

## **AUDIT PROGRAMME FOR AUDIT OF BANKS**

**PREPARED BY:**

Pavan Jain S and Sujith S Kamath,  
CA Final Students,  
Bellary, Karnataka.

1. Peruse through the previous year Long Form Audit Report, Inspection Report, Concurrent Audit Report (if any), Income Audit report(if any), Information Systems Audit (if any), Statutory Audit Report and the replies for the irregularities found in the aforementioned report.
2. Make note of any persisting irregularities remaining unaddressed as on the date of audit and get explanation of the management in regards to the same. Make it a point to include in qualifications in LFAR<sup>1</sup>, if no satisfactory explanation is received from the management.
3. Discuss with the management regarding the inefficiencies in the Internal Control Systems if any due to transition from TBA<sup>2</sup> to CBS<sup>3</sup> Environment.
4. Conduct Physical Verification of Cash Balance available at the branch as on the audit date and confirm that it tallies with the balance mentioned in the books.
5. Where the bank is having balances with other banks, verify the certificates supporting the same.
6. In case if the bank is holding any investments in the form of Gold, conduct the physical verification of the same.
7. Interact with the management and obtain sufficient knowledge regarding the various types of loans lent and their nature.
8. Request the MSM – List of Loans and Advances (Borrowerwise) as on the audit date. Fix up a Materiality Level and List down all the borrowers according to their respective O/S balances and also Overdue Amounts.

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<sup>1</sup> Any adverse remark in LFAR, need not be a qualification in Statutory Audit Report. Only such material items which affects the true and fair view of the financial information to be disclosed has to be addressed as a qualification in Statutory Audit Report.

<sup>2</sup> Total Branch Automation

<sup>3</sup> Core Banking Solutions.

9. Request the Physical Documents of all Large Advances (depending upon the no. of advances made) and some of the selected borrowers from the remaining (test check selection recommended) and verify their completeness and correctness.
10. While the verification of the documents the following points have to be considered:
  - a. Ensure that the stock statements are obtained monthly and drawing-power limit are determined *within 1<sup>st</sup> week of every month*.
  - b. Ensure the Insurance Policy document supported for sanctioning the advance is not expired as on the audit date.
  - c. In case of Collateral Security being given, ensure that valuation report is obtained once in three years. Compare the value of security ( as per the recent valuation report) with the balance outstanding, and consider provisioning if any deficit is found.
  - d. In case of Equitable Mortgage being made, ensure that the encumbrance certificate is received and appropriate amount of stamp duty has been paid.
  - e. In case of Hypothecation, ensure that the documents depict the hypothecation made with the seal of the Bank in the title deeds. Check regarding the stamping of the agreement, availability of one set of keys(in case of Vehicle Loans),etc.
  - f. Ensure that the Statements of Assets and Liabilities of Borrowers as well as the Guarantors are obtained, duly filled and signed by the respective parties *at the end of the every year*.
  - g. In case of large advance of more than 10 Lacs, confirm that the audited financial statements are obtained *every year*.
  - h. In case of Overdrawn CC or OD Accounts, ensure necessary permission is obtained from the competent authority.
11. From the list of borrowers selected, examine each of the account whether the asset classification is appropriate. In case if the account has been classified as NPA<sup>4</sup>, confirm whether the head(B,C1,C2,C3,D1,D2) under which it has been classified is justifiable.

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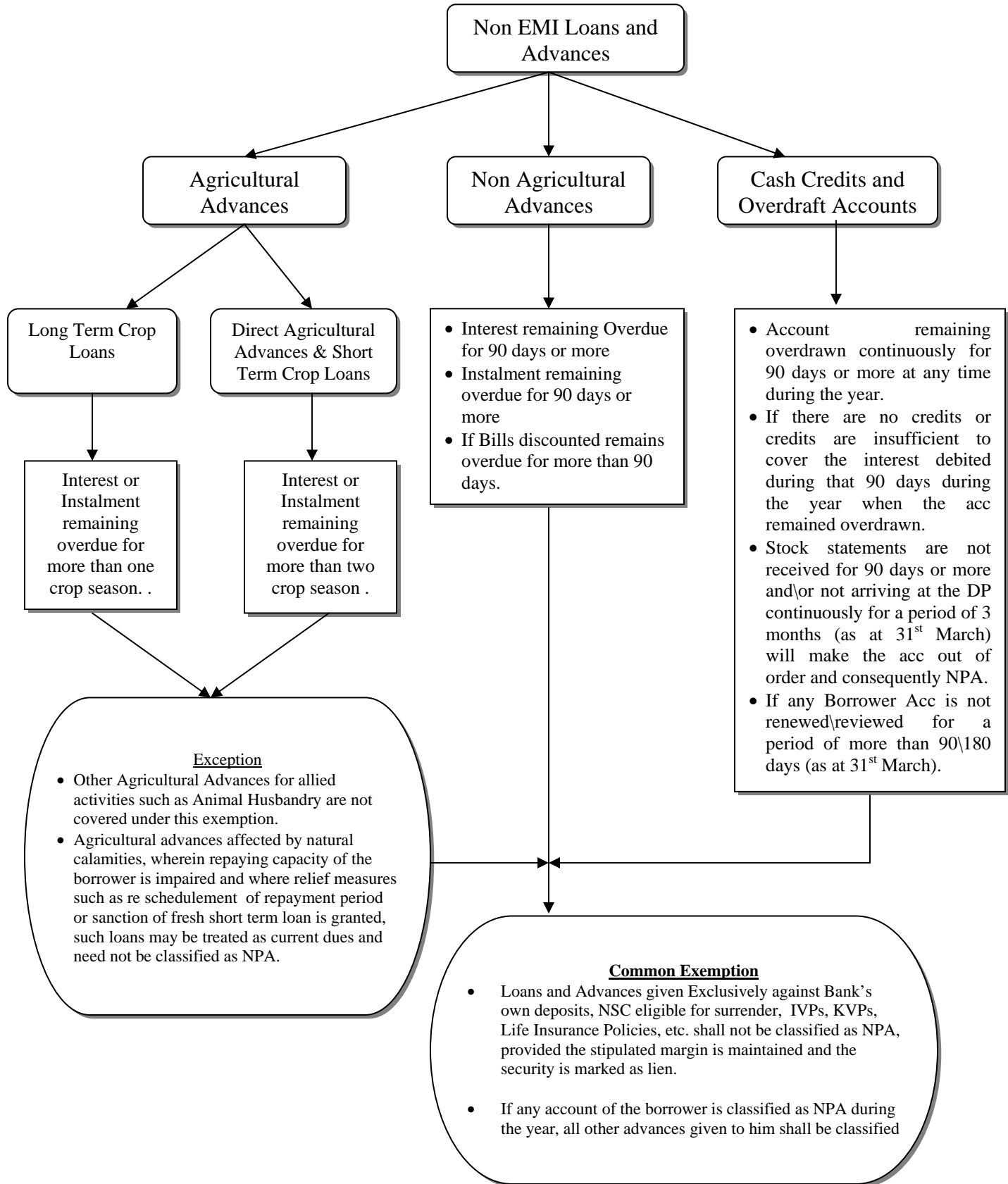
<sup>4</sup> Non-Performing Asset

12. Take special care in case of Agricultural Advances in respect of which the repayment schedules are quite different from other advances. Due to this, their classification as NPA are least probable.
13. In case of Agricultural Advances being rephased or rescheduled or reorganized, check for the intimation letter received by the Bank permitting them for the same.
14. Peruse the MSQ1 – P/L Account portion to list out the item of expenses on which TDS is required to be made under Chapter XVIIB of the Income Tax Act, 1961. Request for Statement No. 10 - Tax Audit, and see whether the TDS has been made at the appropriate rate vis-à-vis the amount debited to P/L Account and whether the same has been deposited in time. In case the provisions of the Chapter XVIIB are not complied with, the same need to be reported in Form 3CD.
15. Similarly, List out the items in the nature of Fringe Benefit from the P/L Account and see whether FBT at appropriate rate has been reported in the annexure to Statement No. 10. The provisions regarding payment of FBT and filing of returns will have to be complied at Head office level.
16. The Bank usually prepares a Statement showing the amount of Expenditure and the corresponding amount of Service tax, FBT or the TDS Made thereon, as the case may be. The Arithmetical accuracy of the Tax deducted or paid can be deduced from the statement.
17. Compare the items of P/L with that of the previous year figures. If some unusual significant movements are noticed, seek appropriate explanation from the management.
18. Usually, a bank branch is in the nature of Dependent Branch. As such, all the Fixed assets register are maintained at the Head office. Therefore, an statutory auditor need not bother about the physical verification and other auditing aspects concerning fixed assets. However, in some cases, branches maintain a memorandum Fixed assets register recording therein the particulars of assets acquired and disposed off by the branch. Verify such register to see that the same is up-to-date. Vouch instructions, if any, received from the Head office authorizing any significant acquisition or disposal of the Fixed assets and see whether the same has been complied with and properly recorded.
19. A Statutory Auditor is required to certify Statement No. 7 – Statement of Govt. and other Securities. Therefore, the auditor must physically verify such investments, if available

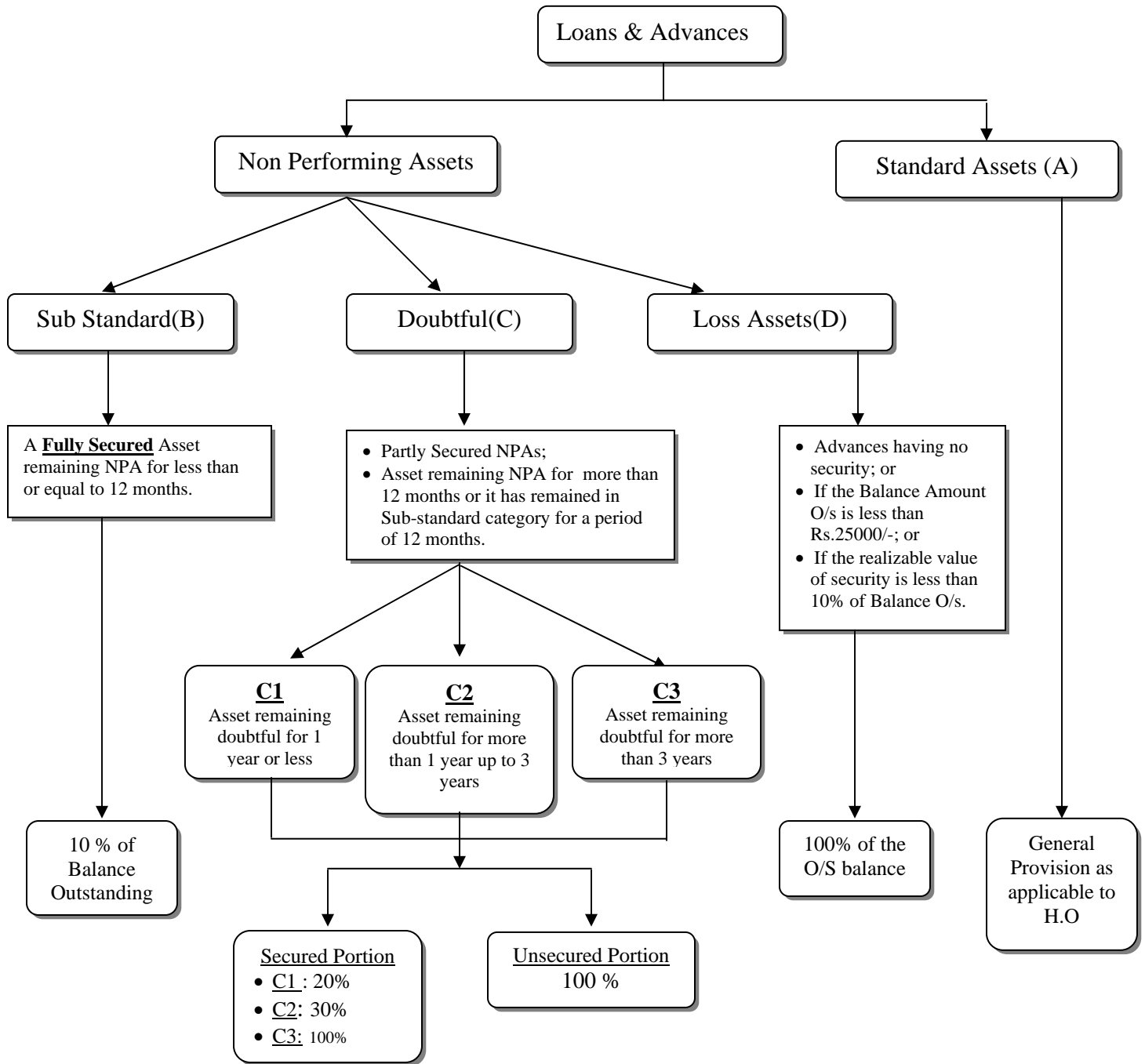
with the branch or else obtain necessary evidence to satisfy that the same are in proper custody.

20. If there are credits of round sums in the borrowal account during the last few days of March, the auditor is required to make further enquiries to ensure that the credit so made are not temporary so as to avoid the classification of account as NPA. For this purpose, the auditor must verify the operations in the subsequent month also. He must also probe into the source of credit and satisfy that they are genuine.

21. Classification of an Asset as a NPA



22. Provisioning of NPAs :



**23. Classification of EMI Accounts as NPA:**

- a. If an installment is due for a period of 30 days, the account will be classified as NPA. If the repayments are through EMIs then repayment may be in any day of the month till the last day. Hence, the auditor has to look for installments, which are due and not paid for 30 days from the end of the month in which they became due.
- b. E.g., If ABC has to pay Rs. 2 lakhs every month. If he has not remitted Rs. 2 Lakhs in the month of January and further if he has not remitted the January installment even up to 29<sup>th</sup> day of following February then the installment has become due as on 30<sup>th</sup> of January and on 1<sup>st</sup> of march, the account will become NPA if the installment is not paid up to 31<sup>st</sup> march also.
- c. In short, if an EMI overdue for more than 30 days from the end of the month in which it was due, it becomes an NPA. If the installment is paid before 31<sup>st</sup> march, the classification gets reversed.

**d. Interest & other expenses Reversal:**

In case an EMI is classified as NPA, there are no extant guidelines as to the reversal of Interest & other expenses. Generally, the appropriation guidelines followed until an account becomes NPA is that anything received is first appropriated towards interest, then towards principal. As such, there can be no interest reversal whatsoever even if the account is classified as NPA since any amount credited to the account earlier to its becoming NPA will be appropriated towards interest.

In practice, we calculate total credits to be made to the account till 31<sup>st</sup> march. Then the following procedure is adopted for interest reversal;

Total credits to be made (Total no. of Inst. Due * EMI per Inst.)	= xxx
Less: Total credits actually made till date	= xxx
Balance overdue	= <u>xx</u>

Total No. of EMI installments overdue = Balance Overdue \ EMI amount

Once we get the total no. of Installments overdue, the proportionate interest debited to the account will be reversed.

**24. Fill up the Memorandum of Changes (MOC) I<sup>5</sup>, II<sup>6</sup> & III<sup>7</sup> and Annexure III(a)<sup>8</sup>, III (b)<sup>8</sup>, III(c)<sup>8</sup>.**

<sup>5</sup> Items affecting P&L Account being less than Rs. 10,001/-

<sup>6</sup> Items affecting P&L Account being more than Rs. 10,000/-

<sup>7</sup> Memorandum of Changes in the classification of Advances.

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III(b) – Changes in the movement of NPAs

III(c) – Changes in the provision to be made facilitywise, sectorwise, securitywise.

25. **Income Recognition in respect of NPA Advances:**

- a. All unrealized interest and/or expenses should be reversed by the branch even if it pertains to previous year(s).
- b. Interest and/or expenses should not be debited to NPA Accounts.
- c. Once an asset is classified as NPA, interest/expenses thereon shall be recognized on Realization basis.
- d. Once an asset is classified as NPA then, subject to the internal principles of the bank, any recovery made in respect thereof shall be first appropriated towards principal, then towards interest and balance if any, towards expenses.