972	39,94,69,972	75,078	02-10-2015
						22,53,578	02-10-2015

Reversal of Income:

If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

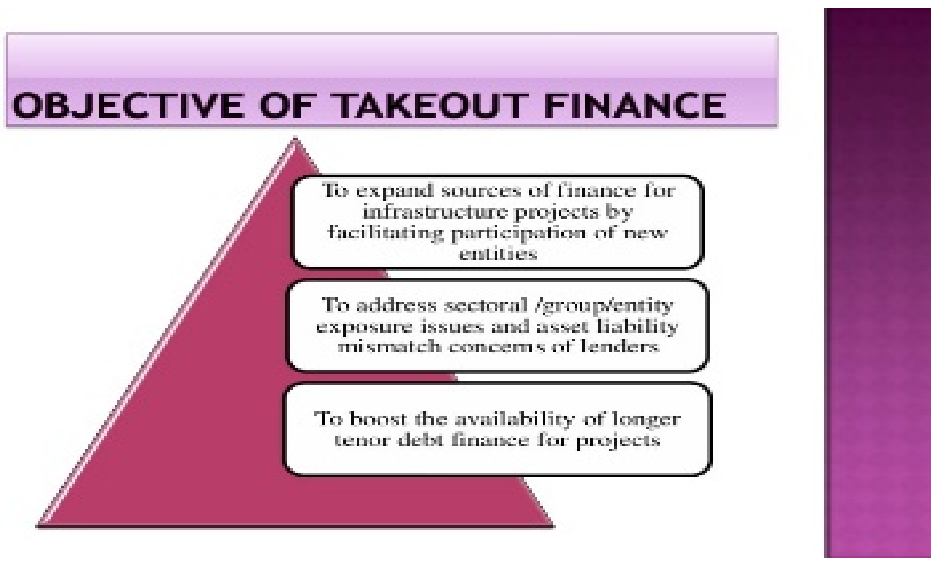
In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).

Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard.

On leased assets: The component of finance income (as defined in AS 19 – Leases) on the leased asset which was accrued and credited to the income account before the asset became non-performing and remaining unrealised, should be reversed or provided for in the current accounting period.

On Take-out finance: A takeout loan is a method of financing whereby a loan that is procured later is used to replace the initial loan. More specifically, a takeout loan, or takeout financing, is long-term financing that the lender promises to provide at a particular date or when particular criteria for completion of a project are met. Takeout loans are commonly used in property development *(Source :- Investopedia)* In the case of take-out finance, if based on record of recovery, the account is classified by the lending bank as NPA, it should not recognize income unless realised from the borrower/taking-over institution (if the arrangement so provides).



Source :- slideshare.net

On Partial Recoveries in NPAs:

In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e., towards principal or interest due), banks are required to adopt an accounting policy and exercise the right of appropriation of recoveries in a uniform and consistent manner. The appropriate policy to be followed is to recognise income as per AS 9 when certainty attaches to realisation and accordingly amount reversed/derecognised or not recognised in the past should be accounted.

Interest partly/fully realised in NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.

Memorandum Account: On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books for control purposes. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

Income from Investments

Interest Income on Investments: This includes all income derived from Government securities, bonds and debentures of corporates and other investments by way of interest and dividend, except income earned by way of dividends, etc., from subsidiaries and joint ventures abroad/in India. Broken period interest paid on securities purchased and amortisation of premium on SLR investments is net off from the interest income on investments.
Profit on Sale of Investments: Investments are dealt in the course of banking activity and hence the net profit or loss on sale of investments is taken to profit and loss account.
Profit/Loss on Revaluation of Investments: In terms of guidelines issued by the RBI, investments are to be valued at periodical intervals and depreciation or appreciation in valuation should be recognised and taken to profit and loss account.

15.2 EXPENSES

Expenditure is to be shown under three broad heads:

(1) Interest expense

(2) Operating expense

(3) Provisions and contingencies.

The following items are included under this head:

Interest Expense	Operating Expenses	Provisions and Contingencies
♦ Interest on Deposits	♦ Payments to and Provisions for Employees	♦ Provisions made in respect of the Non-performing assets.

♦ Interest on Reserve Bank of India/Inter–Bank Borrowings	♦ Rent, Taxes and Lighting ♦ Printing and Stationery	♦ Provisions for Taxation
♦ Others	♦ Advertisement and Publicity	♦ Provisions for Diminution in the value of investments
	♦ Depreciation on Bank's Property	♦ Provisions for contingencies
	♦ Directors' Fees, Allowances and Expenses	
	♦ Auditors' Fees and Expenses	
	♦ Legal expenses	
	♦ Postage, Telegrams, Telephones, etc.	
	♦ Repairs and Maintenance	
	♦ Insurance	
	♦ Marketing Expenses	
	♦ Other Expenses	

15.2.1 Audit Approach and Procedures

- In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.
- The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the

relevant deposits as per the annual accounts and enquire into the difference, if material.

- The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences. The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger. The auditor should understand the process of computation of the average balance and re-compute the same on sample basis.
- The auditor should, on a test check basis, verify the calculation of interest and ensure that:
  (a) Interest has been provided on all deposits upto the date of the balance sheet;
  (b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;
  (c) Interest on savings accounts are in accordance with the rules framed by the bank/RBI in this behalf.
  (d) Interest on inter–branch balances has been provided at the rates prescribed by the head office/RBI.

The auditor should ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period. The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly. The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers. The auditor should re-compute the interest accrual i.e., by referring to the parameters like frequency of payment of interest amount, rate of interest, period elapsed till the date of balance sheet, etc. from the term sheet, deal ticket, agreements, etc. and ensure that the recomputed amount is tallying with the amount as per books of accounts without any significant difference.

For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures. The auditor should examine whether there are any divergent trends in respect of major items of expenses. The auditor should perform substantive analytical procedures (proforma given below for reference) in respect of these expenses. e.g. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years. The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

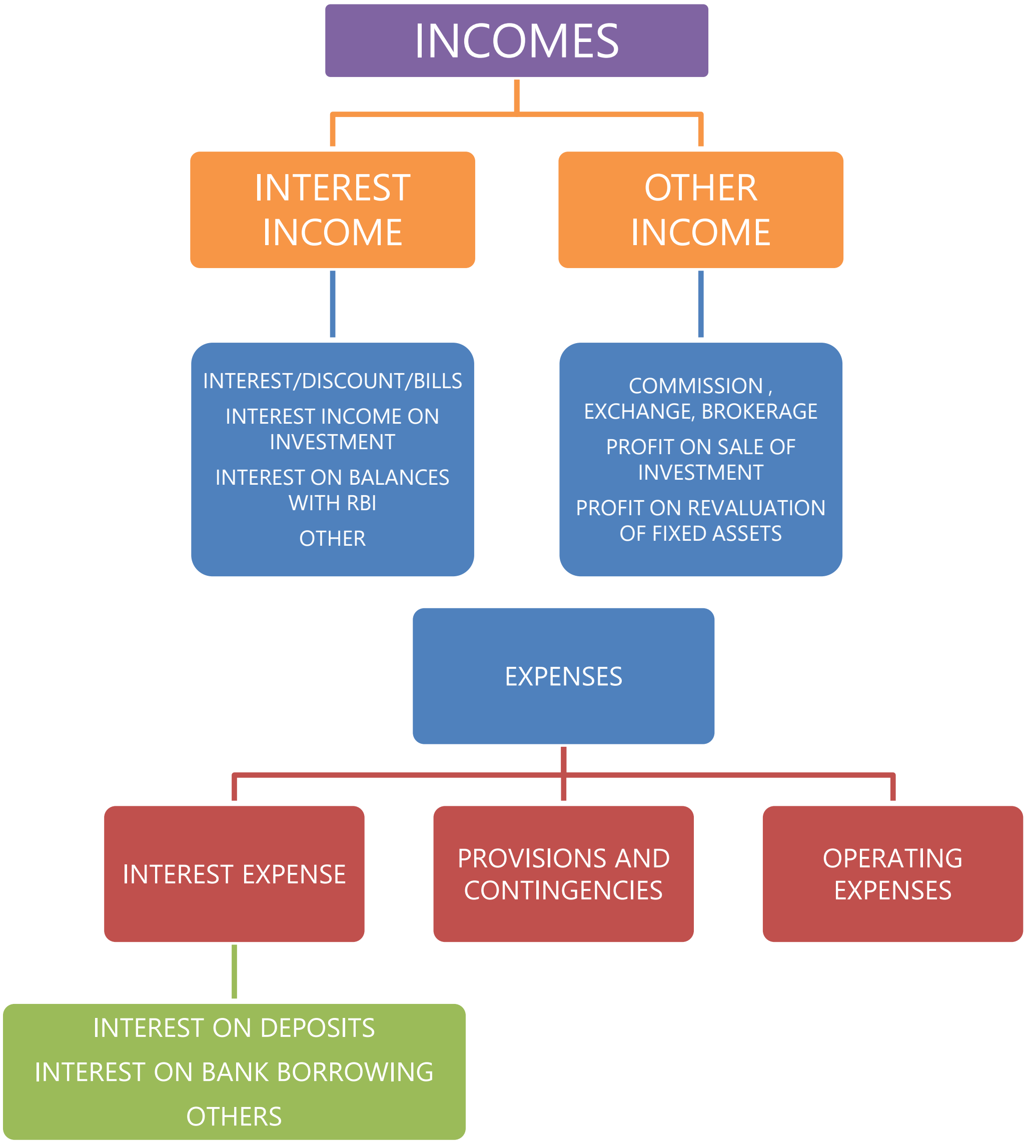
For audit of Provisions and contingencies, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.

The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation. The other provisions for expenses should be examined vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Proforma for Analytical Procedure:

Analytical - Profit & Loss items

	Balances as at				Variation	
Particulars	31-03-13	31-03-14	30-09-13	31-12-13	March13 to March 14	%
Interest Expended	4,43,09,706	4,73,74,798	2,40,11,555	3,50,56,870	30,65,092	7%
General Charges	1,16,02,373	1,11,87,055	56,70,073	82,78,307	-4,15,318	-4%
Interest Collected	3,62,69,39,756	3,42,34,94,462	1,73,51,72,054	2,53,33,51,198	-20,34,45,294	-6%
Commission, Exchange, Brokerage & Other Income	6,87,76,134	6,61,28,900	3,35,16,929	4,89,34,716	-26,47,234	-4%
Net Profit	3,63,98,03,811	3,43,10,61,509	1,73,90,07,354	2,53,89,50,737		



15.3 Disclosure of the prior period items

Since the format of the profit and loss accounts of banks prescribed in Form B under Third Schedule to the Banking Regulation Act, 1949 does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss, such disclosures, wherever warranted, may be given.

SUMMARY

Banking sector is the backbone of any economy as it is essential for sustainable socio- economic growth and financial stability in the economy. There are different types of banking institutions prevailing in India. Commercial banks are the most wide spread banking institutions in India. Two of its main functions are accepting deposits and granting advances. The functioning of banking industry in India is regulated by the RBI which acts as the Central Bank of our country. There is a sea change in banking as use of technology and its continuous evolution has enabled banks to provide its customers comfort of anytime-anywhere-banking. The auditor should not assume that the system generated information is correct and can be relied upon without evidence.

A bank audit can be divided into following stages:

- ✓ Initial consideration by the statutory auditor
- ✓ Identifying and Assessing the Risks of Material Misstatements
- ✓ Understanding the Bank and Its Environment including Internal Control
- ✓ Understand the Bank's Accounting Process
- ✓ Understanding the Risk Management Process
- ✓ Engagement Team Discussions
- ✓ Establish the Overall Audit Strategy
- ✓ Develop the Audit Plan
- ✓ Audit Planning Memorandum
- ✓ Assess of audit materiality
- ✓ Consider Going Concern
- ✓ Assess the Risk of Fraud including Money Laundering
- ✓ Assess Specific Risks, Risk Associated with Outsourcing of Activities
- ✓ Response to the Assessed Risks
- ✓ Stress Testing
- ✓ BASEL III framework
- ✓ Reliance on / review of other reports
- ✓ Execution
- ✓ Conclusion and reporting.

TEST YOUR KNOWLEDGE

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

(1) RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.

(2) In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines that have bearing on the classification/ provisions and income recognition.

(3) The auditor can assume that the system generated information is correct and relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

(4) Collateral security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank.

(5) Registered mortgage is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof

(6) Any amount due to the bank under any credit facility is 'overdue' if it is not paid within 90 days of becoming due.

(7) An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

(8) Banks recognize income on Non-Performing Assets on accrual basis.

(9) Auditor of a Nationalised bank is to be appointed at the annual general meeting of the shareholders.

Theoretical Questions

1. The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country. Explain

2. "The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference". Explain

3. Write a short note on reversal of income under bank audit.

4. What are the general requirements of an effective Risk Management System in Banks ?

5. Explain the audit approach you would follow to check the Operating Expenses of a Bank.

6. The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. Explain this statement.

ANSWERS/SOLUTIONS

Correct/Incorrect

(1) **Incorrect.** RBI has been entrusted with the responsibility of regulating the activities of commercial and other banks.

(2) **Incorrect.** In the Computerised environment, it is imperative that the auditor is familiar with, and is satisfied that, all the norms/parameters as per the latest applicable RBI guidelines are incorporated and built into the system that generates information/data having a bearing on the classification/ provisions and income recognition.

(3) **Incorrect.** The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

(4) **Incorrect.** Primary security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.

(5) **Incorrect.** Equitable mortgage, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

(6) **Incorrect.** Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

(7) **Correct.** An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

(8) Incorrect: Income from non-performing assets (NPA) is not recognised on accrual basis due to its uncertainty but is booked as income only when it is actually received.

(9) Incorrect- Auditor of a nationalized bank is to be appointed by the bank concerned acting through its Boards of Directors and approval of the Reserve bank is required before the appointment is made.

Answers to Theoretical Questions

1. Refer Introduction paragraph
2. Refer Para 2
3. Refer Para 15.1

4. **(a)** **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (Board of Directors/Managing Director) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.

(b) **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.

(c) **Control activities:** A bank should have appropriate controls to mitigate its risks including effective segregation of duties (particularly between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.

(d) **Monitoring activities:** Risk management models, methodologies and assumptions used to measure and mitigate risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.

(e) **Reliable information systems:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

5. Auditing the Operating Expenses of a Bank:-

(a) **Internal Controls:-**The auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures.

(b) **Divergent Trends:-**The auditor should examine whether there are any divergent trends in respect of major items of expenses.

(c) **Substantive analytical Procedures:-**The auditor should perform substantive analytical procedures in respect of these expenses. eg. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.

(d) **Vouching & Verification:-** The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

6. The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, *inter alia*, the following:

- The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
- All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
- The compliance with the terms of sanction and end use of funds should be ensured.
- Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.

- If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
- All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
- In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
- Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
- The accounts should be kept within both the drawing power and the sanctioned limit.
- All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
- The operation of each advance account should be reviewed at least once a year and at more frequent intervals in the case of large advances.