

A PRACTICAL APPROACH TO STATUTORY BRANCH AUDIT (SBA) OF BANKS 2020-21

This article is prepared with an intension to benefit the members and articles assistance for the quick and easy practical approach to the branch statutory audit of banks for FY 2020-21.

A brief area covered in this article includes:

- Advances
- General banking
- Forex
- Fraud
- Comments on the Latest RBI circulars on COVID -19 assistances.

Audit of advances and NPA related matters

- **Closing Circular/ Closing guidelines:** This will help the Statutory branch auditor (SBA) about the details of the process and policies followed by Bank during the annual closing
- SBA is advised to obtain the latest sanction order of the credit facilities for the sample selected before the commencement of audit.
- **Retail advances:** The bank has a credit policy which defines process to be followed for sanction and disbursement of retail loans. Retail advances generally includes home loans, loans against property, vehicle/automobile loans, personal loans, credit cards, gold loans etc, hence SBA is advised to obtain the retail loan policy of respective banks before the commencement of branch audit.
- SBA is advised to look for the overflow EMI report in the CBS to ensure that the EMI are not wrongly classified/ entered in the Bank's system.
- **Income Recognition and Asset classification (IRAC)** report List preferably on 3 different dates for the sample selection. (Say 15th, 20th and 31st March 2021): This will help the SBA for appropriate sample selection and test checks should be carried out regarding classification of these advances.
- **SMA Report:** Special Mentioned account with SMA 2 status as on 28th Feb 2021 will most probably turn out to be NPA as on 31st march 2021, if sufficient credits are not made during the Month of March 2021, even though the latest RBI moratorium applies.
- **INSPECTION Report:** SBA is advised to go through the branch Internal/ concurrent audit report for the past 1 year. More stress should be given to the comments of the operation of the Loan accounts.
- **UNIT visit reports of Branch officials:** SBA is advised to go through the branch unit visit report/ register. This will provide the confidence of the branch on the operation of the loan account.
- **Credit Audit reports:** SBA is advised to go through the latest Credit Audit reports conducted by the bank's specialised team. These reports are applicable to large credit accounts based on the risk appetite of individual banks. Eg: some banks insist for the performance of Credit Audit yearly or in two years interval or Above Rs 2.00 Crs or Above Rs 5.00 Crs etc.
- **Stock audit reports:** SBA is advised to go through the latest Stock Audit reports conducted by the independent chartered accountant/cost accountants who are in practice and are empaneled by the bank. These reports are applicable to large credit

accounts based on the individual banks credit policies. This will give an independent opinion on the stock and receivables position on that loan accounts. If there is a major variation in the stock and receivable mentioned in the stock statement submitted to the branch and Stock audit report, SBA should comment in the LFAR and Main Audit report. More over if the last stock statement submitted is more than 6 months old, the account should be classified as NPA. SBA should also ensure that the creditors are excluded from stock statement for arriving DP.

- **ROC compliance** for the corporate accounts: SBA is advised to go through MCA website and confirm the adequacy of compliance. This includes:
 - ROC Charge creation,
 - Satisfaction of charge for the closed loans with current and previous lenders,
 - List of directors / authorized signatories, KMP etc

- **System Driven reports from CBS (Core Banking Solutions)** as on given dates :
 - NPA upgraded report
 - NPA Exclusion List
 - NPA recalled report
 - Fresh NPA report/list
 - Credit Sanction limit expired reports
 - OD/CC interest Debit unsatisfied report
 - A/c Continuously overdrawn report
 - LC/BG - devolvement/ invoked report
 - Stock statement defaulters report
 - Interest rate modified report
 - BP/FBP/FCP/DBD/UBD/UBP Overdue reports etc

- **Interest Application on agricultural advances**
 - Unlike normal loans, the interest on agricultural advances is not charged at monthly rests but is charged normally at half yearly or annual rests.
 - Compounding of Interest is generally not permitted in respect of an Agricultural advance, unless it turns out to be a non-performing advance.
 - The RBI *vide* its circular no. DBOD No. Dir. BC. 25/13.03.00/2002-03 dated September 19, 2002 had advised the banks that instructions regarding charging of interest on monthly rests shall not be applicable to agricultural advances and and banks shall continue to follow the existing practice of /compounding of interest on agricultural advances linked to crop seasons

Examples of Interest application according to crop seasons and for other activities:

Crop Season	Kharif	Rabi	Horticulture
Disbursement Period	April 01 to Sept 30	Oct 01 to March 31	
Interest Application	Annual	Annual	Annual
Interest Application Date	31st March	30th June	31st March
Compounding	Annual	Annual	Annual
Due Date	31st March	30th June	One year after first

			disbursement every year.
Compounding from Date	After 31st March	After 30th June	After end of year (to be calculated from date of first disbursement every year)
Penal Interest	If overdue, after 31st March	If overdue, after 30th June	If overdue, from the due date

	Allied Activities	
	Dairy, Poultry	Goat Rearing, Piggery
Repayment	Quarterly	Half Yearly / Yearly
Interest Application	Quarterly	Half Yearly / Yearly
Interest application date	Quarter end	Half Year end / Year end
Compounding Frequency	Quarterly	Half Yearly / Yearly
Compounding from date	After Quarter end	After Half Year end / Year end
Penal Interest	If overdue, after Quarter end	If overdue after half year /year end.

- **Interest Subvention**

- Scheduled Commercial Banks (in respect of loans given by the rural and semi urban branches) are eligible under the scheme.
- On a loan given at 9% interest, subvention of 2% p.a. is allowed on short term crop loans upto Rs.3.00 lakh per farmer. Short term credit, thus made available at 7% p.a. to farmers, is considered for interest subvention.
- This is calculated on the crop loan amount from the date of its disbursement/ drawal up to the date of actual repayment of the crop loan by the farmer or up to the due date of the loan fixed by the banks, whichever is earlier, subject to a maximum period of one year.
- From 2011-12, additional interest subvention of 3% to those farmers, who repay their short term crop loans promptly and on or before the due date, thus making total interest subvention @ 2%+3% i.e. 5%.
- Farmers, who promptly repay their crop loans as per the repayment schedule fixed by the banks, are offered loans at an effective interest rate of 9% - 5% i.e. 4% p.a.
- Auditors have to submit certificate of Interest Subvention along with annual accounts of the branch audited by them.

Audit Procedure

- ✓ Obtain relevant circular / policy about the scheme and its applicability.
- ✓ For details of short term crop loans qualifying for subvention, obtain information / reports submitted by the Branch to HO or Bank to RBI.
- ✓ Obtain list of eligible borrowers with outstanding balance.
- ✓ Interest on the loan account has been properly charged. Ensure that the interest is first credited to the account and then a claim is made for reimbursement.

- ✓ The subvention is computed properly for the eligible year and credited in respective borrower account.
- ✓ Inquire about any rejection made in earlier year's claims and reasons thereof.
- ✓ As per RBI circular, the auditor needs to certify the correctness of the claim, so the substantive testing needs to be carried out for examinations.

General banking compliances

Obtain the following reports as on 31st March 2021 or given dates

- DEAF Reports (Depositor Education and Awareness Fund) and its Compliances.
- KYC – High / Medium/Low risk reports and its Compliances.
- STR/CTR/AML (Suspicious and Cash transaction) reports and its Compliances.
- ECGC Claims made and received/ rejected status reports.
- DICGC Claims made and received/ rejected status reports.

Forex (FEMA Compliances)

Obtain the following reports as on 31st March 2021 or given dates

- BOE (Bill of Entry) reports: More than 180 days for normal imports and 3 years for Capital goods and its Compliances by B and C category Branches.
- ODI – ODI made during the FY reports along with following Forms / declarations
 - Liberal remittance scheme for individuals forms
 - Automatic / approval for corporates/ Firms etc
 - Form A2 and TT applications
 - FEMA declarations
 - Other forms as per the individual banks policies/ compliances

Note: SBA are advised to look for the purpose codes mentioned/used in the customer applications and the codes used by the branch for fund transfer are one and the same.

- MTT (Merchanting Trade Transactions) report: More than 9 months outstanding and its Compliances by B and C category Branches.
- FLA : Foreign Liabilities and Assets compliance
 - ✓ Annual return on Foreign Liabilities and Assets has been notified under FEMA 1999 and it is required to be submitted by all the India resident companies which have received FDI and/ or made overseas investment in any of the previous year(s), including current year by July 15 every year.
 - ✓ Non-filing of the return before due date will be treated as a violation of FEMA and penalty clause may be invoked for violation of FEMA.
- Others reports as per the banks internal policies

FRAUD

Standard on Auditing 240 issued by ICAI defines Fraud – “An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Few types of fraud found in Banking System

- ✓ **Account opening fraud:** This involves an account being opened with either fake or original KYC documents with an intent to depositing and cashing of fraudulent cheques/ instruments
- ✓ **Cheque fraud:** It is most common method where frauds are committed through stolen cheques and forged signatures
- ✓ **Counterfeit securities:** In this type of fraud, forged, duplicated or tampered documents, securities, bonds and certificates are presented as security for availing loan.
- ✓ **Digital fraud:** Under this type of fraud, fraudster resorts to hacking/tampering to gain unauthorised access to siphon off or misappropriate funds.
- ✓ **Loan fraud:** This type of fraud is committed by lending funds to a non-borrowing customer or allowing a borrowing customer to exceed his credit limit, without adequate sanction / authority.
- ✓ **Money laundering fraud:** This type of fraud is committed by concealing the existence, source or use of illegally obtained money, by converting the cash into untraceable transactions in banks.
- ✓ **Letters of Credit:** This type of fraud is most common in international trade but has been observed in domestic trade also. In respect of international trade, these instruments used in cross borders transactions with underlying trade documents which are forged, altered, adjusted and take longer to identify ultimate destiny of merchandise. In respect of domestic trade these instruments are used to convert non funded facility into cash in purported trade transactions. Cash generated through such transactions is diverted or misappropriated out of system.

Role and Responsibility of Branch Auditor

Branch Auditor's primary objective is to opine on true and fair view of branch financial statements. The audit process needs to confirm compliance with standards on auditing issued by the Institute of Chartered Accountants of India (ICAI).

Specific to the area concerning fraud, as laid down in SA-240, the auditor has responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements taken as a whole are free of material misstatement, whether caused by error or fraud. SA 240 requires auditor to perform procedures with following objectives:

- ✓ To identify and assess the risks of material mis-statement in the financial statements due to fraud;
- ✓ To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- ✓ To respond appropriately to identified or suspected fraud

While reporting on fraud in LFAR, the Statutory Branch Auditor has to provide appropriate responses to identified or suspected fraud.

References

- 1) RBI Notifications : Merchanting Trade Transactions (MTT) – Revised Guidelines RBI/2019-20/152A.P. (DIR Series) Circular No.20
- 2) RBI Notifications and FAQ on Annual Return on Foreign Liabilities and Assets (FLA return) under FEMA 1999
- 3) RBI Master Direction ‘Master Direction on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad.
- 4) RBI Notifications : Overseas Direct Investment - Submission of Annual Performance Report RBI/2015-16/373 A.P. (DIR Series) Circular No.61 dated April 13, 2016
- 5) RBI Notifications : The Depositor Education and Awareness Fund Scheme, 2014
- 6) RBI Notifications : COVID-19 – Regulatory Package: RBI/2019-20/186 DOR.No. BP.BC.47/ 21.04.048/2019-20 dated March 27, 2020 and subsequent dates
- 7) RBI Press release: Statement on Developmental and Regulatory Policies
- 8) Guidance Note on Audit of Banks (2020 Edition) ICAI

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