

Statutory Bank Audits: - FY 2020-21

Dear Fellows,

As we all are aware about that the season of Statutory Bank Audits is on its verge. It's the time when professionals are getting the straps of their boots ready to have a crisp walk. I thought it desirable to pen down a few things, which are basic and my experience of Bank Audits and having worked in banking industry post qualification and experiences with two of the big banks (StanC and Axis Bank) and having done the Statutory Bank Audits of PSU Banks.

The Key Deliverables for understanding Bank Audit are: -

1. Long Form Audit Report (LFAR)
2. Memorandum of Changes (MOC)
3. RBI Circulars and Notifications
4. Tax Audit Report of Branch/H.O.
5. Audit Report of Bank Branch/H.O.
6. Other Certifications/Reports
7. Performing Risk Based Audit Assessment and Checking of Advances
8. Compliance with Capital Adequacy Norms and SLR, CRR etc.
9. Reviewing Concurrent Auditors Findings and Observations
10. Checking the Loans & Advances given in last 12 months period
11. Analysing Revenue Leakages and Reporting thereof

Now, we shall be having a brief overview of all these points discussed above. For detailed discussion, we can connect in comment section or in inbox. Most of Indian Banks Normally Use Software such as FINACLE by INFOSYS, BaNCS by TCS and Flexcube by Oracle.

1. Long Form Audit Report (LFAR): -

As the name, it suggests, that it is Long Form Audit Report, which an Auditor is required to issue while performing his duties as Central Statutory Auditor or Branch Auditor of a Bank. The Balance Sheet of a Bank is as per the Third Schedule to Banking Regulation Act, 1949. The Balance Sheet and Profit & Loss Account forms integral part of LFAR. LFAR is a vital tool available to auditors through which they can comment on Balance Sheet, Profit & Loss account, Prudential norms, process lapses in operations and other issues relating to Branch Statutory Audit.

Branch auditors are required to answer a detailed questionnaire formulated by RBI. Most of the questions in LFAR contain following lines:

- 1) Does the branch generally carry or comply.....
- 2) In the cases examined by you, have you come across instances.....
- 3) Verification on test check basis.....

Hence, it becomes very important for auditor to keep the record of all samples verified for framing the opinion on the different processes in the questionnaire.

2. Memorandum of Changes (MOC): -

Memorandum of Changes more often referred to as MOC is an important document enclosed with the Bank Audit Report whenever the Auditor observes significant issues effecting the Financial Statements of the Bank.

Because Financial Statements of the Bank are prepared on Real Time Basis. Therefore, Position as on 31st March of the respective financial year are audited by the auditor. Since the financials stand frozen as on 31st March. Therefore, any modification in items of profit and loss or balance sheet requires passing of memorandum of changes, which is filled at Head Office Level, while consolidating the individual Branch LFAR.

3. RBI Circulars and Notifications: -

The overall objective of the Long Form Audit Report (LFAR) should be to identify and assess the gaps and vulnerable areas in the business operations, risk management, compliance and the efficacy of internal audit and provide an independent opinion on the same to the Board of the bank and provide their observations. Therefore, in performing the same, an Auditor is required to have a deep understanding of the applicable RBI circulars and Notifications, which underlie his performance of audit function.

4. Tax Audit Report of Branch/H.O.: -

Since All the Branches of Bank (Let's Say PNB-South Delhi Branch) and PNB-Head Office are different. Due to Operational Feasibility, All the Branches and Head Office have different PAN and TAN Numbers. Therefore, instead of 30th September of the Assessment Year, Tax Audit of a Bank is conducted along with Statutory Audit. Therefore, Bank Auditor is also required to issue Form 3CA along with Form 3CB in case of a Bank Branch Audit in addition to LFAR and Statutory Audit Report.

5. Audit Report of Bank Branch/H.O.: -

Statutory Audit is an audit which is prescribed by the different statute like Reserve Bank of India, Income Tax, Companies Act, etc. A Chartered Accountant need to conduct many audits as per the different statute requirement. Statutory Audit of banks is mandatory. Statutory Auditors are appointed by RBI in association with the ICAI. Every year after the end of the previous financial year, in every branch of the banks, a very rigorous audit is conducted.

The Statutory 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 – Modifications to the opinion in the Independent Auditor's Report &

SA 706 – Emphasis of matter paragraphs and other matter paragraphs in the Independent Auditor's Report.

Nowadays, all statutory auditors are given a time frame in which they must undertake the audit of the branches that are allotted to them. An auditor should immediately accept the appointment send a formal communication to the branch management and all other information that he would require in his audit. The auditor will have to ensure that their report should include the quantification of advances, deposits, interest income and interest expenses. The important elements to check in the statutory audit of banks are:

- A. Cash Verification Procedure
- B. Tax-Related Items
- C. Verification of Loan Accounts

6. Other Certifications/Reports: -

Besides, the financial points, and audit report, an Auditor is also required to comment on various other factors, such as whether cash level kept by branch exceeds 20% of its deposits and liabilities on 12 odd days. If the Branch is having Agri Advances, then the details of utilisation, any moratorium granted, any interest/principal waived off, etc. Accordingly, there are certain other reports, which Auditor must certify, such as Jilani and Ghosh Report, Cash Certificate, etc.

7. Performing Risk Based Audit Assessment and Checking of Advances: -

The risk profile of a bank or its branch is based on an assessment of the inherent business risks and control risks in key areas of its functioning. A business risk assessment will cover risks relating to capital, credit risk, market risk, earnings risk, liquidity risks, business strategy and environment risk, operational risk, and group risks. Control risk assessment will cover assessment of the quality of internal control, organisation, management, and compliance with statutory requirements.

8. Compliance with Capital Adequacy Norms and SLR, CRR etc.: -

Under Basel III, the minimum capital adequacy ratio that banks must maintain is 8%. The capital adequacy ratio measures a bank's capital in relation to its risk-weighted assets. The capital-to-risk-weighted-assets ratio promotes financial stability and efficiency in economic systems throughout the world.

CRR or cash reserve ratio is the minimum proportion / percentage of a bank's deposits to be held in the form of cash.

SLR or statutory liquidity ratio is the minimum percentage of deposits that a bank must maintain in form of gold, cash, or other approved securities.

An Auditor is also required to comment upon Capital Adequacy Norms, SLR and CRR while performing Statutory Audit of a Bank.

9. Reviewing Concurrent Auditors Findings and Observations: -

According to Standard on Auditing (SA)-610, Using the Work of Internal Auditors, Statutory Auditors of Bank can rely upon the work done by the Concurrent Auditors/Revenue Auditors of Bank. However, they shall be responsible for the opinion given by them and they cannot scapegoat the work performed by internal/concurrent auditors. They shall apply professional scepticism and independent mindset, before concluding about any specific matter.

10. Checking the Loans & Advances given in last 12 months period: -

Secured loans can again be divided into two types such as-

10.1-Loan against Security of Land & Buildings, and

10.2 -Loan against Movable Properties.

In case of Loans against Land & Building, Auditor shall review valuation of property, whether mortgage has been registered in the name of bank and CHG-1 has been filed with ROC within due time. Auditor should cross check the Loan to Value (LTV) ratio being followed by branch in line with the internal circular/policy of the bank.

Movable properties include stock, shares, goods, insurance policy, bonds, and debentures, etc. Loans are also granted against the security of these movable properties. In case of short-term

working capital limits, Auditor should verify that stock statements are submitted regularly and drawing power is in line with stock statement submitted by client.

11. Analysing Revenue Leakages and Reporting thereof: -

Nowadays, the bank branches are computerized. Therefore, the auditor should concentrate more on the parameters set in the system, the logic of programming, etc. He should concentrate more on the master data entered and validated at the branch. In such a scenario, how the parameters are changed and the person who is authorized to change these parameters needs to be understood and the compliance should be verified. Unauthorized change or input of wrong parameters may lead to wrong calculation of income or expenses.

Therefore, Statutory Auditor shall also give some purview to revenue leakage.

Thanks & Regards.

CA Manpreet S. Taneja

Manpreet Taneja & Co.‘

Chartered Accountants

New Delhi