

STATUTORY BRANCH AUDIT (SBA)



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The banking industry is the backbone of any economy as it is essential for the sustainable socio-economic growth and financial stability in the economy.

Statutory audit of banks involves a number of peculiarities due to some unique features of banks and banking operations e.g. huge volumes, 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. All these factors make the task of statutory auditors of banks quite challenging in maintaining quality in bank audits.

The overall objective of the branch audit is to have transaction testing and provide inputs to the Statutory Central Auditors (SCA) on adequacy of implementation of various policy and regulatory requirements, including efficacy of the system and assurance functions (risk management, compliance and internal audit) at branch level.

SBA should read and study recent updates, impact of amendments and changes in banking environment such as, latest & relevant RBI circulars, master directions, notification, pronouncements of ICAI having bearing on bank audits and the Banking Regulation Act, 1949.

The following are the guidelines for conducting Statutory Branch Audit (SBA) of any Bank:

1. Communication with Branch management & Understanding the Branch business

Soon after the receipt of appointment letter, Auditor should try to visit Branch or discuss with Branch manager to understand the size of the branch and nature of activities carried out at the bank branch. Since timelines are limited, co-ordination between the auditor and the branch management is essential for an effective audit and timely completion with the highest audit quality. A NOC from the previous auditor should be obtained and kept on record by the Statutory Branch Auditor. Immediately after accepting the appointment, the SBA should send a formal communication to the Branch management/HO accepting his appointment and other declarations and undertakings as required. The SBA needs to issue the audit engagement letter in accordance with Standard on Auditing (SA) 210, "Agreeing the Terms of Audit Engagements" and the requirement letter which will contain the details or information needed to conduct the audit to enable the branch management to keep the requisite documents, information, etc., ready.

2. Audit planning

The SBA should plan the audit keeping in mind the requirements of SA 300, "Planning an Audit of Financial Statements. The auditor should work out an overall audit strategy for execution of the audit within the time limits and composition of persons in the audit team should be kept accordingly who are acquainted with the rules and regulations governing branch and have a basic knowledge about RBI regulations and circulars governing. SBA should take the basic understanding of the internal guidelines/circulars/policies followed by the bank. Risk Assessment is to be carried out based on clear understanding of the business profile of the bank.

3. Audit of Advances and NPA matters

SBA should prepare / suitably create check list to verify advances and see that sanctioning, disbursement, review / renewal and monitoring of advances are being done properly. The auditor should select appropriate sample from all categories of advances so that they truly represent the entire population and carry out appropriate test checks. SBA should document the criteria for test check which he has chosen for verification of advances and should prepare a check list in accordance with the circulars issued by RBI on time to time.

SBA should study the latest Income Recognition and Asset Classification (IRAC) guidelines of RBI. The RBI vide its notification dated September 14, 2020 has mandated that income recognition, asset classification and provisioning should be totally automated by the banks. The auditor should appropriately deal with the deviations in classification and accordingly, Memorandum of Changes (MOC) should be issued if required.

The RBI is now insisting on checking of Central repository of Information on Large Credits (CRILC) for advances over Rs. 5 Crores, which maintains history of the borrowers from inception. Banks have to update this every time the borrower moves into or out of default. Similarly, for advances less than Rs. 5 Crores, the RBI maintain Central Fraud Registry (CFR) which holds all the data regarding frauds reported by banks in India. These accounts should be verified by SBAs. Needless to say, if there are deviations in advances, the auditor should report the same.

4. Audit related to Cash and Housekeeping Matters

SBA should check internal controls on custody of cash and examine as per the cash management policy of the bank. The SBA should physically check cash at the branch and at the ATM attached to the branch. SBA should examine rotation of duties of key management at branch for effective operations. Observations on Daily Cash limits exceeded needs to be reported in LFAR.

5. Audit related to Financial Statements

SBA should carry out analytical and substantive audit procedures to verify true and fair view of the financial statements and apply basic audit principles. The auditor should set materiality level in accordance with SA 320, "Materiality in Planning and Performing an Audit" and carry out substantive audit procedures for all material transactions. The SBA may apply analytical procedures such as ratio analysis and comparative analysis to find out material misstatements, if any in the financial statements. Based on these procedures, SBA should frame his audit opinion.

6. Long form Audit Report (LFAR)

LFAR is a questionnaire prepared by RBI which SCAs communicates with SBAs to answer all relevant data in a predefined structured format. This questionnaire contains questions, which are relevant to the specialized branches dealing in foreign exchange transactions, branches having very large advances, recovery of non-performing assets (NPA) and clearing house operations, if any. Auditors of foreign branches of Indian banks should also furnish this report. The SBA should report all deficiencies noted by him in the Long Form Audit Report. Many at times it is observed that Branch LFARs may contain comments that may need attention in the main statutory audit report. The consolidation takes place based on LFARs submitted by the SBAs in respect of branches/offices.

7. Internal Financial Controls over Financial Reporting (IFCoFR) -

The RBI has made reporting on IFCoFR for Public Sector Banks mandatory from Financial Year 2020-21. SCAs of Nationalised Banks report on the same on the basis of testing of various controls by them. However, some of the controls have to be tested at branch level on sample basis which are decided and communicated to SBA by SCA in consultation with bank management.

8. Reports and Certificates to be issue by Bank Branch Auditor

The SBA should carefully make a list of all the annual returns/ financial statements and certificates to be verified and certified as part of the branch audit. Final audit report and LFAR are two documents that are issued by the statutory auditor to the bank management. In final audit report, reporting on IFCoFR also have to be done wherever applicable. The Auditors should ensure that the audit report issued by them complies with the requirements of Revised SA 700 - Forming an Opinion and reporting on financial statements, SA 705 - Modification to the opinion and SA 706- Emphasis of matters para.

The SBA are required to issue certificates besides their main audit report and LFAR, following matters are few samples out many:

- Certificate to Statutory Central Auditors
- Certificate as to whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.
- Certificate of Cash and Bank balances
- Certificate relating to DICGC transactions
- Certificate for claims relating to interest subvention under various govt. schemes.
- Certificate on recommendations of Ghosh committee & implementation of Jilani committee
- Certificate on Break-up of Suspense Account and outstanding for 6 months and above
- Certificate on all outstanding entries above Rs. 50,000 up to 6 months.
- Certificate for Having Given Effect of MOCs Suggested, if any.
- Statutory Auditor's Certificate Relating to CGTMSE
- Certificate for Borrowers Restructured Under One Time Policy on Restructuring of MSME Sector Advances and Relating to Relief for MSME Borrowers Registered under GST.
- Certificate of Contingent Liabilities, Bills for collection, payables etc.

SBAs are also required to comply with the requirements of UDIN while issuing such reports & certificates.

9. Audit Documentation in Bank Branch Audit

The auditor should prepare the audit plans and make a note of the checks that will be carried out by him during the audit process. He should note the queries raised by him and how the same have been resolved, nature of issues that have arisen and the documents obtained for the same and significant matters which have come across. Audit documentation should ensure that it provides sufficient evidence of the auditor's basis for a conclusion about the true and fair view of the financial statements of the branches, certificate issued, and his observations mentioned in the LFAR. Further, audit documentation should also ensure satisfactory evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

An Illustrative list of documents to be maintained in the bank branch audit file is given below:

- Appointment formalities, including appointment letter, NOC from previous auditor, engagement letter etc.
- Latest RBI Master Directions / Circulars, other material for conducting the audit.
- Closing guidelines / circular issued by the bank.
- Summary of the relevant provisions of the RBI master directions, IRAC norms, closing circular used at the branch.
- Details branch audit plan and program as per SA 230.
- Understanding the powers and responsibilities at various levels in the branch.
- Summary of the accounting policies, observations from previous audits, inspection reports, concurrent audits etc. and how the auditor has verified their satisfactory compliances.
- Audit procedures adopted and determination of materiality levels. understanding of the internal controls, IT system controls.
- Audit working papers and issue trackers. How the issues raised during audit were concluded.
- Financial Statements of the previous year and current year.
- Management certified Trial Balance for the year.
- Various Audit reports such as internal inspection report, concurrent audit reports, previous year statutory audit report.
- Statement of advances with classification along with various fields duly filled such as security, sanction limits, date of sanction / renewal, outstanding balance etc.
- Specific representation, notes and working papers received by the bank's management on sensitive or significant audit issues or accounts.
- List of latest and updated stock and security statements, valuation and inspection reports.
- List of documents verified and minutes of meeting with the bank's management.
- Copies of supporting documents verified and confirmations obtained during the audit.
- Verification of other assets and liabilities.
- Proof of various securities, cash and other assets physically verified during the audit.
- ATM verification details.
- KYC verification, anti-money laundry verification, FEMA compliance at branches.
- Verification of third-party products.
- Off balance sheet items, claims against banks and contingent liabilities.
- Other Bank / RBI balance confirmation.
- Management Representation Letter.
- Various other audit documents / evidence considered in audit process.

Few lists of reports will benefit SBAs (if shared in advance or taken from CBS) while undertaking the Audit in a fully computerised environment

- List of SMA / Watch list / Probable NPA/Weak account accounts as on the last date of audit period.
- List of LCs devolved/ BG invoked during the period / year.
- List of accounts slipped to NPA including quick mortality/upgraded and written off during the period.
- Red Flagged Accounts since more than 6 months
- List of Project Loans (infra and non-infra) including fields such as Date of Financial Closure, Original DCCO, extended DCCO, Achieved DCCO, Time/ Cost Overruns
- List of advances, where significant erosion in security value is observed and List of NPA Accounts with Security Valuation not carried out within the prescribed period.
- Backdated updation of stock and book debt statements i.e. difference between date of updation in CBS and date of actual receipt of the Stock Statement.

Checklist for Statutory Bank Branch Audit:

Sr. No.	Particulars	Remarks
1	<u>General: Areas of Review Pre Audit</u>	
	Review of Latest available inspection reports of Internal/ Concurrent/RBI/Statutory Auditors and compliance thereof.	
	Review of Closing Circular issued by Head Office	
	Study of Significant accounting policies of the Bank & computer system	
	Study of Business mix of the Branch & determination of the sample size and percentage of checking in each area	
	Compliance of Mandatory Accounting Standards / Auditing Standards and RBI circulars	
	Intimation in writing whether given to the Branch Manager regarding requirements for audit and documents to be kept ready for audit.	
2	<u>Deposit (Term, Saving, Current, FCNR/ NRE/ NRNR)</u>	
	i) New Accounts opened & Accounts closed;	
	ii) Dormant Accounts;	
	iii) Interest calculations;	
	iv) Test check account statements for unusual/ large/ overdraft transactions;	
	v) Overdue Term deposits & banks policy for its renewal;	
	vi) Accrual of interest;	
	vii) RBI Norms for Non-resident deposits & its operations - with due importance to opening and operation of accounts like NRE, NRNR, FCNR, RFC, etc.;	
	viii) Interest on various types of deposits;	
	ix) Tax Deducted at Source.	
	x) Large deposits placed at the end of the year (probable window dressing).	

Sr. No.	Particulars	Remarks
	xi) Examine unusual trend in account opening or account closing, dormant accounts that have suddenly been reactivated by heavy cash withdrawals or deposits, overdrawing, etc.	
	xii) Examine interest trends as compared to average annual deposits (monthly average figures).	
3	<u>Advances</u>	
	i) Review monitoring reports (irregularity reports) sent by the branch to the controlling authorities in respect of irregular advances.	
	ii) Review appraisal system, Files of large as well as critical borrowers, sanctions, disbursement, renewals, documentation, systems, securities, etc.	
	iii) Review on test check basis operations in the Advances Accounts.	
	iv) Compliance of sanction terms and conditions in the case of new advances.	
	v) Whether the borrower is regular in submission of stock statements, book debt statements, insurance policies, balance sheets, half yearly results, etc. and whether penal interest is charged in case of default / delay in submission of such data.	
	vi) Charge of interest and recovery for each quarter or as applicable to be verified.	
	vii) Review the monitoring system, i.e. monitoring end use of funds, analytical system prevalent for the advances, cash flow monitoring, branch follow-up, consortium meetings, inspection reports, stock audit reports, market intelligence (industry analysis), securities updation, EWS etc.	
	viii) Check classification of advances, income recognition and provisioning as per RBI Norms/ Circulars.	
	ix) Examine interest trends as compared to average annual advances (monthly average figures).	
	x) Scrutinise the final advances statements with regard to assets classification, security value, documentation, drawing power, out standings, provisions, etc.	
	xi) Check whether Non-Fund based (Letter of Credits/ Bank Guarantees) exposure of the borrowers is within the sanctioned limits.	
	xii) Compare projected financial figures given at the time of project appraisal with actual figures from audited financial statements for relevant period and ascertain reasons for large variance.	
	xiii) Take into account the assessment of RBI if the regional office of RBI has forwarded a list of individual advances to the bank, where the variance in the provisioning requirements between the RBI and the bank is above certain cutoff levels	

Sr. No.	Particulars	Remarks
4	Profit & Loss Account	
	Verify:	
	i) Short debit of interest/ commission on advances;	
	ii) Excess credit of interest on deposits;	
	iii) In case the discrepancies are existing in large number of cases, the auditor should consider the impact of the same on the accounts;	
	iv) Determine whether the discrepancies noticed are intentional or by error;	
	v) Check whether the recurrence of such discrepancies is general or in respect of some specific clients;	
	vi) Proper authority in sanction and disbursement of expenses as also the correctness of the accounting treatment given as to revenue/ capital/ deferred expenses.	
	vii) Check accrual of income/ expenditure especially for the last month of the financial year.	
	viii) Divergent Trends– Divergent trends in income/ expenditure of the current year may be analysed with the figures of the previous year. Wherever a divergent trend is observed, obtain an explanation along with supporting evidences like monthly average figures, composition of the income/expenditure, etc.	
5	Balance Sheet	
	Cash & Bank Balances:	
	i) Physically verify the Cash Balance as on March 31, 20## or reconcile the cash balance from the date of verification to March 31, 20##.	
	ii) Confirm and reconcile the Balances with banks as on March 31, 20##.	
	Investments:	
	i) Physically verify the Investments held by the branch on behalf of Head Office and issue certificate of physical verification of investments to bank's Investments Department.	
	ii) Check receipt of interest and its subsequent credit to be given to Head Office.	
	Advances Provisioning:	
	i) As per RBI norms, unrealised interest on NPA accounts should be reversed and not charged to "Advance Accounts". Reversal of unrealised interest of previous years in case of NPA accounts is required to be checked.	
	ii) Partial Recovery in respect of NPA accounts should be generally appropriated against principal amount in respect of doubtful assets.	
	Fixed Assets:	
	Check Inter-branch transfer memos relating to Fixed Assets and whether they have been correctly classified in the accounts and depreciation accounting thereof.	
	Inter Branch Reconciliation (IBR):	
	i) Understand the IBR system and accordingly prepare an audit plan to review the IBR transactions. The large volume of Inter Branch Transactions and the large number of unreconciled entries in the banking system makes the area fraud-prone.	
	ii) Check head office inward communication to branch to ascertain date upto which statements relating to inter branch reconciliation have been sent.	

Sr. No.	Particulars	Remarks
	Check and report:	
	i) Reversal of any large/ old/ unexplained entries, which had remained outstanding in IBR.	
	ii) Items of revenue nature, cash-in-transit (for example, cash meant for deposit into currency chest) which remains pending for more than a reasonable period.	
	iii) Double responses to the entries in the Accounts.	
	iv) Test Check accuracy and correctness of "Daily statements" which are prepared by the branch and sent to IOR department. The auditor should duly consider the extent of non-reconciliation in forming his opinion on the financial statements. Where the amounts involved are material, the auditor should suitably qualify his audit report	
	Suspense Accounts, Sundry Deposits, etc.:	
	v) Suspense accounts are adjustment accounts in which certain debit transactions are temporarily posted whose authorisation is pending for approval. Sundry Deposit accounts are adjustment accounts in which certain credit transactions are temporarily posted whose authorisation is pending for approval, As and when the transactions are duly authorised by the concerned officials they are posted to the respective accounts and the Suspense account/Sundry Deposit account is credited/ debited respectively.	
	vi) Ask for and analyse their year-wise break-up. Check the nature of entries parked in such Accounts.	
	vii) Check any movement in such old balances and whether the same is genuine and has been properly authorised by the competent authority.	
	viii) Check for any revenue items lying in such accounts and whether proper treatment has been given for the same.	
	<u>Auditors Report & Memorandum of Changes</u>	
6	i) The Auditors Report should be a self-contained document and should contain no reference of any point made in any other report including the LFAR;	
	ii) Include Audit Qualifications in the Auditors Report and not in the LFAR;	
	iii) Quantify the Audit Qualifications for a better appreciation of the point made to the reader;	
	iv) For suggesting any changes in the financial statements of the branch, quantify the same in the Memorandum of Changes (MOC) and make it a subject matter of qualification and annex it to the Auditors Report.	

Thank you for reading this article. I hope it helped you in understanding and expanding your horizon about Bank Branch Audits. Refer latest **ICAI Guidance note on Branch Audit** and **Technical Guide on Audit of Internal Financial Controls** in case of Public Sector Banks for more details and knowledge.

