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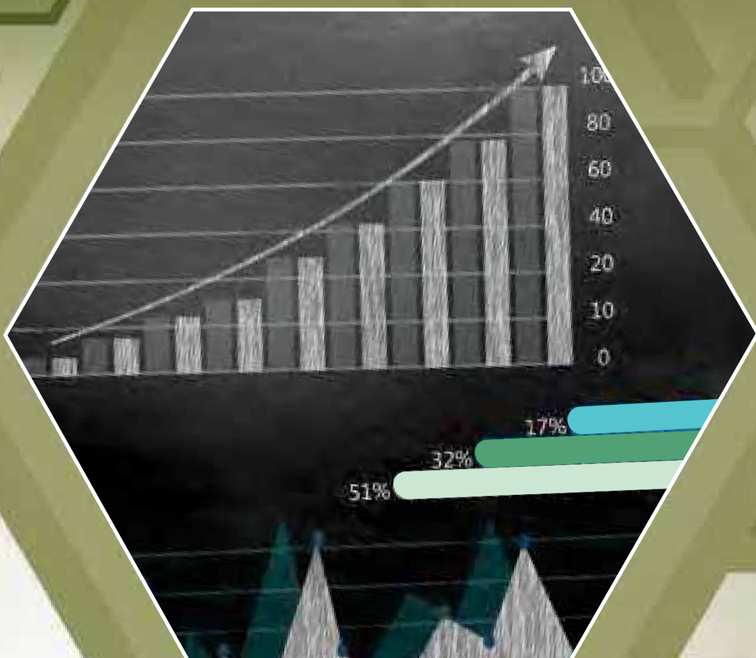

Statutory Audit of Bank Branches

Compilation of Papers 2018

Excellence *Independence* *Integrity*

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The Institute of Chartered Accountants of India

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Opinions expressed in this book are those of the Contributors. Western India Regional Council of The Institute of Chartered Accountants of India, does not necessarily concur with the same.

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Foreword

The Indian banking and financial sector has had a varied and evolutionary journey and has gone from strength-to-strength. The credit, market and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well.

Indian banking industry has witnessed the roll out of innovative banking models like payments and small finance banks. RBI's new measures may go a long way in helping the restructuring of the domestic banking industry. Access to banking system has improved greatly due to Government efforts to promote banking-technology and promote expansion in unbanked and non-metropolitan regions.

As per the Reserve Bank of India (RBI), India's financial and economic condition is far superior to many other countries in the world.

Enhanced spending on infrastructure, speedy implementation of projects and continuation of reforms are expected to provide further impetus to growth. All these factors suggest that India's banking sector is also poised for a positive growth as the rapidly growing business would turn to banks for their credit needs.

We compliment and give our thanks to the banking sector – which has been responsible to a large extent – for India's entry into the top 100 countries of the world in the 'Ease of Doing Business' index.

At the same time, the onus of ensuring that banking and finance foundations remain strong with compliances and controls being satisfied falls onto the broad shoulders of Chartered Accountants.

As auditors, we are responsible for bringing integrity to banks and ensuring the stakeholders at large of the integrity and robustness of the bank being audited. As partners in nation building, our professional outlook is critical for the growth of industry and economy overall.

This publication by WIRC provides an excellent overview of the best practices in the area of audit of bank branches to our members. The publication will help us review the various recent reforms and concepts thereby creating a more informed and transparent audit.

While the audit of thousands of branches of banks to be carried out in a very short period is an onerous task, I am proud to state that our fraternity has been satisfactorily performing this function for decades as per the guidelines and advisories that guide the audit and disclosure processes from time-to-time.

I congratulate CA Shilpa Shinagare, Chairperson of Banking, Insurance and Pension Committee of WIRC as well as the galaxy of contributors for their time and expertise towards the timely publication of this welcome compilation.

We sincerely thank our sponsors - Thane Janata Sahakari Bank Ltd., Thane and Warana Sahakari Bank Ltd., Kolhapur, for their support in this initiative of WIRC of ICAI.

CA. Sandeep Jain
Chairman, WIRC

Preface

The banking system is the lifeline of any modern economy which is one of the important pillars of the financial sector. The banking sector plays a vital role in the functioning of an economy and the strength of an economy depends on the strength and efficiency of the financial system, which in turn depends on a sound and solvent banking system.

The Indian banking system consists of 27 public sector banks, 26 private sector banks, 46 foreign banks, 56 regional rural banks, 1,574 urban co-operative banks and 93,913 rural co-operative banks, in addition to co-operative credit institutions and has played a critical role as a catalyst to the progress and growth of the Indian economy. At the same time, it has evolved greatly assisted by the fast changing conversion to digital as well as the reforms initiated by the Government.

Key investments and developments in India's banking industry include the bank recapitalisation plan by the Government of India, raising funds *via* Qualified Institutional Placements (QIP) and the RBI amends statutes thereby allowing lenders to invest in Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) not exceeding 10% of the unit capital of such instruments.

A new portal named **'Udyami Mitra'** has been launched by the Small Industries Development Bank of India (SIDBI) with the aim of improving credit availability to Micro, Small and Medium Enterprises (MSMEs) in the country. Policymakers are making all the efforts to provide facilitating policy framework and infrastructure support to ensure meaningful financial inclusion.

The Government and the regulators have undertaken several measures to strengthen the Indian banking sector like introducing 'The Banking Regulation (Amendment) Bill, 2017', which will replace the Banking Regulation (Amendment) Ordinance, 2017, and will allow the Reserve Bank of India (RBI) to guide banks for resolving the problems of stressed assets.

The Insolvency and Bankruptcy Code (Amendment) Act, 2018, which is gazetted on 19th January, 2018, is expected to strengthen the banking sector.

Indian banking industry is moving so fast on the technological front that Bill Gates has stated that India will move quite rapidly to a digital payments economy in as little as seven years, based on the introduction of digital payment banks combined with other things like direct benefit transfers, universal payments interface and Aadhaar.

This sector is facing a number of challenges – actually more of house cleaning – in the way it functions. It is evident that in the current scenario, it is clearly the Chartered Accountant as Bank Auditor who will lead the banks towards clarity of purpose in terms of compliance and procedures.

Chartered Accountants, with their vast, grassroots experience, will play a critical role towards streamlining and improving banking operations, setting up the internal controls as well as professional inputs on risk management and on technological upgradations and more importantly in their core competency area of bank audit.

As the scope for Chartered Accountant professionals increase, we at WIRC, have put together this publication to equip and update our members regarding recent guidelines, processes, with essential material to enable them to conduct their bank audit assignments efficiently and effectively. The step-by-step practical guide on bank branch audit is meant specially for the auditors who are going to handle statutory bank audits for the first time. The checklist on Audit of Urban Co-op. Bank is a special feature this time. I am sure this publication will work as a quick referencer for all the members who will be carrying out bank branch audits.

I, on behalf of my Committee and the WIRC, would like to express my gratitude to WIRC Chairman CA. Sandeep Jain along with all other Office Bearers and Regional Council Members for reposing faith in me and giving me the opportunity to work on the compilation of this book.

My sincere thanks to CA. Shriniwas Joshi, Past Chairman, WIRC; RCM CA. Kamlesh Saboo and CA. Parul Saraf for their continuous guidance and support for this publication.

I am thankful to all the contributors for sparing their valuable time in compiling, collating and scripting the various articles for this publication. While I am confident that all readers will be able to derive maximum benefit from the knowledge contained within this book, I look forward to your valuable feedback regarding the same in order to improvise and carry it forward for the betterment of all.

CA. Shilpa Shinagare
Chairperson – Banking, Insurance &
Pension Committee of WIRC of ICAI

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Seminar Series 2018

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Current Developments In Banking Industry

CA. S. B. Bhagwat, CA. Mohd. Jawed

The financial and economic conditions in India are far superior to many countries in the world. Credit, market and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global turbulence in the past.

Indian banking industry has recently witnessed the roll out of innovative banking models like payments and small finance banks. RBI's new measures such as instructions to the banks for strict recognition of NPA, faster resolution of such NPA, improvement of norms for fixing the lending rates, enactment of Insolvency bankruptcy code 2016 and its strict implementations, recapitalisation of the banks by the Government etc. may go a long way in helping the restructuring of the domestic banking industry.

The banking industry is already facing problems of NPA, lack of adequate capital, low credit offtake, lesser productivity, non-compliance culture, non-updating the systems and the procedures and non-upgradation of technology. In view of the various measures taken by the RBI and the Government it is expected that the position will improve and the banks will once again start functioning normally.

In terms of easing out of NPA crises & Improvement in bank credit, the year 2018 has not started as expected but presently the Industry is in turbulent stage.

Rating

On 16th November, 2017 Moody has upgraded the Government of India's rating from Baa3 to Baa2. The Moody have also revised the outlook of three Indian Public Sector Banks from negative to stable.

Potential /Scope

Considering the present Economic scenario, the credit offtake to corporate sector may be subdued but there are huge potentials untapped in the unorganised retail sector. Most of the banks, whether they are in private, public or foreign banks, since last few years are concentrating on increase in the business in retail sectors and the position is likely to continue during the current year also.

Credit Growth

As per the Reserve Bank of India, the credit growth has been accelerating and the economic expansion cycle is back to normal. Bank credit has grown by 8.6 per cent as of November 10, 2017 vis-a-vis 7.5 per cent a year ago indicating an improvement in credit demand.

Credit flowing was more in November 2017as compared to October 2017. The economy is picking up and the demand for credit is also likely to go up and there is an enough liquidity to meet such demands to support higher economic growth.

Government Initiatives

a) The Government of India is planning to introduce a two-percentage point discount in the Goods and Services Tax (GST) on business-to-consumer (B2C) transactions made via digital payments.

b) A new portal named 'UdyamiMitra' has been launched by the Small Industries Development Bank of India (SIDBI) with the aim to improve credit availability to Micro, Small and Medium Enterprises' (MSMEs) in the country.

c) The Government and the Regulator have undertaken several measures to strengthen the Indian banking sector such as:

   i) **The Banking Regulation (Amendment) Bill, 2017:** This Bill was introduced in Lok Sabha by the Minister of Finance, Mr. Arun Jaitley, on July 24, 2017. It seeks to amend the Banking Regulation Act, 1949 to insert provisions for handling cases related to stressed assets. Stressed assets are loans where the borrower has defaulted in repayment or where the loan has been restructured (such as by changing the repayment schedule). It will replace the Banking Regulation (Amendment) Ordinance, 2017.

ii) **Initiating insolvency proceedings:** The Central Government may authorise the Reserve Bank of India (RBI) to issue directions to banks for initiating proceedings in case of a default in loan repayment. These proceedings would be under the Insolvency and Bankruptcy Code, 2016.

iii) **The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017:** Bill has been passed by Rajya Sabha and is expected to strengthen the banking sector and to reduce NPA.

iv) **Issuing directions on stressed assets:** The RBI may, from time to time, issue directions to banks for resolution of stressed assets.

v) **Committee to advise banks:** The RBI may specify authorities or committees to advise banks on resolution of stressed assets. The members on such committees will be appointed or approved by the RBI.

vi) **Applicability to State Bank of India:** The Bill inserts a provision to state that it will also be applicable to the State Bank of India, its subsidiaries, and Regional Rural Banks.

d. A two-year plan to strengthen the Public sector banks through reforms and capital infusion of ` 2.11 lakh crore, has been unveiled by the Government of India that will enable these banks to play a much larger role in the financial system and give a boost to the MSME sector. In this regard, the Lok Sabha has approved recapitalisation bonds worth ` 80,000 crore (US$ 12.62 billion) for public sector banks, which will be accompanied by a series of reforms, according to Mr. Arun Jaitley, Minister of Finance, Government of India.

New Direction for lending Rates

RBI in July, 2016 has introduced the Marginal Cost of Lending Rates (MCLR) however, it has been experienced by the Regulator that the benefit of reduction in the rates were not passed on to their customers. In view of this RBI has now proposed for linking the lending rates to market benchmarks such as treasury bill, Repo rate etc. This has been opposed by almost the entire banking industry barring few banks. The basic reasons for such approach is bank deposits rates are not linked to the market rates.

Resolutions of NPAs

One of the major challenges of Indian Banking system is NPA. This has affected the profitability of the banks besides hampering ability of future lending.

The non-performing assets have increased from 6.18 lakhs crores to ` 8.29 lakhs crore as on June 2017 as compared to June 2016. In percentage term the ratio of NPA has deteriorated from 8.42 to 10.21. It is also expected that the position may deteriorate further.

The Government in January 2018 has acted proactively and passed the amendment to the Insolvency and Bankruptcy Code to keep defaulting promoters out of the resolution process of insolvent companies.

The IBC ordinance sought to bar wilful defaulters, defaulters whose dues had been classified as non-performing assets (NPAs) for more than a year, and all related entities of these firms from participating in the resolution process.

More than 300 cases have been admitted under the IBC by the National Company Law Tribunal (NCLT) for resolution. These cases include big corporate accounts having large exposures.

RBI has already identified 12 accounts in the first list for immediate resolutions. Such accounts have got exposures to the extent 25% of the total Bank credit. Out of 12, few accounts, have already come to the stage of bidding. In addition to this RBI has also identified 28 more accounts in second list which banks have to refer to NCLT for resolutions.

Revised framework on stressed asset

The RBI in February 2018 has given the revised framework for resolution of stressed asset.

- As per the said circular the lenders have to classify the stressed accounts into 3 categories SMA-0 where the overdues is 1 to 30 days, SMA-1 overdues is 31 to 60 days and SMA-2 overdues is 61 to 90 days.

- All the lenders must have a Board approved policy for timely resolution of stressed asset.
- In respect of the large accounts, independent credit evaluation (ICE) of the residual debt by credit rating agencies (CRA) will also have role to play.
- For accounts having exposures between ` 100 crores to less than ` 500 crore ICE is required from one approved CRA and for the accounts above ` 500 crore ICE is required from two approved CRAs.
- There are other terms which need to be complied for timely resolution.

Non-Fund based facilities

- The Banking industry has witnessed several major frauds due to fraudulent use of non-fund based facilities.
- It has been observed that Bank is less cautious while sanctioning non-fund facilities as compared to fund-based facilities.
- Reserve Bank of India has already issued guidelines and the precaution which are required to be taken care of while sanctioning non-fund facilities. i.e. Proper Assessment must be made, the release of the loan should be only after compliance of all terms of sanction and its accounting in their Core Banking Systems.

Systems and procedures

Recently the banking industry has witnessed a fraud of the magnitude of ` 12,700 crore. The LOUs (Non-Fund based facility) were used by one of the branches of the PSB in connivance with the party without recording the transactions in core banking system of the bank, which remained undetected. The fraudulent transactions continued from the year 2010-11 onwards. It was reported that the fraud could take place due to non-integration of the SWIFT system with CBS and non-implementation of rotation of the staff posted in the said branch. LOU issuing bank has also not carried out the reconciliation of the entries of NOSTRO accounts with SWIFT messages.

The Foreign Branches of Indian Banks while extending the loans under LOUs have also failed to undertake due diligence such as LOUs were issued and used for a longer period as against 90 days allowed after shipment of goods for concerned industry by RBI.

This has shaken the entire banking industry and has shaken the confidence of the public on the banks. The need of the hour is the bank must improve their compliance culture in all their functioning.

Prompt Corrective Actions (PCAs)

In view of the breaching of certain norms prescribed by RBI on account of NPA,11 Public Sector banks have come under RBI direction of prompt corrective action (PCA) leading to the restrictions on capital expenses, expansion of the credit, expansion of the branch and further recruitment of the staff.

Further, as per the latest information, 5 more banks have come under PCA.

Overseas Branches of Public Sector Banks

The Government is in the process of rationalisation of the overseas branches of PSBs. The Government has formed a committee of the 4-5 bankers to take a call on closure/consolidation of all unviable branches.

National Financial Reporting Authority (NFRA)

The Government is set to introduce a new regulatory body called National Financial Reporting Authority, with a view to take disciplinary action against the auditors. Earlier such powers were with the Institute of Chartered Accountants of India (ICAI). The constitution of NFRA is enshrined in the section 132 of the Companies Act, 2013. It has been approved by the Cabinet.

Financial Resolution and Deposit Insurance (FRDI)

The Government has passed the Financial Resolution and Deposit Insurance (FRDI) Bill in August, 2017.

The FRDI Bill is part of a larger, more comprehensive approach by the Centre towards systematic resolution of all financial firms — banks, insurance companies and other financial intermediaries. The Bill comes together with the Insolvency and Bankruptcy Code to spell out the procedure for the winding up or revival of ailing institutions.

The banking system is built on the trust that depositors have in their banks. The confidence that money is safe, keeps depositors away from withdrawing their funds unless they really need it. Meanwhile, it allows banks to lend out the money to borrowers which generates interest income for the depositors, profit for the bank and economic growth for the country.

However, the ‘bail-in’ clause in the Government’s Financial Resolution and Deposit Insurance (FRDI) Bill has created fear as the Bill allows the proposed Resolution Corporation (i.e. bail in clause) to cancel the liability owed by a failed bank. Since the main liability of a bank is to repay the money to the depositors, it naturally causes concern whether depositors stand to lose their money beyond what is insured in the event of a bank failure. Unless nipped in the bud, a panic reaction may destabilise the banking system. The reasons for the fear is specially in States where few banks in co-operative sectors have failed and could not repay to their depositors.

Way forward to the Banking Sector

Following are some suggestions for Improvement in Banking Sector

- The legal system needs to be strengthened. The decision in respect of banking cases must be within the time-limit say maximum one year.
- If required, separate courts need to be set up. DRTs so far has not fulfilled the expectations.
- The cases involved for recovery of the bank dues is normally filed as civil cases. Since there is an involvement of public money, all the cases specially of ` 5 crore and above should be treated as criminal offence.
- The court may be barred to stay the actions under SARFAESI Act.
- Risk management system in the banks needs to be further strengthened. There should be arm’s length policy in respect of all credit proposals between the credit department and risk management department. Both the departments should be independent and act on equal footing.
- The resolution under IBC should continue to be implemented as is being done now.
- In case of all accounts under IBC, the bid amount should cover at least the principal amount disbursed by the bank.
- Efforts should be made to hold the promotors and other guilty persons accountable for the balance amount which could not be recovered out of resolution process. Their personal properties should be seized and they should be permanently debarred from availing the credit facility from the banking system.
- In no case the provision made by the bank should be consideration for fixing the minimum reserve price or liquidated value.
- The transfer policy in the bank for the staff must be implemented strictly.
- Proper training needs to be imparted to all the staff members of the bank.
- All the flaws in the systems and procedures need to be addressed.
- All the systems need to be integrated with the core banking system of the bank.
- Sharing of the passwords in the banking systems should be treated as major lapse on employees.
- There should be proper accountability in all the banks and at all levels of the officers including top management.
- At frequent intervals the systems and the procedures need to be reviewed and upgraded.
- Audit and Inspections department in most of the banks are not properly manned, it should be headed by the professionals and the staff working under the said department should also be professionally qualified and should have minimum three to four years experience before placement in the department.
- Study need to be made by the Regulator to assess the possibility of providing some other improved version of credit facility instead of LOU/LOC.
- Government need to reconsider the populist measure such as loan waiver which destroys the basic culture of the repayment which affects banks adversely as well as the Economic development.
- NPA is the biggest menace/challenge for the industries and needs to be controlled at any cost.

Bank Branch Audit Planning

CA. Arvind Joshi

Statutory Audit of Bank Branch is an exercise to be carried out every year. However under the current Banking scenario, ever-changing legal framework, current challenges faced by the economy and banking industry in particular, changes in technology, various laws governing banking business, interpretation of various circulars & notifications of RBI etc., it has become very essential that the chartered accountants should carry out audit more carefully. Recently many frauds have come to light where top bank officials and also those having access to banking system were involved. There have been issues in the internal controls being by-passed. This has given a setback to the banking industry as a whole. Therefore one not only needs to be updated in respect of the current scenario but also have knowledge of how to verify the system followed by banks which is necessary to control frauds, misuse of funds, NPAs and many more areas at branch level. We, as chartered accountants and Auditors for bank branch need to equip ourselves appropriately to carry out our responsibility in a proper manner.

Moreover, the auditors are having a very limited time period within which they have to understand the scope, area coverage, carry out the work, interact with bank branch staff, get required information, actual verification and submission of report. Auditor is not only required to report on the accounts of the bank branch but also required to issue numerous certificates. There is a limitation of resources. chartered accountants have to rely on the articled clerks and paid staff for the purpose. Capability and capacity of every assistant may differ. It has also been experienced that even the staff of the bank many a times does not know much about the accounting application being used by the bank and therefore are unable to give us information as required and also in time.

Therefore to control such risk considerably, prior and proper audit planning is very essential. Preparing exhaustive checklist, standardisation of audit procedures to be followed, defined process of documentation, maintaining and presenting of queries etc., with proper and prior discussion with the concerned staff who will be executing the work is very important.

Considering the background as elaborated above the need of audit planning is better explained by following:–

- ✓ SA 300 -Audit Planning emphasises that the auditor should plan his audit work to enable him to conduct an effective audit in efficient and timely manner.
- ✓ In Bank branch audit, adequate audit planning is required because it facilitates the following:
- ✓ Ensures that appropriate attention is devoted to all important areas of audit like deposits, advances, Bank charges etc.
- ✓ Ensures that potential problems are properly identified e.g. frauds
- ✓ Ensure that work is completed expeditiously and effectively
- ✓ Effective utilisation of audit staff. No important area of work is left out and no work is duplicated
- ✓ Co-ordination of the work done by other auditors – Important Points of Other Inspection/ Audit Reports are taken care of.

It is very well said that - **IF YOU FAIL TO PLAN……**
YOU PLAN TO FAIL……..

For the purpose of audit planning one needs to consider the process followed for bank branch audit.

Bank Branch Audit Process

1) Appointment of auditor
2) Understand the type of bank branch – Nature of business at the branch.
3) Making effective audit plan / audit programme
4) Performing audit procedures

5) Assessing Internal Controls in Banks

6) Form and Contents of Financial Statements

7) Reporting - Compilation of Information and Reports to be signed

1. Appointment Letter

- ✓ Audit Planning starts with the receipt of appointment letter
- ✓ Check the compliance with regard to qualifications/disqualifications
- ✓ Take decision for acceptance or refusal of audit assignment. Accordingly issue letter to bank
- ✓ Communication with previous auditors
- ✓ Understand the expected date of Submission of Reports
- ✓ Find out the Scope of Work so that nothing is missed out and accordingly proper plan can be prepared.
- ✓ Issue engagement letter under SA 210 – "Agreeing the terms of Audit Engagements"

2. Understanding the Business of Bank Branch

- ✓ Type of branch and nature of business handled by the branch
- ✓ Nature and type of branch (CBB/IFB/ SME/ AFB/ Service Br/ Asset Recovery Br. etc.)
- ✓ Size of the branch (small/medium/large/ very large etc.)
- ✓ No. of extension counters/ATMs
- ✓ Key Business Figures – Deposits, Advances, Net Profit, NPA Level, New NPA Accounts etc.
- ✓ Operating Environment (CBS, Internet Banking, RTGS etc.)
- ✓ Details of Government / Other Contractual business handled by the Branch
- ✓ Type/Nature of transactions at Branch
- ✓ Quantum of transactions
- ✓ Laws applicable to bank
- ✓ Accounting Standards applicable to bank
- ✓ Computerization system – software
- ✓ Internal Control – risk assessment
- ✓ Risk Management – back up system
- ✓ Obtain previous year audit reports
- ✓ RBI inspection reports, internal inspection / concurrent audit reports
- ✓ Internal audit rating / risk rating of the branch assigned by internal auditors
- ✓ Collect closing instructions Circular, important H.O. Circulars and details of Changes in Accounting Policies.
- ✓ Attend the Meeting of Statutory Auditors and Bank Audit seminar.

3. Making effective audit plan / audit Programme

Considering the above one needs to prepare audit plan which will cover all the areas to be covered during the audit, standard audit procedures to be followed. For the purpose following also needs to be considered:-

- ✓ **Composition of Audit Team:** Selection of team members need to be done carefully. As bank branch audit is essentially a time bound programme, audit team must be chosen with proper SWOT analysis. Interpretation and analysis of data, drafting skills and timely compliance need to be properly understood by the team members. Team should be guided to work with proper Co-ordination.
- ✓ **Training:** Basic training at office before sending the team to the branch is necessary. Particularly there should be an understanding of CBS which is quite different than other accounting software. There are many reports which are system generated. Understand those reports. Also discuss with those who are in the team, audit programme in detail, make them understand clearly the process & procedure to be followed.
- ✓ **Distribution of work-** Work to be distributed among the staff depending upon seniority, understanding of work, capability & capacity as well as prior experience of each of the

team member. This will avoid any confusion in execution of work.

- ✓ **Review & monitoring of the Audit Plan during the actual conduct of audit.** Revising the plan whenever & wherever necessary depending upon the audit findings.

4. Performing Audit procedures & assessing Internal Controls in Bank Branch

The performance of audit procedures depends upon the assessment of internal controls at the branch. Audit planning therefore should cover the process of evaluating of the internal controls.

Management is primarily responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate according to the size and nature of the business. The auditor should examine and study the accounting system and related internal controls and should evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

Where the auditor concludes that he can rely on certain internal controls, his substantive procedures would normally be less extensive and may also differ as to their nature and timing. If he observes any deficiencies in the internal controls in any area- his substantive procedures would be more extensive.

<u>Evaluation of Internal Controls</u>

The auditor should obtain information in respect of Internal Control Systems in the following areas:

- ✓ General software related controls
- ✓ Revenue items related controls
- ✓ Controls related to general administration and housekeeping
- ✓ Controls related to certain special accounts like sundries and suspense accounts
- ✓ Controls with respect to Advances- Sanctions, Renewals, Credit Appraisal, Disbursement, Documentation, Recovery etc.
- ✓ Controls related to Classification of advances and income recognition
- ✓ Deposit related controls and controls with respect to inoperative / dormant accounts
- ✓ Controls with respect to compliance of tax laws.

CONSIDERING THE EVALUATION AS ABOVE AUDITOR MAY DECIDE THE AUDIT PROCEDURES TO BE APPLIED FOR DIFFERENT TYPES OF VERIFICATIONS:-

- ✓ Inspection e.g., Vouching.
- ✓ Observation
- ✓ Inquiry & confirmation e.g., Confirmation of Bank Balances
- ✓ Computation e.g., Interest Calculations
- ✓ Analytical Procedures like Comparisons-ratio analysis etc.

5. Understand forms and contents of the Financial Statements: According to the form & contents of the financial statements, audit programme needs to be devised & executed. Extent of checking & verification depends upon the internal controls as well as on reporting requirements also.

6. Reporting: Proper planning helps proper execution of plan, quality of audit and consequently quality of reporting also. Reporting is end result of the proper execution of the audit plan.

<u>**Following points need to be considered in audit planning as well as execution thereof**</u>

1) Should have basic understanding of:

RBI Circulars: Basic understanding and knowledge of RBI circulars is necessary. Earlier, RBI used to issue Master Circular every year on 1st July. Last such circular was issued on 1st July, 2015. Since January 2016, RBI has started issuing Master Directions. Such Master Directions are issued regularly whenever there is a need to clarify something or to change, modify existing provisions or impose new one. Therefore, knowledge of RBI Circulars etc., is very much necessary while conducting any bank audit.

Bank's Closing Circulars: Closing Circulars cover the policies framed by the bank within the scope of RBI Circulars and SEBI Guidelines etc. These Closing Circulars are enclosed with appointment letter sent to the auditor. Basic understanding about these circulars is necessary as the policies followed by the bank are within the framework of these circulars.

ICAI Guidance Notes: Guidance Notes are issued by our institute on bank branch audit every year so as to give appropriate guidance to the members to carry out branch audit in an effective manner. Audit report is the final outcome of the audit process. An auditor issuing the audit report is liable for the opinion given by him. Audit is generally carried out considering the risks. ICAI Guidance Notes help members to control such risks and give guidance. The Guidance Notes contains reporting formats including some checklists and in particular some disclaimers which we should use appropriately wherever required.

Allied Laws: We should have basic knowledge of Allied Laws in order to carry out effective audit. For example, Indian Contract Act 1872, The Bombay Stamp Act, 1958, Negotiable Instruments Act, 1881 etc. The impact of provisions under these laws on the documents especially in the area of loans and advances need to be considered appropriately wherever required.

After having the basic knowledge of above mentioned circulars, guidance Notes etc., you can plan the audit. Tracking information from various sources and using the same to design check-list and audit program will certainly help quality audit.

2) During the execution of audit at the branch:-

- ✓ Decide day-to-day plan keeping in mind the date of signing of final audit report
- ✓ Discuss all required points with branch manager and do not miss important points for sure
- ✓ Maintain minutes of discussion with branch manager throughout audit process
- ✓ Carry duplicate book to communicate your requirements to branch staff
- ✓ Avoid communication gap
- ✓ Strictly follow time lines & achieve daily targets. Discuss the doubts and queries arising during verification there and then
- ✓ Preparation of Certificates and LFAR should be simultaneous. Take Photocopies of important documents for your records
- ✓ Discuss Audit Reports & Certificates.
- ✓ Confirm MOCs with branch manager. In case of disagreement send signed MOC along with other documents with an appropriate note address to Central Statutory Auditors (CSA). If possible, discuss the issue with CSA before issue of MOC
- ✓ Complete other formalities like stamping, signing and affixing date
- ✓ Collect & file all working papers
- ✓ Sign-off all query sheets & other documents
- ✓ Confirm attendance sheet with branch manager
- ✓ Ensure all queries and notings are quantified and no jargons are used in the drafting of any query as well as report.
- ✓ Take acknowledgment on submission of your report

An Illustrative checklist has been annexed to this write-up which can be considered and modified as may be required considering the business of the branch under audit

CONCLUSION

Bank branch audit is an exercise to be carried out facing various challenges like limited time, limited resources, unlimited expectations from auditors etc. Considering all these factors, to ensure deadlines and delivering quality audit by paying adequate attention to high risk areas, planning and proper execution thereof plays a very important role.

■■■

Draft Bank Branch Audit Program for the year ended March 31, 2018

NOTE:

1) The above audit program is illustrative and the members are advised to modify the same suitably to suit their requirement.

2) Documentation should be done to support the above audit programme.

Name of the Bank and Branch:		
Branch Code No.		
IFSC Code		
Region/ Zone in which the Branch is located:		
Name & position of the authorised person in Branch(BM/AGM)		
Sanction Limit of authorised person in branch (BM/AGM)		
Advances as on 31st March,2018		
NPA as on 31st March, 2018		
Deposits as on 31st March,2018		
Date of Commencement:		
Date of Completion:		
Audit Team		
Partner/s:		
Qualified Assistant		
Semi Qualified Assistant		

Details of the Authorised Persons of the bank

Branch Manager:		
Others (Specify):		
Audit Aspects	**Covered By Whom**	**Extent of Check**
General		
1. Engagement letter to the appointing authority		
2. letter of requirement to the Branch		
3. letter for NOC to previous auditors		
4. Meeting and discussion with the bank branch management and understanding the profile of the bank and its business		
5. Intimation in writing whether given to the branch manager regarding requirements for audit and documents to be kept ready for audit including for LFAR, tax audit report and certification		

6. Review of • Previous year's audit report/ LFAR, • Current period's Internal Audit Report/ Concurrent Audit Report • Revenue Audit Report/ • IT System Audit Report • RBI Inspection Report • Compliance of the branch to any of the above and • Any other special review report		
7. Physical verification of • Cash • Stationery • Unused DD etc. and • Valuable securities.		
8. Note down • Shortage of cash appearing in Trial Balance • loss/theft DDs reported to respected authority		
9. Physical verification of Investments (obtain certificate from bank manager for the same). If no investment is hold /done by the Branch, such certificate to be obtained		
10. Understand the system in CBS Branch a) Verify controls b) Start of day and end of day report c) Verify exceptional report d) Understand the editable & uneditable fields at Br anch, e) Creation & entries in Masters, f) Various short-cut keys for checking the accounts g) System of downgrading & upgrading of accounts, h) Interest calculations etc.		
11. Compliance of instructions issued by bank's year and closing circulars, other relevant internal instructions/ circulars, Master circulars and other notifications issued by RBI, significant accounting policies of the bank Mandatory Accounting Standards/Auditing Standards and other notification.		
12. Prepare a list of various closing returns to be verified and certified, and then checking of the same during the audit.		
Checking of Balance Sheet Items		

1. Checking of the advances		
• Critical review of all large advances and their reporting as per prescribed norms.		
• Classification of advances as per IRAC norms.		
• Latest valuation of security given against advances.		
• Provisions on NPA as per IRAC norms.		
Loan Accounts (Performing)		
I. Review of all large advances with balance of lower of 5 % or ` 2 crore of total advances.		
II. Review of loans sanctioned during the year. (specifically those that have been sanctioned by the BM and are within his power)		
III. Review of other advances on test check basis.		
IV. Review of adverse comments by Concurrent auditors, RBI/internal inspectors and the reply given and corrective actions taken by the branch		
V. Review of suit filed and decree accounts with respect to provision thereon and progress of recovery thereof and Classification as per IRAC norms		
VI. Review of accounts upgraded during the year from NPA to standard. and ensure full recovery of total overdues		
VII. Review of all accounts frequently exceeding limits/DP and watch-list accounts		
VIII. Also verify all the credit card dues which are overdue & debit balances in SB A/c.		
Loan Accounts (Non Performing)		
IX. Review the accounts which are classified as NPA during the year w.r.t Security Value, Interest Reversed, Date of NPA, provisioning thereon etc.		
X. Review the annual stock audit report for the NPA & latest valuation report for the immovable properties in case the valuation is older than 3 years.		
NOTE:		
(i) Following aspects of the advances to be verified:		
Pre-sanction: System of credit appraisal and review/renewal.		
Post sanction: Compliance of terms of sanction, documentation, end use of funds.		
Monitoring: Stock and Book statements, drawing power, insurance, inspection of stock/security, operations in the account, etc.		
(ii) All the accounts verified in category (i) to (x) should be documented.		
2. Verify controls in respect of the following important items of assets.		

	(i)	Dual custody of cash		
	(ii)	Custody and issue of /pay orders other stationery items etc		
	(iii)	ATM cash as per books and actual balance tallied at year end.		
3.	**Fixed Assets**			
	I.	Checking of additions/deduction/transfers of fixed assets, supported by proper bills/invoices and confirmation of date put to use. Compliance of Accounting Standard related to fixed assets		
	II.	Checking of Depreciation on additions, deduction during the year and on existing assets as per the policy of the bank.		
	III.	Verification of Fixed Assets Schedule for furniture & fixtures and other assets and reconciliation with figures appearing in the Balance Sheet and FA management software used by the bank (if any).		
4.	**Deposits**			
	a)	Verification of Anti Money Laundering guidelines and Compliance with KYC norms on test check basis		
	b)	That overdue deposits, matured time deposits, cash certificates and certificates of deposits are shown in Demand Deposits.		
	c)	Interest accrued but not due should not be included in deposits but, should be shown under other liability.		
	d)	Check TDS compliance on the interest paid and on test check basis checking of Form 15G & 15H and confirm whether those forms are submitted with respective Income Tax Authority		
	e)	Movement of Deposit *vis-à-vis* movement in interest expense.		
	f)	Verify that dormant accounts more than 10 years are transferred to Depositors Education and Awareness Fund		
	g)	Near the balance sheet date & till the date of audit whether there have been any unusual large movements in the aggregate deposits held at the yearend		
	h)	Verify staff Accounts		
5.	**Inter-Office & Suspense A/c**			
	1.	Reconciliation of accounts with other banks, head office and inter branch adjustment accounts.		

2. Inter Office Reconciliation (IOR) Accounts: I. Verify Inter Branch Items In Transit (IBIT) account for old entries. II. Compare on test check basis, the balance and the entries in IOR Accounts with the copies of the statements submitted to the IOR department/s. III. Critically verify the daily enquiry memos received from the respective IOR department/s for any old and odd items and action taken by the branch for the same IV. Old un-reconciled entries are being provided/ reported to HO for provision		
3. Detailed checking of suspense accounts – credit as well as debit schedules. i.e., Nominal ledger.		
Balance Sheet Finalisation		
1. Scrutiny of Balance Sheet, particularly –		
i) That all the balances are shown in proper heads and broadly compare previous year figure to understand material variance		
ii) Check in case of advances that:		
a) Interest accrued but not due on loans is not included in advances.		
b) Credit balances in O/D, C/C in–operative current accounts should not be netted off with advances and the same should be shown under demand deposits.		
c) Verification of Anti Money Laundering guidelines and Compliance with KYC norms on test check basis		
d) Overdue deposits, matured time deposits, cash certificates and certificates of deposits are shown in Demand deposits		
e) Interest accrued but not due should not be included in deposits but, should be shown under other liability		
2. Checking, (i) Liability under Bank Guarantee/ L/C and effects of expired BGs (ii) Reconciliation of general ledger and subsidiary ledger.		
Checking of Profit and Loss Items		

1. Test checking of interest on deposits, (particularly, Interest checking should be done on test basis for the period subsequent to the period of revenue/ concurrent audit). Ensure that interest provision on overdue F.D. has been made as per latest RBI guidelines		
2. Test checking of interest/commission on various advances, bills, L.C., Guarantees, etc		
3. Test checking of discount/commission on bills discounted and others income like commitment charges, processing fees, recovery of insurance/ legal fees etc		
4. Derive various ratios of items of income with comparable and related assets (like Avg. Interest Income to Average Advances etc.) and verify major movements or variances		
5. Checking of proper classification of revenue and expenditure items		
6. Critical scrutiny of the Expenses/Income accounts and checking of important vouchers, including proper accounting for outstanding and prepaid expenses		
7. Provision for expenses, accrued interest on deposits and advances. (Particularly check whether or not interest has been provided/charged on all types of deposits/ advances disputed rent		
8. Checking of interest in NOSTRO Accounts debit balances		
9. Verification of recovery on account of locker rent, staff accommodation, etc., with details of arrears, if any		
10. Commission income on account of Government Business, i.e., collection as well as remittance of Income tax, VAT, Service tax, GST etc.,		
11. Details of prior period items of Income as well as expenses and complete details of provisions to be made, if any		
12. Rebate on Bills discounted		
13. Checking of depreciation on fixed assets		
14. Verification of provision of interest on standard, substandard, doubtful & loss assets and appropriate accounting treatment thereof and reversal of interest and charges not recovered on new NPAs. Booking of Interest Income on account of partial recovery in NPA's.		
15. Ratio analysis with previous years figures.		
16. Note down the reasons for material variances, if any		
Others		
1. Checking of statement of frauds, adequacy of provision, timely reporting to competent authority, recovery and movement in balances.		

2.	Checking of statement of claims against the bank not acknowledged as debt		
3.	Checking of Foreign Currency forward exchange contracts showing sales and purchase separately. Review of NRE and FCNR accounts, if any		
4.	Checking of Guarantees given on behalf of Constituents		
5.	Checking of Acceptance, endorsements and other obligations, i.e., L/C and bills accepted by the bank on behalf of customers (Particularly check in case of Clause 4 and 5 above, whether the above guarantees and L/C issued are within the powers of the authorised person and proper procedures have been followed for issuing the same. Review the position of the above as at the year-end)		
6.	Other contingent liability, if any.		
7.	Checking of and preparation of interest subsidy certificate (as per various RBI & Government schemes), correct accounting & whether the same are given to the eligible .borrowers		
8.	Checking of write off proposal and DICGC claims, sharing of recovery, etc.		
9.	Checking of annual returns on protested bills/ recalled debt accounts (PB/RD).		
10.	Checking of LFAR schedules and preparation of LFAR. (Detailed planning for preparation of LFAR be done at the time of commencement of audit and detailed guidance be sought from the chapter on LFAR in this guidance note).		
11.	Checking of Tax Audit annexures and preparation of Tax Audit Report.		
12.	Checking of service tax/ GST collected and paid.		
Final Audit and Reporting			
1.	Preparation of audit report as per format prescribed under SA-700, ICAI and under any other regulatory authority.		
2.	Preparation of memorandum of changes for changes to be made in classification of advances and in any item of asset/liability and profit and loss account with other remarks and/ or information which requires further attention at Regional/Zonal Office level.		
3.	Preparation of Tax Audit Report.		
4.	Preparation of Long Form Audit Report (by giving annexures where ever necessary)..		
To Collect the following Certificates			
1.	Physical verification of the fixed assets carried out on March 31, 2018 / during the year		

3. Physical verification of Investment carried out on March 31, 2018 / during the year. If investment are not held or appearing in the Trial Balance, Nil certificate should be obtained		
3. Physical verification of the cash & other items as on March 31, 2018		
4. Physical verification of cash periodically by officers of the bank		
5. Certificate from the branch for the persons attended the audit		
6. Written Representation Letter.		
To verify and issue the certificates (as applicable): Illustrative list		
1. Certificate of Ghosh and Jilani committee Recommendations.		
2. Cash on 12 odd dates.		
3. Commitment charges payable to IDBI/ SIDBI.		
4. Interest claim on (FCNR) deposits.		
5. Certificate giving details of claims lodged with DICGC / ECGC however, rejected by them		
6. Risk weighted assets as per the capital adequacy report		
7. Certificate for treating an account as bad or doubtful of recovery as per the requirement of DI and CGC		
8. Average month end rural branch advances.		
9. Subsidy claim under Prime Minister Rojgar Yojna Or any other scheme of the Central/State Government		
10. Certificate for Interest Subvention		
Discussion of the Draft Reports with the Manager		
Preparation of Final Report		
Submission of Final Report along with Copies of Signed Balance Sheet, Profit & Loss Account and certificates.		

Prepared by: ___________________

Reviewed by: __________________

Audit of Agricultural Advances

CA. Prakash P. Kulkarni

1. Introduction

Even during the current trend of globalisation, domination of IT & other Services Industries and 'Make in India', the Indian Economy is still, to a larger extent, dependent on agriculture. Agricultural Finance thus constitutes a pivotal category under the ambit of priority sector credit. In fact, realising the importance of agricultural lending, most of the banks have set up specialised agricultural credit centres and branches.

Agricultural Finance, as opposed to generic lending, is subject matter of specialised skills, requiring the bankers as well as auditors to have understanding of specific procedures developed by each bank as well as specific RBI guidelines. The RBI guidelines relevant to on Agricultural Lending along on the Key concepts of Agricultural Finance, which are relevant for the purpose of bank branch auditors are summarised. Auditors are advised to refer to relevant RBI guidelines as well as Bank's Internal Guidelines/policies and procedures to have an exhaustive understanding of the subject matter.

Agency-wise Agricultural Finance in last 4 years

(Amount Rs. Crore)

Agency	2013-14	2014-15	2015-16	2016-17	Share
Commercial Banks	5,27,506	6,04,376	6,42,954	7,33,201	76.4%
Regional Rural Banks	82,653	1,02,483	1,19,261	1,03,974	10.8%
Co-op. Banks	1,19,964	1,38,469	1,53,295	1,22,651	12.8%
Total	**7,30,123**	**8,45,328**	**9,15,510**	**9,59,826**	**100.0%**
Crop Loans	5,48,435	6,35,412	6,65,313	6,22,685	64.9%
Term Loans	1,81,688	2,09,916	2,50,197	3,37,141	35.1%
Total	**7,30,123**	**8,45,328**	**9,15,510**	**9,59,826**	**100.0%**

(Source : NABARD Annual Report)

2. Gist of RBI guidelines in respect of Targets on Agricultural Lending

RBI's directions on Agricultural Credit are last updated *vide* RBI/FIDD/2016-17/33 Master Direction FIDD.CO.Plan.1/04.09.01/2016-17 dated July 7, 2016.

a. Within the overall target for Priority Sector Advances of 40% of total advances, Minimum 18% of ANBC or Credit Equivalent Amount of off Balance Sheet Exposure, whichever is higher, should be extended to Agricultural Sector.

b. Further within overall 18% limit of Agricultural Advances, 8% of ANBC or Credit Equivalent Amount of off balance sheet whichever is higher is prescribed for small & marginal farmers to be achieved in phased manner i.e.

- 7% by March 2016
- 8% by March 2017

c. Different benchmarks have been stipulated for foreign banks to achieve these goals.

d. In Agricultural finance, the distinction between direct & indirect agricultural is dispensed with.

e. SLBC

- An inter-institutional bankers' forum for co-ordination & joint implementation of development programmes and policies by all the financial institutions operating in a state.
- Government officials are also members of SLBC.
- In terms of RBI directives, SLBC of respective state required to determine "Crop Season" for each crop.

3. Key Concepts of Agricultural Finance with summary of RBI Guidelines

a. Farm Credit

Farm credit means and includes:

- Loans to individual famers, self help groups (SHGs), Joint Liability Group (provided banks maintain disaggregated data) directly engaged in agricultural allied activities viz. Dairy, Fishery, Animal husbandry, poultry, bee keeping & sericulture.
    - o Crop loans to farmers which will include traditional/non traditional plantations and horticulture and loans for allied activities.
    - o Medium and long term loans to farmers for agriculture & allied activities i.e., Purchase of agricultural implements & machinery loans for irrigation & other development activities under in the farm & developmental loans for allied activities i.e. tractor, trailer, bullocks, bullock cart, Power filler, pump set, well, drip irrigation, poultry, Dairy etc.
- Loans to farmers for pre & post harvest activities such as spraying, weeding, harvesting sorting grading and transporting of their own farm produce.
- Loans to farmers up to ` 50 lakhs against pledge/hypothecation of agricultural produce (including warehouse receipts) for period not exceeding 12 months.
- Loans to distressed farmers indebted to non institutional lenders.
- Loans to farmers under Kisan Credit Card Scheme.
- Loans to small & marginal farmers for purchase of land for agricultural purpose.
- Loans to corporate farmers, farmers' producer organisations/companies of individual farmers, partnership firms and co-operative societies of farmers directly engaged in agricultural & allied activities i.e. dairy, fishery, animal husbandry, poultry, bee keeping & sericulture up to an aggregate limit of ` 2 Crores per borrower.

b. Finance for Agricultural Infrastructure

Finance for Agricultural Infrastructure, among other things, includes:

- Loans for construction of storage facilities such as warehouse, market yards, godowns & silos including cold storage chains.
- Soil conservation & watershed development.
- Plant tissue culture & agri-biotechnology culture, seed production, production of bio-pesticides, vermi-composting.

(**Note** – For above, an aggregate sanction limit of ` 100 crores per borrower from the banking system will apply.)

c. Finance for Ancillary Activities

- Loans up to ` 5 Crore to Co-op. Societies of farmers for disposing of the produce of members
- Loans for setting up of Agri-lines and Agri business Centres

- Loans for Food & Agro processing up to an aggregate sanctioned limit of ` 100 crores per borrower from the banking system.
- Loans to customer service units managed by individuals, institutions or organizations, who maintain a fleet of tractors, bulldozers, well boring equipment, threshers etc. and undertake farm work for farmers on contract basis.
- Bank loans to Primary Agricultural Credit Societies (PACS), Farmer Service Societies (FSS), and Large sized Adivasi Multipurpose societies (LAMPS) for on lending to agriculture.
- Loans sanctioned by banks to MFIs for on lending to agriculture sector
- Outstanding deposits under RIDF and other eligible funds with NABARD on account of priority sector shortfall.

d. Crop Loans

- Crop Loans are normally referred as a short term finance, which caters to credit requirements of a crop season.
- Crop Loans are also called as production loans or farm credit. Generally crop loans are divided into kind and cash components.
- The kind component is based on the cost of inputs such as fertilizers, seeds and pesticides etc. which are essential for cultivation of crops. By and large, it is expected that such amount should be disbursed directly to the supplier of inputs to ensure end use of funds.
- Cash component mainly denotes to the expenses towards payment of hired labourers, hire charges for tractors, machinery, electricity charges etc.
- The disbursement of crop loans should be in stages linked up with inspection to ensure ultimate use of funds. It thus follows that crop loans are granted for meeting the current expenditure in connection with raising of crops.
- An essential feature of crop loan is that a cultivator's eligibility for a loan and size of the loan are determined not with reference to the value of land or any other tangible security but on the basis of the size of the holding that he cultivates and the cost of cultivation of crops which the farmer proposes to grow.
- The credit requirement for raising a particular crop is also termed as "scale of finance". The scale of finance is determined by a Technical Group comprising members of DCCB, PACS, Agriculture, State Govt., Lead bank of the district etc. The scale of finance thus determined is then approved by District Consultative Committee.

e. Investment Credit

- Investment Credit normally refers to medium and long term agricultural finance, which includes the following:
  - o Development of farm land
  - o Digging of Well/ bore-well
  - o Acquisition of farm machinery
  - o Other Irrigation facilities

f. Crop Season

- Crop season refers to the time period from preparation cultivation of a crop till its ultimate realisation.
- **It is essential for auditors to understand concept of crop season, since the repayment of agricultural advances is linked with "the season of each crop".**
- Crop season can vary from crop to crop. In fact, common crops like

paddy or sugarcane etc. may have different crop seasons, depending on the state of cultivation or manner of cultivation (i.e., a single crop or multiple crops etc.)

- A crop is classified as “Short Duration Crop” or “Long Duration Crop”, based on the crop season.
- For each state, a State Level Banker’s Committee (SLBC) is constituted, which reviews and decides the crop season and duration thereof for various crops cultivated in that State.

g. Kisan Credit Card (KCC)

Kisan Credit Card scheme introduced by RBI has been last modified *vide* circular RBI/2017-18/4 FIDD.CO.FSD. BC.No.7/05.05.010/2017-18 dated July 3, 2017.

- The scheme was aimed at providing adequate & timely credit support under single window to the farmers for their cultivation and other needs as indicated below:
    - o Short term credit limits
        - – To meet the short term credit requirement for cultivation of crops
        - – Post harvest expenses
        - – Produce marketing loan
        - – Consumption requirement of farmer household
        - – Working capital for maintenance of farm assets & activities allied to agriculture like dairy, inland fishery etc.
    - o Long term Credit Limit: Investment credit requirement for agriculture & allied activities like pump sets, sprayers, dairy animals etc.
- It is important here to understand that, unlike the general notion, KCC is not a type of loan, but is a channel for granting either short term or long term agricultural finance.

h. Harvesting & Transportation Loans (H & T Loans) for Sugar Industry

- Short term loans extended to labourers engaged for cutting of sugar cane crops and transportation thereof to the sugar factory. (i.e. “Toli Finance”)
- Loans are primarily unsecured, guaranteed by the sugar factory.
- Repayment of Loans from pay bills released by sugar factory. Proportionate remittance to banks from each bill.
- Repayment depends totally on capacity and financial health of the sugar factory, as such careful assessment thereof is also required.
- KYC of labourers required to be done carefully.
- Bank should ensure proper end-use of funds.
- Pre & Post Disbursement visit are essential.
- Instances of diversion of these funds towards factory activities.

i. Interest Application

- 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 advances, unless it turns out to be a non-performing advance. Further banks should ensure that the total interest debited to an account should not excess principal amount in respect

of short term advances granted to small and marginal farmers.

j. Other aspects

- The aggregate of credits into the account during the 12 months period should at least be equal to the maximum outstanding in the account.
- No drawal in the account should remain outstanding for more than 12 months in case of normal crops and 18 months in case of sugarcane and banana crops.
- In order to have operational and accounting convenience, the card limit is bifurcated in to separate sub-limits for short term cash credit limit cum savings account and term loans.

4. NPA Norms In respect of Agricultural Advances

- The NPA classification of agricultural loans is linked with the nature of crop, duration of crop and the crop season for each crop. In India, several crops are cultivated having different crop season in different states, as such, applying a single form for NPA and setting up the system parameters becomes difficult.

  — A Short Term Crop Loan is classified as Non-Performing, if instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops.

  — A Long Term Crop Loan is classified as Non-Performing, if instalment of principal or interest thereon remains overdue for one crop season for long duration crops.

  — For allied agricultural loans the general norms of 90 days delinquency is used.

- Auditors should carefully verify the parameters set up in the system to ensure that crops are not categorised in an incorrect manner. Further, it is to be ensured that system parameters are correctly configured to capture relevant SLBC guidelines for crop seasons and classification of crops.
- If the system parameters are not configured correctly, it will certainly lead to incorrect classification of loans.

5. Restructuring of Loans under Natural Calamities

Restructuring of agricultural loans, due to natural calamities is governed by separate RBI guidelines. Recently such guidelines are issued vide RBI Master Direction FIDD.CO.FSD. BC.No. 8/5.10.001/2017-18 dated July 03, 2017.

- In the event of occurrence of natural calamity, State Level Banker's Committee (SLBC) or District Consultative Committee (DCC) to convene a meeting to evolve a coordinated action plan for implementing the relief programme.
- The common thread to extend the relief measures including the re-schedulement of loans by the banks, is that the crop loss assessed should be 33% or more.
- Banks allowed to restructure loans granted to borrowers affected by natural calamities.
- All short-term loans, except those which are overdue at the time of occurrence of natural calamity, should be eligible for restructuring. The principal amount of the short-term loan as well as interest due for repayment in the year of occurrence of the natural calamity may be converted into term loan.
- In all restructured loan accounts, moratorium period of at least one year should be considered. Banks should also not insist on additional collateral security for such restructured loans.

  The existing term loan instalments should be rescheduled keeping in view the repaying capacity of the borrower and the nature of natural calamity.

- Accepted departure from the basic principle of IRAC norms, i.e. NPA should be borrower-wise and not facility-wise.
- Banks are required to make higher provisions for such restructured standard advances as prescribed by Department of Banking Regulation from time to time. (At present @ 5%).

Consequently, different dues from the borrower (e.g. current dues, dues which are not restructured etc.) will be classified under different asset classifications, which is an accepted departure from the basic principle of IRAC norms, i.e. NPA should be borrower-wise and not facility-wise.

6. Audit of Agricultural Advances: Key Audit Steps

While auditing advances, auditors have to perform certain generic audit procedures applicable to all advances. Such audit procedures have been covered in detailed fashion elsewhere in this compilation. A few Key Aspects in the audit of Agricultural Advances are summarised here. These procedures are inclusive and not exhaustive.

a. Sanctioned amount of Agri Loans should be as per scale of finance applicable to the land under cultivation and the crop being cultivated. Further, necessary securities should be obtained as per the guidelines framed by the bank.

b. Auditors should verify that the agricultural credit is extended only after obtaining 'No dues/ No objection certificates' from the existing credit agencies in the area of finance.

c. Disbursement of agricultural finance is required to be carried out in various 'stages' based on the requirements of farming activity. This needs to be ensured strictly. In some cases, the expenditure is incurred by farmer from his/her own sources or from non institutional lenders and subsequently banks are requested to reimburse the same. In such cases, auditors have to carefully verify the facts from the documents/evidences available on record. Under all situations, auditors should verify that the bank holds documents evidencing the utilisation of loans for agricultural activities.

d. For crop loans, primary security is normally the standing crops under cultivation, as such pre and post sanction visits by the officers of bank, who are experts in Agri finance and adequate documentation of visit report is a key control.

e. While verifying the security offered for agricultural loans, it is to be confirmed that the security is legally enforceable. Standing crops and agricultural machinery and implements are secured by a hypothecation charge, while the agricultural land is secured by a mortgage charge. Auditors have to ensure that amongst others, the following has been duly taken on record by the banks:

   - Copy of the land revenue extracts.
   - Land Tax Assessment and payment receipt.
   - Copy of record with sub registrar (wherever applicable)
   - Original copies of the title deeds
   - Search of title deeds and Legal opinion from the advocate on the Bank's approved panel
   - Valuation of land from a valuer on the Bank's approved panel.

f. Loans granted to farmers against the security of NSC, KVP or Fixed Deposits of Banks, which has been utilised for agricultural purposes, is allowed to be classified under the category of finance to agriculture. However, auditors should carefully verify the loan documents and other supporting documents to ensure that non agricultural loans are not classified as Agricultural Finance.

g. Agricultural Advances are required to be serviced through realisation of sale proceeds to crop. Auditors should be sceptical about the nature and timing credits coming in to service the agricultural loans and ensure that they are from genuine sources.

h. NPA Classification of Agricultural Loans

7. Interest Subvention

- Eligibilty
  - — Public / Private Sector Scheduled Commercial Banks (in respect of loans given by the rural and semi urban branches)
  - — Co-op. Banks
  - — Regional Rural Banks
- The Central Government will provide interest subvention of 5% p.a. to all prompt payee farmers for short term crop loan upto ` 3.00 lakhs borrowed during 2017-18. In case farmers do not repay the short term crop loan in time they would be eligible for interst subvention of 2% as against 5% available.
- Short term credit made available at 7% p.a. to farmers.
- 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.
- Farmers, who promptly repay their crop loans as per the repayment schedule fixed by the banks, extended loans at an effective interest rate of 4% p.a.

  Interest subvention scheme to post harvest loans
- Scheme extended to small & marginal farmers (having Kisan Credit Card) for a further period up to six months post harvest, against negotiable warehouse receipt for keeping their produce in warehouses.
- To discourage distress sale by farmers & to encourage them to store their produce in warehouses against warehouse receipts.

Auditors' Role

- Certificate of Interest Subvention to be submitted along with annual accounts

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Audit of Advances – Funded/Non-Funded

CA. Shriniwas Y. Joshi

I] INTRODUCTION

Bank audit is a very challenging assignment. The banks work in highly controlled environment. Reserve Bank of India mandates not only procedures and practices in banking but also controls profitability of the banks by directing the provisioning required for non-performing assets. The bank audit is a part of the Internal Control Mechanism of the bank. RBI has high expectations from CA fraternity to play a crucial role in Risk Management of the bank.

The banks are currently facing challenges in terms of keeping the NPA in control, to check frauds, to keep cost of operations low, meet high customer expectations, and use technology platforms for new age banking.

II] IMPORTANCE OF BANK AUDIT ASSIGNMENT

The bank audit requires extensive planning, timely execution, high level knowledge and understanding working of the bank. If audit is done impartially and efficiently, it may substantially change the final results of the bank in terms of reduction in window dressing and higher provisioning for bad advances. Long experience and expertise, knowledge of technology, risk management system and new practices of supervision and control employed by the bank should be known to the chartered accountants conducting bank audit.

III] PECULIARITIES OF BRANCH OPERATIONS

While conducting the audit of advances of any branch, the following needs to be first assessed.

a) Type of advances that form major percentage of total advances – SSI, Industrial, Housing, Agriculture, against FDRs/NSCs/Govt. Securities, Vehicle Loans

b) Whether advances have increased substantially over short period

c) Whether transfer of borrower accounts seen

d) Whether new scheme offering advance to special category of customers like exporters, professionals, students, senior citizens is launch, whether special terms are offered to various loan categories like housing loan, vehicle loan, agricultural loan etc.

e) Whether there is a substantial increase or reduction in NPA percentage over last year

f) Whether any frauds have been reported during the year and what is the perceived weakness in internal control that will affect audit methodology and assessment of risk

g) Whether bank is dependent on few borrowers which may result into compromise in procedures and charges and accommodation in terms of overdrawing and liberal attitude towards documentation .

All these and more enquiries would enable statutory auditor to be more focused, more vigilant and excellent planner and executor or bank audit assignment.

IV] ANALYSIS OF FINAL ACCOUNTS AND STATEMENTS

Following need to be seen by analysing final accounts and statements of the branch

1. Divergent trends in income or expenses in relation to movements in assets or liabilities – Increased percentage coverage and proper sampling

2. Volume, value and categories of outstanding loans – to allocate work at appropriate level of competence of staff

3. Sample – Percentage verification – 5% or ` 2 crore, whichever is less and all aspects of bank business to be covered

4. To select accounts for verification – accounts opened and closed during the year with severe documentation defects and officials exceeding their authority

5. Understanding accounting packages – to know appropriate commands to get desired reports in short time

V] PREPARATIONS PRIOR TO STARTING THE WORK

1) Reading reports of other auditors – Statutory, Inspection, Concurrent, System Audit, Stock and Debtors Audit, Manager handing over charge report and Revenue Audit

2) Visit to RBI website – www.rbi.org.in – for master circulars and other circulars like Deficiencies in sanctioning and monitoring loans, frauds in housing finance, frauds in non-resident accounts, etc.

3) Reading internal circulars – Closing circulars for listing out accounting entries and accounting policies to be followed

4) Guidance Note on Audit of Banks by ICAI for understanding Legal and Accounting frame-work, accounting system and internal controls.

5) Delegation of authority

VI] UNDERSTANDING ADVANCES

Following aspects need to be properly understood by the team members on Audit

a) Types of advances – Funded, Non-Funded

b) Classification of securities – Tangible, Intangible, Primary, Collateral

c) Bank Lien – General lien on assets of borrower of guarantors, negative lien (does not require registration), fixed and floating charge, not barred by law of limitations

d) Margins

e) Sectorial Classification – Priority, Non-Priority, Inland, Foreign

f) Base Rate vs. Bench Mark Prime Lending Rate (for other than DRI, Employees, deposit Loans and Export Credit)

g) DRI Advances (Differential Rate of Interest) – May be eligible for subsidy in interest and indemnifying bad debts)

h) Nature of borrowing arrangements – Sole banking, consortium arrangement, multiple banking arrangement (Exchange of information)

i) Prudential Exposure Limits (Single - Group Borrowers. Tier I (15%), Tier-II (40%)

j) Sector specific limits

k) Type of Advances – T/L, C/C, O/D, bills (purchased and discounted)

l) Pre-shipment Credit vs. post shipment credit

m) Export packing credit as running account

n) Sharing of export credit between export order holder and manufacturer of goods to be exported (precaution on double financing)

o) Gold ornament and bullion loan – For agriculture and non-agriculture – Loan to value ratio

p) Restriction on loan to directors, their relatives and loan to officers and relatives of senior officers

q) Financing Housing Projects – Direct Finance (Lending to Housing Intermediaries – Guidelines of National Housing Board), Indirect Finance (Innovative Housing Loan Products),

VII] STAGES OF ADVANCES

a. Credit Appraisal

Credit appraisal is done to confirm that project technically feasible, economically viable and commercially acceptable

Auditor should give opinion on whether the branch generally complied with the procedures / instructions of the controlling authorities of the bank regarding loan applications, preparation of proposals for grant/renewal of advances, enhancement of limits, etc, including adequate appraisal documentation in respect thereof.

Auditor to ensure whether prescribed forms and procedures/instructions for preparation of proposals/grant/ renewal/ enhancement of limits has been followed or not & report. If in the auditors' opinion there are major short comings in appraisal, the application form or the procedures need improvement, suggestions for improving the appraisal system, application form or the procedures may be given. Whether the branch has seen borrower's standing the market, integrity, experience and capabilities need to be verified.

Auditor to check whether branch is conducting credit rating of major advances accounts on periodic basis.

b. Sanctioning/Disbursement

Auditor to examines whether branch has sanctioned advances beyond the delegated authority and whether telephonic sanctions are followed by written confirmations by appropriate authorities. Whether the ad hoc limits given to borrower were liquidated in time.

Auditor should ensure that no advance was disbursed without complying with terms and conditions of sanction.

Examples/instances of non-implementing of terms and conditions of sanction:

- Promoters contribution not brought in
- Guarantors' Networth not furnished
- Unit not inspected
- Borrower instructed to close other bank accounts. But the same is not complied with
- Security not created e.g., equitable mortgage of immovable property
- End use of the loan not verified
- Share application money – Not converted to share capital
- Confidential Reports of other banks not obtained before disbursement
- In case of takeover of limits from other banks, pay order should be made in favour of the said bank and a no–due Certificate obtained. Also, loan documents should be obtained from that bank on timely basis
- Advances given to a group in excess of RBI norms during the year

c. Review/Monitoring/Supervision

Auditor should read the procedure laid down by the controlling authorities of the bank, for periodic review of advances including periodic balance confirmation/ acknowledgment of debts, followed by the Branch.

Auditor should see whether the stock / book debt statements and other periodic operational data and financial statements, etc., received regularly from the borrowers and duly scrutinised? Is suitable action taken on the basis of such scrutiny in appropriate cases. Auditor should verify whether Quarterly Book Debts statements are duly certified by Statutory Auditors/ CA, if stipulated in Terms of Sanction, Whether the unit is providing age–wise analysis of Book–debts. Auditor should also see whether stocks are being critically scrutinised for non–moving/ obsolete/damaged stock and action taken thereon, whether such year–end stock/ book debt statements are compared with audited Balance Sheet to ascertain variance in Stocks/ book debts. Is the stock received for Job-work, stock under LC and stock against packing credit excluded from stock statements against CC need to be seen.

The auditor should see whether the Branch compares Debit / Credit summation in the Account with turnover of the company to ascertain diversion of funds. In cases where borrower is availing Multiple banking Facility, whether the branch obtains outstanding position from each Bank and compares the limits availed with stocks held and DP applicable, in order to know whether the borrower is over – financed, and any margin is to be introduced.

Stock audit for large advances is essential for effective monitoring of the advance. Auditor should comment on its adequacy and frequency and Review the stock audit reports critically.

Check the cases of advances to non–corporate entities with limits beyond ` 10 lacs and see where the Branch has obtained the accounts of borrowers, duly audited under the RBI guidelines with regard to compulsory audit or under any other statute.

Auditor to verify whether the inspection or physical verification of securities charged to the Bank been carried out by the branch as per the procedure laid down by the controlling authorities of the bank. He should obtain and check the statement of "inspections due" and "inspections actually done", Scrutinize the inspection reports submitted by the inspector and verify the action taken on inspection report.

Auditor should list the major deficiencies in credit review, monitoring and supervision. The following aspects be seen –

- Timely submission of Quarterly Information System (QIS) statements. If the same is not submitted, whether penal interest is charged?
- Whether there is proper follow up by the Bank Officer in case of irregular accounts
- Consortium Accounts not properly monitored by way of periodic joint meetings
- Monitoring of sub–limit transferred to other branches. Borrower Operating accounts with other non lending banks
- Diversion of funds/ operation in accounts
- Frequent devolvement of LCs or Invocation of Bank Guarantees Returning of bills discounted unpaid on due date
- Whether further have been bills discounted though earlier bills remained unpaid/ realized late

VIII] SECURITY

Checking security is the most important aspect of bank audit. Auditor should see the following-

i. Mode of creation of security – Mortgage, pledge, hypothecation, assignment, or set-off.

ii. Verify

   a) Whether it is legally enforceable

   b) Whether it is in effective control of the bank/transferability

   c) Whether it is recently inspected

   d) Whether valuation of security is realistic, current and stable

   e) Whether security covers value of advance

IX] DOCUMENTS VERIFICATION

Documentations depends on legal status (Proprietor, Partnership, Company), Government recognize status (Priorities Sector, SSI, Manufacturer), purpose of loan (Machinery, Stock, Vehicle) and security (Primary, Collateral).

Even though, there is no standardisation of the documents taken by various banks from the borrowers, a representative list of the documents/papers/reports the scrutiny of which is required to be done by the auditor while checking any file on advances, can be made as follows :

a) Documents submitted by the borrower (application, project report, financials, address proof, statement of wealth, pan, statement of income, income tax return copies, ssi registration, pollution control board certificate, shop & act establishment certificate, sales tax, profession tax registrations, industrial licence, memorandum/partnership deed, details of sister concerns.

b) Documents obtained by bank from borrower – (mortgage deed, invoice and receipts, valuation reports)

c) Documents prepared by Bank – Internally – Appraisal Note, Sanction Letter, Demand Promissory Note, General Lien and Set-off Letter, Guarantee Bond, Visit Report

d) Documents to be collected from third party – Credit Report, Insurance, Lien Marking by RTO, NOC of Society, Charge Noting by ROC, direct confirmation of dealership

X] DEFFECTS / INCONSISTENCIES IN DOCUMENTS

The auditor, on checking of the documentation, can note several defects/ inconsistencies therein, such as

i. Documents blank /incomplete / with change in ink or handwriting/not signed by the borrowers at appropriate places

ii. Sanction letter not signed by the borrower as acknowledgement of accepting terms and conditions

iii. Promissory Note

— Guarantors signature should not be taken

— Tick Marks and other writing not permitted

— Interest rate not mentioned.

iv. Deed of Mortgage/Hypothecation not signed on each page by borrowers.

v. Personal papers of borrowers/guarantors not available

vi. Documents more than 3 years old and acknowledgement of debts not available

vii. Only Proforma Invoice / Quotation / Receipt on record, No Final Invoice available

viii. Final Accounts not certified by CA. or not certified properly

ix. Documents not properly stamped

XI] OBSERVATIONS ON VARIOUS TYPES OF ADVANCES (OTHER THAN DOCUMENTATION DEFECTS)

Auditor while checking various types of advances would like to report on matters other than documentation defects. Some of the representative comment by the auditor can be as follows:

A. TERM LOAN

a. Property valuation report not in file or not current

b. Original Agreement / Share Certificates/ NOC of the society not on record

c. Legal Opinion on clear title not available or not favourable

d. Mortgage not extended to additional facility

e. ROC certificate not obtained / not modified

f. Guarantors changed without appropriate procedure

g. Common guarantors taken for many loans where guarantors' income is not adequate to cover installments of such loans

h. Cross Guarantees Noticed

i. Change in Constitution of the Borrower not recognized

j. New loan taken to repay old loan

k. Facilities disbursed without complying with sanction terms

B. **CASH CREDIT**

a. Frequent overdrawing with or without sanction of higher authorities of the bank

b. Repeated request for against effects

c. Whether ECGC cover is available

d. Whether Certified accounts of Non-Corporate Entity are available

e. STOCK AND BOOK DEBTS

i) Stock Statements not submitted / submitted irregularly / submitted without appropriate break-up

ii) CA Certificate, Stock Audit Report

iii) Debts due from Group Companies

iv) Unpaid Stocks

v) Stocks under L/C, Packing Credit, received for Job work

vi) Drawing Power – Inadequate, Limit not changed in Computer, Creditors Statement not provided, age-wise debtors not provided

vii) Valuation – Interest included, 31st March value not tallying, CA. Certificate not obtained at periodic interval

viii) Non moving / Slow Moving

ix) Data in the stock statements not logical

x) Pledged stock not checked for obsolescence.

xi) Age-wise Debtors Statement not provided

f. Insurance - NIL

- Expired
- Inadequate
- Not assigned to the Bank

g. Inspections

- Not done
- Frequency not appropriate
- Reports not on record
- Adverse comments not attended
- Rotation of Inspection duty absent.

h. Renewal papers not submitted in time.

i. Review done without financials

Scrutiny of Operations in Cash Credit Accounts

Most of the serious defects and deficiencies in the account of the borrower and the financial health of the borrower can be judged by scrutiny of operations in the Cash Credit account. While scrutinising the account, the following points should be observed

i. Whether turnover in the account is adequate compared to the turnover of the business.

ii. Whether cash withdrawals are excessive compared to business needs

iii. Whether Cash withdrawn immediately after sanction

iv. Where cheque payments are not substantial whether stock is fully paid for.

v. Whether inter transfer of funds between associate concerns are observed

vi. Whether term loans have been given by crediting the same to cash credit account

vii. Whether diversion of funds for purchasing fixed assets noted

viii. Whether payment for off balance sheet items such as lease are observed

ix. Whether payment of loan instalments to other banks or institutions or private parties observed

x. Whether payments to parties unrelated to business observed

xi. Whether frequent bouncing of cheques deposited as well as issued noted

xii. Whether cash deposits sufficient to clear cheques issued noted.

xiii. Whether irregular or infrequent credits observed

xiv. Whether temporary enhancement was regularised

xv. Whether overdue bills have been cleared by debit to cash credit account

xvi. Whether last month's transactions include discounting of cheques of sister concerns

xvii. Whether there are few credits in the last month and cheques deposited at the end of the year bounced in the subsequent year

C. OVERDRAFTS

Fixed Deposits

a. Receipts not discharged by all joint holders

b. Lien not marked on deposit receipts and/or registers and/or ledgers

c. Receipts not in the name of borrower

d. Deposit Receipts of other banks used

e. Receipts in the name of Minor used for loan

f. Loan not adjusted on maturity of FD's

g. Interest rate on loan not changed on maturity of FD's

h. Third Party FDs – Interest, unsecured advance?

National Saving Certificates

a. Endorsement by postal authorities pending

b. Matured deposits not claimed and credited to the account

Loan Against Shares/Units

a. Shares of Companies not approved by the bank given as security

b. Partly paid shares accepted as security

c. Valuation of shares not done with appropriate frequency

d. Mandate for dividend not taken

e. Confirmation for having lien noted with respective companies not taken

Life Insurance Policy

a. Surrender value not received from the Insurance Company

b. The current insurance premium paid receipts not available

c. Insurance policy not assigned in favour of bank

d. Mandate to debit borrower's account to pay premium not available

e. Survival benefit received from time to time need to be kept in FDs or credited to loan account for money back policies

D. BILLS PURCHASED/ DISCOUNTED

a. Purchase (Demand Bills) v/s Discounting (Usance – Time bills)

b. Advance against bills under collection

c. Advance against bills drawn on Public Sector undertakings/ Departments against pre receipted challans – Government Bill facility or supply bill facility

d. Purchase/Discounting of bills against LCs issued by another bank (Documentary bills v/s Clean Bills)

e. Drawing Power not available / exceeded

f. Adequate stamping not done

g. Stamp paper date subsequent to the date of agreement

h. Stamps of other banks previously discounting the bill

i. New bills discounted of parties dishonouring bills previously

j. Bills discounted purchase for parties other than approved parties

k. House bills discounted without appropriation sanction

l. Payment not directly received from party

E. CHEQUES PURCHASED

a. Not drawn on approved banks

b. Not Crossed

c. Several months old cheque purchased

d. Drawer not third party

XII] NON-FUNDED ADVANCES

While the general verification of funded and non-funded advances is done simultaneously, there are certain components of non-funded advances, which need to be looked into. Reserve Bank of India has issued a Master Circular dated 1st July, 2015 under the heading “Guarantees and Co-acceptances”, which can act as a guiding parameter.

Non-funded advances are called “Off Balance Sheet” items, as their value is not reflected in the Balance Sheet. They form the “Contingent Liability” items of the bank. However, for the purpose of keeping a control over these items, banks have a system of passing contra entries in its books of account at the branch level and hence these items get reflected on the liability as well as asset side of the Trial Balance. However, while preparing the Balance Sheet of the bank as a whole, the value of these items are reflected in the “Notes to Accounts”.

(A) GUARANTEES

i. Dual Transactions – Guarantee and Counter Guarantee

A Guarantee transaction usually comprises of two independent, but related components – one is the guarantee issued by the banker (of the buyer) to the beneficiary (i.e., seller) and the other is a counter guarantee given by the buyer to his banker, who has issued the guarantee.

ii. Reflected in Notes

iii. Non Funded Loan sanctioned converted to Funded for Temporary Period Guarantees

iv. Customer should enjoy credit facility

Generally, guarantees should not be issued on behalf of customers, who do not enjoy credit facilities with the bank

v. Financial vs. Performance

Guarantees are of two types – financial guarantee, wherein the guarantor (the bank) promises to pay the stated amount to the beneficiary, if the person for whom the guarantee is given, fails to pay the same (also referred to as invoking the guarantee); performance guarantee, wherein the guarantor promises to pay the beneficiary a stated sum of amount, if the person for whom the guarantee is given, fails to perform, as expected, in a given period of time. Banks are generally discouraged from issuing performance guarantees. Banks should exercise due caution and have sufficient experience with the customer to satisfy themselves that the customer has the necessary experience, capacity and means to perform the obligations under the contract, and is not likely to commit any default.

vi. Risky advance

vii. Over trading by borrower solely on the basis of the guarantees be discouraged.

Since Guarantees invoked could get converted into funded advance to a borrower, banks should not encourage borrowers to over extend their commitments solely on the basis of guarantees.

viii. Specific Guarantees vs. Continuing Guarantees

Guarantees could be for specific transaction (called specific guarantee) or it could be for multiple transactions within a specific time frame (called continuing guarantees)

ix. Maturity not to exceed 10 years

x. Unsecured guarantees not to exceed 10% of total exposures

Guarantees should generally be for short durations; in any case, it should not have a maturity period of more than 10 years

xi. Margins in the form of Cash or term deposits or other securities insisted

xii. Stock Brokers – 50% Margin (25% Cash Margin)

Extensive guidelines on issue of guarantees to exporters and Importers

B) CO-ACCEPTANCE OF BILLS

a. In this type of facility, the seller dispatches the goods and raises the bill on the buyer. The buyer accepts the bill and then it is co-accepted by buyer's banker. The seller's banker then discounts this bill. Valuation of the goods should be verified

b. This type of facility is often used by customers to float accommodation bills (i.e., bills which are not supported by genuine sale and purchase of goods)

C) LETTER OF CREDIT (LC)

a. Letter of Credit (LC) is a promise by a banker to honour the payments to be made by its customer (the buyer or importer) to the seller or exporter. This type of payment facility is generally used in international trade. In this type of facility, at the request of the buyer, his banker opens an LC, which is sent to the seller. Based on such LC, the seller dispatches the goods and then sends the bills and other documents through his banker to the buyer's banker, which has opened the LC, to make payment of the bill

b. The buyer then makes the payment and routes it through his banker to the seller's banker. In case the buyer fails to make the payment (also known as devolvement of LC), the buyer's banker, who has opened the LC, is liable to make the payment to the seller

c. RBI has mandated banks not to discount bills drawn under LCs or otherwise for beneficiaries, who are not their regular clients

XIII] MEMORANDUM OF CHANGE (MOC) & INTERPRETATION OF CIRCULAR

Generally, once the statements of account prepared and submitted to the Controlling Office, the Auditors are permitted to incorporate changes, if any, only through a MOC. This MOC includes changes to be made in the classification of Advances. Many a times, the changes suggested by the Auditors are not acceptable to the Branch Managers and hence they refuse to sign the MOC. **In this context, it may be noted that MOC is a document prepared by the Auditors and it is not mandatory that the Branch Manager should sign it. Branch Manager's signature only denotes his concurrence to what has been stated by the Auditors and nothing more**.

Further, many a times, the Branch Managers interpret the NPA Circular differently than what is actually stated in the circular, under the pretext that it is being done in a particular way for the last so many years – for e.g., 3 to 5 year old vehicles against which the loans have become doubtful, are reflected at their purchase price 3/5 years old and not their depreciated value, or though stocks or book debts have not been inspected for a long period of time, their one or two year old values available with the Branch are taken for the purpose of security. This is a very frequently used method by Branch Managers to avoid classification of NPAs or reduce the provision amount. It is recommended that Auditors should strictly go by what is stated in the RBIs circular, which is quite unambiguous and not by the Branch Manager's interpretation of the same.

XIV] OTHER AREAS IN ADVANCES

a. Agricultural Advance

b. Problems in Computerisation

c. Advances in Foreign Exchange

XV] CONCLUSION

From the above overview, it will be clear that carrying out the bank branch audit is not an easy task.

Enormous preparation and training is required on the part of auditor to face the challenge of auditing a specialised industry working in fully computerised environment and dealing with huge amount of cash and public money. Such training is available to the professionals through various seminars, conferences and certification courses arranged by ICAI on the subjects of Statutory Audit, Internal Audit and Concurrent Audit of Banks.

Further information can be obtained about the method of audit from the publications of ICAI including Guidance Notes on Audit of Banks.

However, as a caution, I wish to state that the professionals, by accepting the bank audit, are entering into a high risk area of work. Therefore, unless appropriate expertise is available with the firm, no such assignment should be accepted looking only at high rewards that it will give.

ANNEXURE

RBI MASTER DIRECTIONS ON FRAUDS DATED 1st JULY, 2016

The Master Directions by RBI on Fraud indicate 42 Early Warning Signals of Frauds which are as under :-

1. Operations of Account

a. Bouncing of high value cheques

b. Foreign bills remaining outstanding with the bank for a long time and tendency for bills to remain overdue

c. Delay observed in payment of outstanding dues

d. Frequent invocation of BGs and devolvement of LCs

e. Under insured or over insured inventory

f. Invoices devoid of TAN and other details

g. Funding of the interest by sanctioning additional facilities

h. Frequent request for general purpose loans

i. Frequent *ad hoc* sanctions

j. Heavy cash withdrawal in loan accounts

k. Significant increase in working capital borrowing as percentage of turnover

2. Concealment or Falsification of documents

a. In merchanting trade, import leg not revealed to the bank

b. Concealment of certain vital documents like master agreement, insurance coverage

c. Frequent change in accounting period and/or accounting policies

d. Claims not acknowledged as debt high

e. Substantial increase in unbilled revenue year after year

f. Material discrepancies in the annual report

g. Significant inconsistencies within the annual report (between various sections)

h. Poor disclosure of materially adverse information and no qualification by the statutory auditors

3. **Diversion of Funds**

a. Frequent change in the scope of the project to be undertaken by the borrower

b. Not routing of sales proceeds through consortium / member bank/ lenders to the company

c. High value RTGS payment to unrelated parties

d. Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet

4. **Issues in Primary/Collateral Security**

a. Dispute on title of collateral securities

b. Request received from the borrower to postpone the inspection of the godown for flimsy reasons

c. Exclusive collateral charged to a number of lenders without NOC of existing charge holders

d. Critical issues highlighted in the stock audit report

e. Liabilities appearing in ROC search report, not reported by the borrower in its annual report

f. Non-production of original bills for verification upon request

g. Significant movements in inventory, disproportionately differing *vis-a-vis* change in the turnover

h. Significant movements in receivables, disproportionately differing *vis-à-vis* change in the turnover and/or increase in ageing of the receivables

i. Increase in Fixed Assets, without corresponding increase in long term sources (when project is implemented)

j. Costing of the project which is in wide variance with standard cost of installation of the project

5. **Inter-Group/Concentration of Transactions**

a. Funds coming from other banks to liquidate the outstanding loan amount unless in normal course

b. Floating front / associate companies by investing borrowed money

c. LCs issued for local trade / related party transactions without underlying trade transaction

d. Large number of transactions with inter-connected companies and large outstanding from such companies

e. Substantial related party transactions

6. **Regulatory Concerns**

a. Default in undisputed payment to the statutory bodies as declared in the annual report.

b. Raid by Income tax /sales tax/ central excise duty officials

7. **Others**

a. Disproportionate change in other current assets

b. Resignation of the key personnel and frequent changes in the management

c. Significant reduction in the stake of promoter /director or increase in the encumbered shares of promoter/director

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Income Recognition and Asset Classification Norms

CA. Nilesh Joshi

Banking sector is one of the most important sectors across the globe for the growth and development of any country. Banking sector must remain healthy and work efficiently so as to meet the demands of the industry as well as consumers.

One of the major challenges for the Indian banking system is to address the NPA issue which has also affected the profitability of banks besides coming in the way of future bank lending as banks have been cautious while lending especially for long term purposes. Non Performing Assets are the major problem for the public sector and private sector banks in India. The present study focuses on analysing the problems and solutions taken for managing and controlling the NPA in both private and public sector banks which help to improve the financial health of the banking sector in India.

The concept of NPA is introduced by RBI to reflect a banks actual financial health in its balance sheet and as per the recommendations made by the Narasimham Committee Report I and II to address the credit monitoring process being adopted and pursued by the banks and financial institutions. To strengthen further the recovery of dues by banks and financial institutions, Government of India promulgated The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

A non-performing asset is defined as a credit facility in respect of which the interest or instalment of principal has remained "past due" for a specified period of time. It results from what are termed as "bad loans" or defaults. It is the failure to meet financial obligations, say non-payment of a loan instalment. Once the borrower has failed to make interest or principal payments for 90 days the loan is considered to be a non-performing asset. 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" for a period of more than 90 days, in respect of an overdraft/cash credit,
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and/or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts except loan against fixed deposit or guaranteed by Central Government.
- Non submission of Stock Statements for three Continuous Quarters in case of Cash Credit Facility.
- No active transactions in the account (Cash Credit/Overdraft/EPC/PCFC) for more than 90 days.
- The installment of principal or interest thereon remains overdue for two crop seasons for short duration crops.
- The installment of principal or interest thereon remains overdue for one crop season for long duration crops.

Project Finance

A loan will be classified as NPA during any time before commencement of commercial operations (DCCO) as per record of recovery (90 days overdue), unless it is restructured and becomes eligible for classification as 'standard asset'.

i. Infrastructure projects

A loan will be classified as NPA if it fails to commence commercial operations within two years from the original DCCO, even if is regular as per record of recovery, unless it is restructured and becomes eligible for classification as 'standard asset'.

Special Dispensation to retain as Standard Advances in case of Infrastructure Projects

(a) Involving court cases Up to another two years (beyond the two year period quoted at paragraph 1(a) above, i.e., total extension of four years), in case the reason for extension of DCCO is arbitration proceedings or a court case.

(a) Delayed for other reasons beyond the control of promoters up to another one year (beyond the two year period quoted at paragraph 1(a) above, i.e., total extension of three years), in case the reason for extension of DCCO is beyond the control of promoters (other than court cases).

ii. Non infrastructure project

A loan will be classified as NPA if it fails to commence commercial operations within one years from the original DCCO, even if is regular as per record of recovery, unless it is restructured and becomes eligible for classification as 'standard asset'.

Special Dispensation to retain as Standard Advances in case of Non-Infrastructure Sector (other than Commercial Real Estate Exposures).

(a) Up to another one year (beyond the one year period quoted at paragraph 1(a) above, i.e., total extension of two years).

Classification of NPA

The non-performing assets can be further classified into four categories based on the period for which the asset has remained non-performing and the realisability of the dues:

Sr. No.	Particulars	Definition
1.	Sub-Standard Assets	An asset is one which has been classified as NPA for a period not exceeding 12 months.
2.	Doubtful Assets	An asset which remains in the sub-standard category for a period of 12 months.
3.	Loss Assets	An assets where loss has been identified by the bank, internal or external auditor or central bank inspectors. But the amount has not been written off, wholly or partly. Such assets are considered uncollectable and of such little values that their continuance as bank assets in not warranted although there may be some salvage or recovery values.

SPECIAL DISPENSATION FOR MSMEs IN VIEW OF IMPLEMENTATION OF GST.

In a measure to provide relief to the micro, small and medium enterprises (MSME) sector which was "badly hit" by the implementation of the Goods and Services Tax (GST), the Reserve Bank of India (RBI) *vide* notification **Relief for MSME Borrowers registered under Goods and Services Tax (GST) RBI/2017-18/129 DBR.No.BP. BC.100/21.04.048/2017-18 dated February 7, 2018** gave them an extension of up to 180 days to clear their loans to banks.

Auditor should ensure that repayment facility of 180 days instead of 90 days given to those MSME borrower who fulfil the below mentioned criteria:

i. The borrower should be registered under the GST regime as on January 31, 2018.

ii. The aggregate exposure, including non-fund based facilities, of banks and NBFCs, to the borrower does not exceed ` 250 million as on January 31, 2018.

iii. The borrower’s account was standard as on August 31, 2017.

iv. The amount from the borrower overdue as on September 1, 2017 and payments from the borrower due between September 1, 2017 and January 31, 2018 are paid not later than 180 days from their respective original due dates.

v. A provision of 5% shall be made by the banks/ NBFCs against the exposures not classified as NPA in terms of this circular. The provision in respect of the account may be reversed as and when no amount is overdue beyond the 90/120 day norm, as the case may be.

vi. The additional time is being provided for the purpose of asset classification only and not for income recognition, i.e., if the interest from the borrower is overdue for more than 90/120 days, the same shall not be recognised on accrual basis.

Provisioning Norms

Classification	NPA date between (both days inclusive)		Provisioning norms		
	From	To	Secured	Unsecured	Unsecured, ab initio
Sub-standard	01-04-2017	31-03-2018	15%	25%	25%
D-1	01-04-2016	31-03-2017	25%	100%	100%
D-2	01-04-2014	31-03-2016	40%	100%	100%
D-3		31-03-2014	100%	100%	100%
Loss			100%	100%	100%

Special Mention Accounts

Verification points for audit of NPAs

- In respect of loans appearing under SMA 1 & SMA 2 categories but not appearing as NPA in March, source of recovery should be verified.
- Review of unit visit reports/ stock audit reports to check for adverse comments like long pending debtors, non-moving stock, affecting classification of advances.
- Analyses of stock and book debt statements to identify non-moving stock / long pending debtors.
- Review of operations in account to identify diversion of borrowed funds.
- Review of valuation report to identify that date of valuation of security is not more than three years.
- Review of accounts regularised as on 31st March (end of year) about balance sheet date by taking fresh loans or transfer from other accounts.
- Review of account
  - To identify any unusual transaction during the audit period, which are inconsistent with nature of business, size/activity of borrower of firm /company.
  - To notice any large amount transaction in favour of associate company/related company during the course of audit period.
- Review of pre shipment /post shipment credit accounts for timely realisation of export proceeds.
- Review of RoC search report carried out on annual basis to check that borrower has not created any additional charge on security.
- Review of CIBIL reports of promoters/partners/ Directors obtained during review or renewal to identify credit score of borrower.

■■■

NEW PHASE FOR STRESSED ASSETS

RBI has put a comma for restructuring by discontinuing special regulatory treatment for Asset classification from March 31, 2015. However commenced/continued with schemes like CAP, SDR, S4A, etc. which allowed banks to keep accounts standard after restructuring.

With the new guidelines issued on February 12, 2018, the RBI has overhauled the restructuring framework by discontinuing prevalent restructuring schemes like CAP, SDR, S4A, etc. The new framework goes one step ahead as it aims at resolution of stressed asset and not just restructuring. With the enactment of Insolvency & Bankruptcy Code, 2016 (IBC), the process of resolution in case of failure of restructuring can be expedited.

The key highlights of the Resolution of Stressed Assets – Revised Framework are as under;

1. Early identification and reporting of stress

    a. Lenders shall identify emerging stress in loan accounts and categorise the same as under:

SMA Sub - Categories	Basis for classification – Principal or interest payment or any other amount wholly or partly overdue between
SMA – 0	1 – 30 days
SMA – 1	31 – 60 days
SMA – 2	61 – 90 days

    b. Report of all borrower entities in default with aggregate exposure > ` 5 crore to CRILC

2. Implementation of Resolution Plan (RP)

    a. All lenders should put Board approved policies for resolution of stressed assets under this framework with timelines.

    b. Lenders (singly or jointly) shall initiate steps to cure the default.

    c. The resolution plan may involve any of the following actions

        - Regularisation of the account by payment of all overdues by borrower entity
        - Sale of exposures to other entities / investors
        - Change in ownership
        - Restructuring

    d. RP shall be clearly documented by all lenders irrespective of change in terms & conditions.

3. Implementation Conditions for RP

    a. Borrower entity is no longer in default with any of the lenders

    b. Resolution plan involves restructuring

        - Completion of documentation by all lenders
        - Revised terms and conditions of existing loans get reflected in books of all lenders and borrower.

    c. RPs involving restructuring / change in ownership where exposure is > ` 100 crores

        - Independent Credit Evaluation (ICE) from Credit rating agencies (CRA) of residual debt
        - Exposure > ` 500 Crore ICE from two CRAs & < ` 500 Crore one CRA
        - RP 4 or better shall be considered for implementation.
        - If ICE from more than one CRA all CRA should give RP4 or better
        - Payment to CRA should be made by lenders **(this is important as earlier payment was made by borrowers)**

- ICE is applicable for all large accounts immediately irrespective whether restructuring is carried out before March 1, 2018.

4. Timelines for Large Accounts to be referred under IBC
   - Aggregate exposure > ` 2000 crores
   - Reference date March 1, 2018
   - Resolution initiated in new or existing framework or restructured standard account, RP shall be implemented as per following timelines
     i. Default on March 1, 2018 within 180 days
     ii. Default after March 1, 2018, within 180 days from default
        - RP not implemented within timeline then insolvency application within 15 days
        - RP implemented no default within specified period (one year from end of moratorium period or date by which 20% of principal and capitalised interest is repaid, whichever is later).
        - If default during specified period referred file insolvency petition within 15 days of default
        - Default after specified period – Fresh default
        - Aggregate Exposure below ` 2000 crore & above 100 crore separate guidelines to be issued
        - Borrower under Specific instructions — Earlier instructions continue

5. Prudential Norms
   - Restructuring – Standard advance to be downgraded as NPA. NPA remain in existing bucket.
   - Ageing criteria as per extant norms continues
   - Upgraded based on
     i. Satisfactory performance during specified period.
     ii. Aggregate Exposure > ` 100 crore satisfactory performance & Credit rating of BBB or better at the end of specified period from CRA.
     iii. Aggregate Exposure > ` 500 crore two CRAs and all rating should be more than BBB-or better
        - Default during specified period then NPA date will be reckoned as per pre-restructuring repayment schedule
        - Provisioning as per Extant IRAC norms
        - Existing restructured accounts as per norms applicable to existing restructuring schemes
        - Additional Finance – Classified as "Standard" during specified period. In case of default or non upgradation as per restructured debt
        - Income recognition: Restructured Standard asset – Accrual basis & Additional Finance to restructured NPA and Restructured NPA – Cash basis

6. Conversion of principal into Debt / Equity & unpaid interest into FITL, Debt or Equity Instrument
   - Asset classification – Same as per restructured account
   - Valuation
     i. Equity : Marked to Market, if quoted. Otherwise break up value

as per previous year balance sheet. If prvious year balance sheet portfolio is valued at ` 1. No set off for depreciation with appreciation in other shares.

- Unrealised income recognition
  - i. FITL / Debt : On sale or redemption
  - ii. Unquoted Equity : On sale
  - iii. Quoted equity : Market value of equity on date of upgradation not excedding unrealized income.

7. Change in ownership

Advance to be classified as standard, if

- Acquirer is not a person disqualified as per IBC
- New promoter holds 26% equity and largest shareholder
- New promoter shall be in control of borrowing entity
- RP implemented as per existing gudelines

Continue to classified as standard based on satisfactory performance during specified period, in case of default classified as Sub standard

Provision held can not be reversed till demonstration of satisfactory performance during specified period

8. Sale & Leaseback transaction

- Treated as restructuring in case of debt of buyer and seller, if
  - i. Seller is in financial difficulty
  - ii. More than 50% revenue of buyer from leased asset to seller
  - iii. 25% or more loan by buyer for purchase of asset are funded by lenders of seller

9. Refinancing of Exposure in foreign or Indian Currency

- Treated as restructuring, if
  - i. Borrower in financial difficulty
  - ii. Foreign currency borrowing from Indian Banking System or based on BGs, LCs Letter of comfort from Indian banking System
  - iii. Rupee loans for refinancing

10. In case of extension of DCCO, the existing IRAC norms are applicable.

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Long Form Audit Report – LFAR

CA. Nayan R. Kothari

- LFAR is an effective tool to the auditors to keep the bank informed about the important matters arising out of the statutory audit exercise. ICAI has issued guidelines to its members for conducting the statutory bank audit.
- LFAR for branches is a question answer format
- LFAR for HO is a narrative format.
- Annexure to be given along with the LFAR which is applicable for branches having large/ irregular/ critical advance accounts having large limits.
- LFAR introduced in 1985, subsequent revision in 1992-93 and 2003.
- The Branch is responsible for compiling the information / statements required for LFAR and the auditors should verify the same.
- Auditors should ensure that the documentation of files is adequate and the records and working papers are planed and filed systematically in respect of matters included in the LFAR.
- Regional Office / Zonal Office / Head Office / Statutory Central Auditors / External Auditors / RBI auditors etc., are the various users of the LFAR

MUST Dos

- Study the Questionnaire thoroughly.
- Each answer should be precise.
- Avoid vague or general comment.
- Give specific instances of weakness/ shortcomings.
- Main Audit Report and LFAR are two separate reports.
- Qualification remarks MUST be part of the main report.
- Main Report is a self contained document and should not contain any references to LFAR.
- Should be sufficiently detailed and quantified to enable expeditious consolidation.
- Do not make current year's LFAR a replica of previous year.

LFAR and Statutory Audit Report

- LFAR is not a substitute for the Statutory Audit Report and are two independent and different Audit Reports, hence cross-referencing for any comments or qualifications should not be done.
- Based on audit, if any matter having impact on true and fair view of financial statements or warrants adding qualification/Matter of emphasis in Auditor's Report (for e.g., non classification of account as NPA/ under-provision for advances) than mere reference of same in LFAR is not sufficient.

I – Assets 1. CASH	
Significantly excess Cash Balances	Check Limits Fixed for retention, including ATM. Check cash records for the entire audit period to report excess.
Insurance cover for Cash at Branch / In Transit	Check Insurance Policy. Check for cash in hand within insured limits and comment.
Joint Custody of Cash	Check Policy of Bank. Check the operations during audit visit.

Verification of cash at Periodical intervals	Check policy of Bank. Check whether such verification has been conducted during the year.
I – Assets 2. Balance with RBI, SBI and Other Banks	
Balance Confirmation & Reconciliation Statements	Check Balance confirmation Certificates. Check Reconciliation Statement Report on transactions appearing in reconciliation Review reconciliation process and comment
Observations on Reconciliation Statements	Cash transactions remaining unresponded. Revenue items requiring accounting for the year.
Any special observation	Any other item which may be reported to controlling office
I – Assets 3. Money at Call and Short Notice	
Has the branch kept money at call and short notice during the year?	Check whether such transactions exists at the branch. If yes, verify the transactions with deal notes, ledger accounts.
Whether guidelines are complied with properly?	Check Bank Policy. Report non compliances.
I – Assets 4. Investments	
Are there investments held by branches on behalf of bank?	Physical verification of investments with holding statement, certificates, deal slips etc. Report discrepancies.
Interest Income if any whether transferred to respective department	Verify from ledger accounts the periodical income is recorded in books of account and transferred to head office as per banks policy.
Investments overdue / not encashed	Verify such investments, report on deficiencies on recovery
Same questions for Branches in India and Outside India Bank Branch cannot hold investment in its own name except investments held for collection on revenue on behalf of the HO.	
I – Assets 5. Advances	
Credit Appraisal	
In your opinion, has the branch generally complied with the procedures/ instructions of the controlling authorities of the bank regarding loan applications, preparation of proposals for grant / renewal of advances, enhancement of limits, etc., including adequate appraisal documentation in respect thereof.	Mention number of borrower accounts tested and then comment in separate annexure, giving details of account such as name, account number, sanctioned limits, balance outstanding, and your observations.
Sanctioned / Disbursed	
Facilities sanctioned beyond delegated authorities	Mention number of accounts tested and report deficiencies with Account number, account name, limit sanctioned, balance outstanding and observations

Disbursement without complying with terms and conditions	Mention number of accounts tested and report deficiencies with Account number, account name, limit sanctioned, balance outstanding and observations
Documentation	
Disbursement without executing loan documents	Verify sample accounts and comment accordingly.
Deficiencies in Documentation	Mention number of accounts tested and report deficiencies with Account number, account name, limit sanctioned, balance outstanding and observations
Marking of lien on Bank Deposits	Test the Account Master of CBS for Term Deposits and comment accordingly.
Review/Monitoring/Supervision	
Periodic Review / Balance Confirmation / Letter of Acknowledgement of Debts	Verify sample accounts and comment accordingly. Comment on Blank LAD
Scrutiny of Stock & Book Debts Statements / Other Financial Statements	Verify sample accounts and comment accordingly. Verify CBS data for recording of DP. Verify the CBS Master for advances and comment.
Reports of Stock Audits	Verify sample accounts and comment accordingly. Any adverse comment of Stock Auditors must be appropriately dealt with.
Review/Monitoring/Supervision	
Non corporate entities with limits of ` 10 Lakh and above, whether audited FS obtained	Each bank has to specify this limit. Whether borrowers have complied with requirements.
Inspection of Securities	Check the visit register, visit reports and comment
Insurance of Securities	Verify the policies and report Non renewal, under insurance, no bank clause
IRAC Classification of Advances	Verify opening/ closing statements, movement, during the year. Check provisions
Major Deficiencies.	Report separately.
Guarantees / Letter of Credits / Letter of Comfortes	
Guarantees invoked and funded by branch.	Check the correspondence. List of guarantees invoked and paid. Steps taken for recovery. Debit to customers.
List of guarantees Invoked, paid but not adjusted & Invoked but not paid.	Check the details in prescribed format prepared by branch and comment.
Details of outstanding amounts of LC/ LOC/Co acceptances funded by branch in prescribed format	Check the details in prescribed format prepared by branch and comment.
I – Assets	**6. Other Assets**
Stationery And Stamps	
Internal Control over issue and custody of TDR/ Drafts/ Pay Orders / Travellers cheques etc.	Review the system and comment. Verify the items of stationery on test check and report observations. Check for maker check controls. Special attention to sensitive stationery as its fraud prone area.
Missing / lost items of such stationery	Report missing / lost items with appropriate details.

Suspense Account / Sundry Assets	
Expeditious clearance of items debited to Suspense Account / Year wise break up to be given.	Review the system and comment. Scrutinise to evaluate normal time taken to clear such entries. Verify the items appearing in the list with sufficient details such as narration of the transaction. Check the year wise break up and tally it with trial balance.
Unusual items / material withdrawals in these accounts	Report all unusual items / material withdrawals in suspense / sundries.
II – Liabilities	**1. Deposits**
Conduct and operation in Inoperative Accounts	Obtain list of inoperative accounts & verify the transaction on test check basis. Check bank policy for operations, & verify. Report deficiencies.
Unusual large movements (increase or decrease) in the aggregate deposit held at the year end	Prepare comparative chart for all quarters in the year. Obtain comments from branch for unusual large movements and comment. Also check after balance sheet date figures.
Overdue/ matured term deposits al the end of the year	Report such deposits. Check Interest provisions on the same.
II – Liabilities 2. Other Liabilities **3. Contingent Liabilities**	
Bills Payable / Sundry Deposits	
Number of items & the aggregate amount of old outstanding items pending for 3 years or more.	Obtain List and check all items pending for more than 3 years. Scrutinise the narration and account details.
Unusual items or material withdrawals or debits in these accounts	Verify transactions during the year and report such transactions
Contingent Liabilities	
Contingent Liabilities Not acknowledged as debts (other than guarantees / letter of credits / acceptances / endorsements)	Check opening Balances from previous Audited statements. Inquire for contingent liabilities, correspondence with CO to be verified.
III – Profit & Loss Account	
Comment on discrepancies in interest (paid/received), discount and timely adjustments thereof.	Review system followed by branch during the year. Check approvals as per DOP in case of concessions.
Compliance with the Income Recognition norms prescribed by RBI.	Check as per requirements of Master Circular on IRAC issued by RBI.
Verification of provision for interest accrued on overdue / matured term deposits.	Check the policy of bank. Generally provided at HO through CBS.
Comment on any divergent trends in major items of income and expenditure, which are not satisfactorily explained by the branch	Analyse comparative data for all quarters in the year as well as post balance sheet date and comment.
IV – General 1. Books and Records	
Manual / Computerised	Obtain list of manual registers and verify. Also obtain status of CBS version.
Whether Inked out / Hard Copies printed	Check the prints of reports through CBS as per policy/circular. Check manual registers and verify the records.

Access and data security, Adequate Internal Controls	Review the process of access controls and data security. Check internal controls on computer system and other sensitive information
Back ups / Disaster recovery plan	Check system followed and report discrepancies.
Reconciliation of Control and Subsidiary Records	
Have the figures, as at the year-end, in the control and subsidiary records been reconciled	Check Reconciliation. All accounts must tall at EOD in CBS. Check the process followed by branch.
Inter Branch Accounts	
Outstanding entries in HO / Other branch accounts are properly responded / reconciled.	In CBS all entries must be tallied. Check the details of outstanding entries. Report discrepancies.
Old Outstanding debits in this account	Check all such entries and verify narration / explanation
Double responses in Head Office Account	Check all the transactions for such entries and report.
Audits and Inspection	
Concurrent Audit or any other audit.	Inquire & report fact whether branch covered by concurrent audit or any other audit
Auditor to consider major irregularities / adverse comments arising out of these various reports.	Review comments of auditors & compliance by branch, check list of pending compliance for such reports.
Frauds	
Furnish particulars of frauds discovered during the year under audit at the branch, together with your suggestions, if any, to minimize the possibilities of their occurrence.	Inquire and understand process of recording fraud. Inquire for frauds discovered during the year and comment on status as at year end. Examine requirement for provision, if any.
Miscellaneous	
Possible window dressing.	Verify large movements in advances & deposit at quarter/year end. Analyse advances & deposits on audit signing date and report.
Fixed Assets Register / Accounting for depreciation	Check records maintained by branch. Verify supporting documents to ascertain date of put to use. Check movement of assets. Check depreciation as per rates prescribed.
Any other matters for the notice of Statutory Central Auditors	Report matters for attention of SCA / Controlling Office.
LFAR For Specialised Branches	
Branches Dealing in Foreign Exchange Transactions	
Adverse features pointed out by other auditor regarding NRE/NRO/ NRNR/ FCNR/ EEFC/ RFC and other similar accounts	Record the extent of check. Check the guidelines. Verify transactions, check returns & comment.
NOSTRO Accounts maintained / operated. Their conduct and reconciliation	Check balance confirmation, reconciliation and comment.

Branches Dealing in Large Advances in excess of ` 100 Crs.	
Advances > ` 2 cr, Annexure with LFAR.	Check the annexures prepared by branch
The advances > ` 1 cr upgraded/ downgraded in NPA Classification, with reasons.	Verify as per the Master Circular issued by RBI and comment.
Branches Dealing in Recovery of NPA / ARB	
Advances > ` 2 cr, Annexure with LFAR.	Do not give cross reference of LFAR in Main Audit Report.
The advances > ` 1 cr upgraded/ downgraded in NPA Classification, with reasons.	Verify as per the Master Circular issued by RBI and comment.
Age wise analysis of recovery in suit filed accounts	Check list prepared by branch and comment. Check comments of legal experts and report discrepancies.
Delayed & Time barred decrees	
Recoveries / account settled / written off / closed	Check bank policy and verify the transactions. Report discrepancies.
New Transferred Account details such as documents / security etc.	Verify the account statement and status of account from CBS. Check correspondence file and comment.
Branches dealing in Clearing House Operations	
Periodic review of outstanding entries in clearing adjustment account.	Check compliance with guidelines issued and comment.

LFAR Audit Approach

- Read All questions in LFAR
- Plan & Design Audit Programme to cover all aspects of LFAR Format
- Prepare separate checklists for each point to be reported.
- Record the extent of checking / sample selected.
- Proper documentation & collecting SAAE during the audit.
- Write descriptive answers. Avoid Y/N/NA
- Include facts, figures and examples to the extent possible in all answers to the questions.
- Observations resulting in adjustments to account heads needs to be reported along with MOC.
- Discuss the contents of report with Branch Management
- Obtain Management Representation from Branch Manager on various matters based on Audit.
- LFAR is an independent report, hence do not give cross reference or qualifications or MOC in LFAR.
- It's a very important report for readers such as SCA and Management of Bank.

Checklist for verification of advances & reporting in LFAR

1. In respect of common irregularities, the Auditors can give their comments borrower–wise in the LFAR in the format given hereunder:

Name of Borrower	Name of Branch	Region	IRAC Status	Sanctio-ning Authority	Facility	Limit	Amount o/s. as at the year end	Irregularity No.
1	2	3	4	5	6	7	8	9

2. In respect of Column 9 above, "Irregularity No.", the number as given in the "Glossary to Irregularities" in Point 5, under the head "Item" below should be given for the irregularity applicable to respective borrower.

   In case the auditors feel that inspite of the list of irregularities given below, there are some other irregularities, which the auditor would like to bring to notice, the auditor may separately disclose under the given head by giving "appropriate number".

   For the aforesaid purpose, "appropriate number" would mean, for example, if the auditors feels that in case of "Review/ Monitoring/ Supervision", which has the number "4", any additional irregularity has to be incorporated, he may give a number after the last number appearing in the list, such as "4.62", and onwards.

   Similarly in case of "Credit Appraisal" which has the number "1", any additional irregularity may be given "1.19", and so on

3. The borrower–wise details may be given in descending order based on the Amount outstanding

4. GLOSSARY TO IRREGULARITIES

Item Remarks

1. Credit Appraisal

1.1 Loan application not on record at Branch

1.2 The appraisal form was not filled up correctly and thereby the appraisal and assessment was not done properly

1.3 Loan application is not in the form prescribed by Head Office

1.4 The Bank did not receive certain necessary documents and Annexures required with the application form

1.5 Basic documents such as Memorandum & Articles of Association, Partnership deed, etc., which are a pre–requisite to determine the status of the borrower, not obtained

1.6 Certain adverse features of the borrower not incorporated in the appraisal note forwarded to the management

1.7 Industry/ group exposure and past experience of the Bank is not dealt in the appraisal note sent to the management for sanction

1.8 The level for inventory/ book–debts/ creditors for finding out the working capital is not properly assessed

1.9 Techno–economic feasibility report, which is required to know the technical aspects of the borrower's business, is not obtained from Technical Cell

1.10 Credit report on principal borrowers and confidential report from their banks are not insisted from the borrowers

1.11 The opinion reports of the associate and/ or sister concerns of the borrower are not scrutinised

1.12 The opinion reports of the associate and/ or sister concerns of the borrower are not called for

1.13 The opinion reports of the associate and/ or sister concerns of the borrower are not updated

1.14 The opinion reports of the associate and/ or sister concerns of the borrower are not satisfactory

1.15 The procedure/ instructions of head office regarding preparation of proposals for grant not followed

1.16 The procedure/ instructions of head office regarding preparation of proposals for renewal of advances not followed

1.17 The procedure/ instructions of head office regarding preparation of proposals for enhancement of limits, etc. not followed

1.18 No exposure limits are fixed for forward contract for foreign exchange sales/ purchase transactions

2. Sanctioning and Disbursement

2.1 Credit facility sanctioned beyond the delegated authority or limit of the branch

2.2 Certain proposals were sanctioned pending approval of higher authorities wherever required

2.3 Ad–hoc limits were granted for which sanctions were pending since long

2.4 Facilities were disbursed before completion of documentation

2.5 Facilities were disbursed without following sanction terms

2.6 Facilities were disbursed without any sanction

2.7 Sanction letter was missing in the branch

2.8 Guarantor as required in the sanction letter was not obtained

2.9 Required promoters stake not invested before disbursement of loan

2.10 Sanctions were made without proper appraisal

2.11 Security charge not created before disbursement as required by sanction letter/renewed letter

2.12 Full disbursement of the facility not made

2.13 Sanction terms were not complied with or were not recorded

2.14 Disbursement Made without proper sanction

2.15 Term loan was disbursed by creating the cash credit or savings account of the borrower

3. Documentation

3.1 The security against which the advance was sanction was not available/ was not on record

3.2 Mortgage for the property given as security is not created

3.3 Mortgage for the property given as security created, was inadequate, as compared to terms of sanction

3.4 Second charge as required, on assets is not created in favour of the bank

3.5 Documents of Second charge on assets is not on the record

3.6 Documents pertaining to registration of charges with ROC or any other concerned authority requiring charging of assets is not obtained

3.7 Copies evidencing lodgment of the original conveyance/ sale deeds with the Sub–Registrars for registration not on record

3.8 Authority letter/ Power of Attorney to the Bank to collect the original documents from the Sub–Registrar not on record

3.9 Documents pertaining to consortium advances not yet executed/ not available with bank

3.10 Documents signed by persons not duly authorised to sign or who have signed in other capacity accepted by the bank

3.11 Signatures of the executants were not found on all the pages of the documents

3.12 Some of the documents on record were blank, without signatures of Branch Manager, witnesses, or guarantors, etc.

3.13 Revival letters in respect of documents to be reviewed from the borrowers not received

3.14 Guarantors have expired

3.15 Guarantors not on record

3.16 Guarantors not renewed

3.17 Guarantors not assigned

3.18 Worth of the Guarantors not available

3.19 Stamping not as per the amended Stamps Act

3.20 Documents have become mutilated, soiled, time barred or not obtained

3.21 Opinion report by the field officer for the borrowers not found on record

3.23 "Nil Encumbrance Certificate/s" or "No Dues Certificate/s" or "No lien Letters" not obtained for the mortgage/s

3.24 Advances for vehicle loans, Registration certificate, transfer certificate, etc. not obtained

3.25 Work completion certificate, sale deeds, share certificates in societies, etc. not on record for housing loans

3.26 Documents are not duly attested/ signed by concerned officials/not renewed

3.27 The agreements for hypothecation do not contain details regarding goods hypothecated

3.28 Copy of Bills/ receipts, on the basis of which the amount was disbursed not found on record. For e.g. Vehicle Loans, Plant & Machinery

3.29 Charge on main &/or collateral securities not created in terms of sanction letter

3.30 Original security papers/ sale deed/ lease deed/title deed/ agreement of sale not available on record

3.31 TDR are not discharged or renewed

3.32 Control returns not sent to the H.O.

3.33 The branch has not taken any action for not compliance with terms of agreement

3.34 No documents executed for enhancement of limit/document not on record

3.35 ECGC Post shipment policy not obtained

3.36 Credit facility released without execution of all necessary documents

3.37 Common Seal not affixed on Letter of Comfort

3.38 Confirm orders for export credit not found on record for facilities released

4. REVIEW/MONITORING/SUPERVISION

4.1 The account is frequently overdrawn

4.2 The account is continuously overdrawn

4.3 The account is overdrawn and the branches have not taken sufficient steps to regularise the accounts promptly

4.4 The balance outstanding have exceeded the drawing power

4.5 Balance confirmation and acknowledgment of debt not obtained

4.6 The stock book-debts statements not received regularly/ promptly

4.7 The FFI/ financial statements/audited statements/FFR 1 & 2/ other operational data, etc., not received regularly/ promptly

4.8 The stock, book-debts statements, etc., not scrutinised and no suitable action is taken

4.9 The FFI/ financial statements/ audited statements/FFR 1 & 2/ other operational data, etc., not received regularly/ promptly/ not scrutinised and no suitable action is taken

4.10 Non-moving stock is not deducted to arrive at the drawing power

4.11 The age-wise break-up of debtors is not found on record. The borrowers are allowed to draw money on entire outstanding debt, which must rather be for the recent debts as prescribed for particular industries and as per margin prescribed in the sanction letter

4.12 Wide discrepancies observed in the stock statements and stock figures in the annual audited financial statements

4.13 No penal interest has been charged for delay in submission of various statements as per the terms of agreement depending upon the type of loan/ credit availed by the borrower

4.14 Many branches have not adhered to the prescribed frequency of physical verification of securities given against loans & advances

4.15 Drawing power limits are not revised as per market value of shares for advances against security of shares

4.16 End–use of funds not ensured/ not known funds utilised for purpose other than for which granted

4.17 The projections submitted by the borrower stay far beyond the actual performance. Further, no explanation for the same is taken from the borrower

4.18 Major sale proceeds of the borrower not routed through the Bank

4.19 Audited statements of non-corporate borrowers having limit beyond ` 10 lakh not received

4.20 Renewal proposals of advances not received on time and in many cases the limits are not renewed

4.21 Application of wrong rate of interest, processing charges, commission, other charges, etc. resulting in income leakage/ excess booking of interest of the bank

4.22 Insurance cover for stock/ property is inadequate/ not on record/ not renewed/ not endorsed in favour of the Bank

4.23 Inspection/ physical verification of security charged, not been carried out

4.24 Expired bills/ foreign currency sight bills which are outstanding, have not been crystallised

4.25 EBW statements on write–off of overdue export bills of ECM not found on record

4.26 Confirmation as to genuineness of export transactions not obtained from Bank's foreign offices/

correspondents/ customs department

4.27 Import credit, bill of entry evidencing import of goods not found

4.28 Documents are not obtained for bills discounted under Letter of Credit

4.29 Advances, which are eligible for whole turnover packing credit guarantee cover of ECGC, are not brought under its cover

4.30 Though government guaranteed accounts are irregular since long, the issue of invocation of guarantee does not seem to have been considered

4.31 Prescribed margins not maintained as per sanctions

4.32 Allocated limits, full terms of sanctions, stock statements, inspection reports, margin, etc. not available at monitoring branches

4.33 For allocated limits, inordinate delays were noticed in responding to transfer by the allocator branch

4.34 Regular meetings not held with other consortium members to review the performance of borrowers and to assess the current state of affairs/not been held as per norms

4.35 Individual members of the consortium are not advised about the quarterly operating limits/ D. P. allocated to each one of them

4.36 Minutes of the consortium meetings not found on record/not been held as per norms

4.37 Inspection report from the consortium members not obtained

4.38 The capital of the borrower has eroded/ networth is negative/ decreasing. Close monitoring needs to be done

4.39 The drawing power is calculated wrongly and/or hence the borrower is allowed to enjoy excess credit than actually eligible

4.40 Signboard of the bank is not displayed in godown, where the pledged/ hypothecated stock is stored

4.41 Limit not fully utilised by the borrower/No commitment charge is levied for the limit not fully utilised by the borrower

4.42 Loan against TDR/ STDR, which is matured, is neither renewed nor credited to loan account

4.43 The Stock and Debtors Audit Report not found on record. No audit has been done for accounts of the borrower

4.44 The valuation report in respect of tangible security from Government approved valuer have not been obtained

4.45 Guarantees, Opinion Reports Financial statements, IT assessment orders and etc. of the guarantor are not found on record

4.46 Opinion report on guarantor is not obtained

4.47 For Small Government Sponsored loan accounts, security cover could not be ascertained since neither any record was available at branch nor physical verification conducted by the branch

4.48 Pre–sanctions and/or post–sanctions inspection reports were not on record

4.49 The account was overdue for repayment and/or no credit was received from the borrower for a long time

4.50 The borrower is absconding or deceased and legal formalities are incomplete and there is wilful default from the borrower. Either establishment was closed or security was disposed off or no action taken by the branch

4.51 Subsidy claim process was incomplete or subsidy was yet to be received or needs follow-up

4.52 Security disposed off/ Entity closed by borrower and no action taken by the branch

4.53 Irregularity not advised to controllers

4.54 Letter of subordination of deposits not taken

4.55 Secured and unsecured portion not segregated properly in advance return of the branch

4.56 Renewal of limits was done before the receipt of financial statements

4.57 Heavy cash withdrawal for which consent of corporate Guarantor is not taken

4.58 Proper valuation of stock not done/ needs critical scrutiny

4.59 Security obtained is inadequate/lower as compared to amount of outstanding/ no collateral security

4.60 The party was dealing with other bank also tough it was not permitted

4.61 Sticky accounts require close follow-up by the management

5. BAD AND DOUBTFUL DEBTS

5.1 The IRAC norms for classification of advances were not followed and the same is implemented through Memorandum of Changes by auditors during audit

5.2 Instalments were not received from the borrowers

5.3 Interest was not received from the borrowers

5.4 Legal action for recovery of advances was not taken although authorised by the Board/ Controlling Authority

5.5 Discontinuance of application of interest not followed although authorised by the Board/ Controlling Authority

5.6 Government guarantees have expired and fresh guarantees not obtained/not renewed

5.7 Terms of the BIFR scheme not complied

5.8 Payment from Government not received although guarantees were unconditional, irrevocable and payable on demand

5.9 Delays in the settlement/ repayment in respect of sanctioned proposals

5.10 The repayment accepted in case of compromise cases inadequate *vis-à-vis* value of security

5.11 Compromise proposals pending at various levels where local government/ outside agencies are involved as guarantors

5.12 Copy of Search Report not on record

5.13 Decree awarded but no further steps taken for recovery

5.14 DI&CGC claims submitted/ rejected/ pending data not available

5.15 Irregular/ sticky advance not reported to the controlling authority promptly

5.16 Compromise/ OTS proposal is recommended and is under negotiation since long but not finalised. Suit is filed in the court/ DRT and pending to be finalised

5.17 ECGC claim not submitted/ lodged for recovery

■■■

Tax Audit of the Branch of the Bank

CA. Abhay V. Kamat

1. As per section 44AB of the Income-tax Act, 1961, every person carrying on business whose total sales, turnover or gross receipts, as the case may be, in the business exceed or exceeds ` 1 crore in the previous year should get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form, duly signed and verified by such accountant. The audit under section 44AB of the Income-tax Act, 1961 is commonly known as Tax Audit.

2. As far as the bank is concerned, it is operating through its branches. However, for Income-tax purpose the bank as a whole is an assessee. Hence the monetary limit of the turnover of ` 1 crore is considered in respect of the bank as a whole. Thus the bank is subject to tax audit. The operations of the bank are carried out through its branch network. Therefore the bank appoints its branch auditor as the tax auditor who is supposed to carry out the tax audit of the branch and report to the Head Office. At Head Office the branch tax audit reports are considered and a consolidated tax audit report is prepared. Thus the tax audit report of the branch plays supplementary role in the entire process of the tax audit of the bank.

3. The audit could be carried out by the accountant as defined in the explanation below sub-section (2) of section 288 of the Income Tax Act, 1961. According to this explanation a chartered accountant within the meaning of the Chartered Accountants Act, 1949 can sign the Tax Audit Report.

4. The auditor should give the report in Form 3CA, as the audit of the branch is conducted under Banking Companies (Acquisition and Transfer of Undertaking) Act, 1980. In case the auditor wants to mention any qualification/ matter of emphasis, it should be mentioned in the Form 3CA with appropriate clarity

5. The details are required to be submitted in the prescribed form viz. Form 3CD. The said Form 3CD is given by way of annexure to this article which also gives the possible answers against every clause in the Form 3CD. These answers are the indicative answers and not necessarily the complete answers. The auditor should apply his mind for every clause and verify the answer given in the form.

6. The prescribe format of Form 3CD does not have a place for the signature of the assessee. It provides the place for the signature of the Chartered Accountant. However it is advisable to take the signature of the Branch Manager on Form 3CD. It is presumed that the answers to the clauses in the form are compiled by the Branch Management and the auditor should verify them by applying suitable test checks as he may think appropriate.

7. Normally the bank prepares a format of Form 3CD. There are certain items for which the details are available at the head office of the bank. The branch may not have the details. Such items are specifically mentioned in the format given herein. For some of the clauses, there will be standard answers which are also stated in the said format. In some cases the details are to be given in a specific manner. In such cases the bank prepares the formats of the annexure to be attached to the Form 3CD and the same are attached along with the said format.

8. The auditor should verify the correctness and completeness of the details given in Form 3CD. In case the auditor is of the opinion that the details given by the branch are not correct or complete, he should bring this fact to the notice of the branch management and get it corrected. In case the branch management is not in agreement with the views of the auditor, the fact should be suitably disclosed and the reasoning should also be given.

9. While signing the audit report in Form 3CA as well as Form 3CD, the auditor should mention his firm name, firm registration number, name of the member signing the report along with his/her membership number. The date and the place of execution of the report should also be mentioned.

10. While carrying out the tax audit, the tax auditor should also refer to the tax audit report of the earlier year. This will help him in understanding the expenses of the prior period, disallowances under section 43B, written down value of the assets as per Income Tax Act, TDS disallowances or allowances, etc,

11. Clause 34 of Form 3CD requires stating the details about tax deduction and its remittance to the government treasury. It is necessary to see the compliance of the provisions of Chapter XVII-B of the Income Tax Act, 1961. In case of violation of the provisions the matter should be reported. Additionally, it is necessary to pay attention to the following for aspects

    a. Tax deductible and not deducted at all – Where it is necessary to deduct the tax at source as per chapter XVII-B and the branch had not deducted the tax from such payments, such details should be given. The auditor should verify the expenses while scrutinizing the profit and loss account and ascertain whether proper tax has been deducted or not. Where the tax is not deducted the amounts should be mentioned.

    b. Shortfall on account of lesser deduction than required to be deducted- The rates of tax to be deducted are specified in the Act. The auditor should verify whether the tax is deducted at appropriate rate or not. In case the tax deducted is less than the amount works out at the prescribed rate, the instances with the amount of short fall should be mentioned. In case the tax deducted is more than the prescribed amount, the instances need not be mentioned.

    c. Tax deducted late – The tax should be deducted at the prescribed time. Usually the tax is to be deducted at the time of credit or on payment whichever is earlier. However, in case the bank deducts the tax subsequently, it should be mentioned here as tax deducted late.

    d. Tax deducted but not paid to the credit of the Central Government – The bank deducts the tax and the accounting entry is passed. The said amount remains as liability till the time it is paid to the Government treasury. In case such tax which is deducted but not remitted to the government treasury, the auditor should enquire whether the amount is paid till the time of conclusion of the tax audit. However, in case, the amount is not remitted till the time of conclusion of the tax audit, it should be mentioned against this sub-clause.

    e. The details of interest paid u/s. 201 should also be mentioned. The auditor should also ask the branch management about the pending demands from the income tax site and if need be it should be mentioned in the contingent liabilities apart from considering it during the course of tax.

    While ascertaining the correctness of the details given under this clause one should remember that the non-compliance of the provisions of chapter XVII-B has an impact on the allowability of the expenditure under section 40(a)(ia) of the Income-tax Act,1961

12. The auditor should obtain proper documentation from the branch to complete the working paper file. Wherever required, proper representation, in respect of certain points, may be obtained.

13. Tax audit is a specific appointment in the process of annual bank branch audit. Therefore the auditor should plan for the tax audit and design appropriate audit program to complete the tax audit effectively. In fact the auditor can enquire about the availability of well prepared Form 3CD along with its annexure. The checking of these details required for the tax audit can be done simultaneously while carrying out the scrutiny of the books of account. Where the accounts are maintained on computer, the auditor should enquire about the availability of the reports supporting the data required for the tax audit and use such reports as additional support to ascertain the correctness and completeness of the details given.

14. In order to complete tax audit effectively the auditor should not only be thorough with the audit, auditing techniques, Standards on Auditing, etc. but also be thorough with the provisions of the Income Tax Act, 1961. Understanding the provisions of Income Tax Act and using the audit techniques efficiently will make the tax audit more effective.

FORM NO. 3CD
[See rule 6G(2)]

Statement of particulars required to be furnished under section 44AB of the Income-tax Act, 1961

PART - A

1	Name of the assessee	:	*Name of the branch/office with C.O. Code Number*
2	Address	:	*Address of the branch*
3	Permanent Account Number (PAN)	:	*Specify the PAN of the bank*
4	Whether the assessee is liable to pay indirect tax like excise duty, service tax, sales tax, customs duty, etc. if yes, please furnish the registration number or any other identification number allotted for the same	:	*Specify the relevant registration number of the bank*
5	Status	:	*Domestic Company*
6	Previous year	**:**	**01-Apr-2017 to 31-Mar-2018**
7	Assessment year	**:**	**2018-19**
8	Indicate the relevant clause of section 44AB under which the audit has been conducted	**:**	**44AB(a)**

PART – B

9	(a)	If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.	*Not Applicable*
	(b)	If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change.	*Not Applicable*
10	(a)	Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession).	*Banking as per Section 6 of the Banking Regulation Act, 1949.*
	(b)	If there is any change in the nature of business or profession, the particulars of such change.	*There is no change in the nature of business.*
11	(a)	Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.	*No.*
	(b)	List of books of account maintained and the address at which the books of account are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of account are not kept at one location, please furnish the addresses of locations along with the details of books of account maintained at each location.)	*As of 31.03.2016 the branch/ office is computerized having Core Banking Solution Platform and the books of accounts are generated by computer system.*
	(c)	List of books of account and nature of relevant documents examined.	*As above*
12	Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First Schedule or any other relevant section.)		*No*

<table>
<tr><td>13</td><td>(a) Method of accounting employed in the previous year.</td><td>Mercantile system</td></tr>
<tr><td></td><td>(b) Whether there had been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.</td><td>Dealt at Head Office.</td></tr>
<tr><td></td><td>(c) If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.
<table><tr><td>Serial number</td><td>Particulars</td><td>Increase in profit (₹)</td><td>Decrease in profit (₹)</td></tr></table></td><td>Dealt at Head Office.</td></tr>
<tr><td></td><td>(d) Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect thereof on the profit or loss.</td><td>Dealt at Head Office.</td></tr>
<tr><td>14</td><td>(a) Method of valuation of closing stock employed in the previous year.</td><td>Not Applicable</td></tr>
<tr><td></td><td>(b) In case of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss, please furnish:
<table><tr><td>Serial number</td><td>Particulars</td><td>Increase in profit (₹)</td><td>Decrease in profit (₹)</td></tr></table></td><td>Not Applicable</td></tr>
<tr><td>15</td><td>Give the following particulars of the capital asset converted into stock-in-trade:–
(a) Description of capital asset;
(b) Date of acquisition;
(c) Cost of acquisition;
(d) Amount at which the asset is converted into stock-in-trade.</td><td>Not Applicable</td></tr>
<tr><td>16</td><td>Amounts not credited to the profit and loss account, being,–</td><td></td></tr>
<tr><td></td><td>(a) The items falling within the scope of section 28;</td><td>Details to be given, if any</td></tr>
<tr><td></td><td>(b) The pro forma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;</td><td>Details to be given, if any</td></tr>
<tr><td></td><td>(c) Escalation claims accepted during the previous year;</td><td>Details to be given, if any</td></tr>
<tr><td></td><td>(d) Any other item of income;</td><td>Details to be given, if any</td></tr>
<tr><td></td><td>(e) Capital receipt, if any.</td><td>Details to be given, if any</td></tr>
<tr><td>17</td><td>Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, please furnish:</td><td>NIL</td></tr>
<tr><td></td><td><table><tr><td>Details of property</td><td>Consideration received or accrued</td><td>Value adopted or assessed or assessable</td></tr></table></td><td></td></tr>
</table>

18	Particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form:– (a) Description of asset/block of assets.	If it is maintained at the Head Office: - Dealt at Head Office If it is maintained at the Branch As per annexure attached
	(b) Rate of depreciation.	
	(c) Actual cost or written down value, as the case may be.	
	(d) Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—	
	(i) Central Value Added Tax credits claimed and allowed under the Central Excise Rules,1944, in respect of assets acquired on or after 1st March, 1994,	
	(ii) Change in rate of exchange of currency, and	
	(iii) Subsidy or grant or reimbursement, by whatever name called.	
	(e) Depreciation allowable.	
	(f) Written down value at the end of the year.	
19	Amounts admissible under sections–	NIL
	(a) 32AC, (b) 33AB, (c) 33ABA, (d) 35(1)(i), (e) 35(1)(ii), (f) 35(1)(iia), (g) 35(1)(iii), (h) 35(1)(iv), (i) 35(2AA), (j) 35(2AB), (k) 35ABB, (l) 35AC, (m)35AD, (n)35CCA, (o)35CCB, (p)35CCC, (q) 35CCD, (r) 35D, (s) 35DD, (t)35DDA, (u)35E:	
	Amount debited to profit and loss account	
	Amounts admissible as per the provisions of the Income-tax Act, 1961 and also fulfils the conditions, if any specified under the relevant provisions of Income Tax Act, 1961 or Income Tax Rules,1962 or any other guidelines, circular, etc., issued in this behalf.	
20	(a) Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(1)(ii)]	NIL
	(b) Details of contributions received from employees for various funds as referred to in section 36(1)(va):	NIL

Serial number	Nature of fund	Sum received from employees	Due date for payment	The actual Amount paid	The actual date of payment to the concerned authorities

21	(a) Please furnish the details of amounts debited to the profit and loss account, being in the nature of	Details to be given, if any
	Capital expenditure	
	Personal expenditure	

		Advertisement expenditure in any souvenir, brochure, tract, pamphlet or the like, published by a political party	
		Expenditure incurred at clubs being entrance fees and subscriptions	
		Expenditure incurred at clubs being cost for club services and facilities used	
		Expenditure by way of penalty or fine for violation of any law for the time being force	
		Expenditure by way of any other penalty or fine not covered above	
		Expenditure incurred for any purpose which is an offence or which is prohibited by law	
	(b)	Amounts inadmissible under section 40(a):– (i) As payment to non-resident referred to in sub-clause (i) (A) Details of payment on which tax is not deducted: (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of the payee	Details to be given, if any
	(B)	Details of payment on which tax has been deducted but has not been paid during the previous year or in the subsequent year before the expiry of time prescribed under section 200(1) (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of the payee (V) Amount of tax deducted	Details to be given, if any
	(ii)	As payment referred to in sub-clause (ia) (A) Details of payment on which tax is not deducted: (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of the payee	Details to be given, if any
	(B)	Details of payment on which tax has been deducted but has not been paid on or before the due date specified in sub-section (1) of section 139. (I) Date of payment (II) Amount of payment (III) Nature of payment (IV) Name and address of the payer (V) Amount of tax deducted (VI) Amount out of (V) deposited, if any	Details to be given, if any
	(iii)	Under sub-clause (ic) [Wherever applicable]	NIL
	(iv)	Under sub-clause (iia)	NIL
	(v)	Under sub-clause (iib)	NIL

<table>
<tr><td></td><td>(vi) Under sub-clause (iii)
(A) Date of payment
(B) Amount of payment
(C) Name and address of the payee</td><td>NIL</td></tr>
<tr><td></td><td>(vii) Under sub-clause (iv)</td><td>NIL</td></tr>
<tr><td></td><td>(viii) Under sub-clause (v)</td><td>NIL</td></tr>
<tr><td></td><td>(c) Amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under sections 40(b)/40(ba) and computation thereof;</td><td>Not Applicable</td></tr>
<tr><td></td><td>(d) Disallowance/deemed income under section 40A(3):</td><td></td></tr>
<tr><td></td><td>(A) On the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, please furnish the details:<table><tr><td>Serial number</td><td>Date of payment</td><td>Nature of payment</td><td>Amount</td><td>Name and Permanent Account Number of the payee, if available</td></tr></table></td><td>In case of expenditure incurred and paid otherwise than by account payee cheque or demand draft.
Details to be given, if any</td></tr>
<tr><td></td><td>(B) On the basis of the examination of books of account and other relevant documents/evidence, whether the payment referred to in section 40A(3A) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft If not, please furnish the details of amount deemed to be the profits and gains of business or profession under section 40A(3A);<table><tr><td>Serial number</td><td>Date of payment</td><td>Nature of payment</td><td>Amount</td><td>Name and Permanent Account Number of the payee, if available</td></tr></table></td><td>Details to be given, if any</td></tr>
<tr><td></td><td>(e) Provision for payment of gratuity not allowable under section 40A(7);</td><td>NIL</td></tr>
<tr><td></td><td>(f) Any sum paid by the assessee as an employer not allowable under section 40A(9);</td><td>NIL</td></tr>
<tr><td></td><td>(g) Particulars of any liability of a contingent nature;</td><td>NIL</td></tr>
<tr><td></td><td>(h) Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income;</td><td>NIL</td></tr>
<tr><td></td><td>(i) Amount inadmissible under the proviso to section 36(1)(iii)</td><td>NIL</td></tr>
</table>

22	Amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.	Details to be given, if any
23	Particulars of payments made to persons specified under section 40A(2)(b).	NIL
24	Amounts deemed to be profits and gains under section 32AC or 33AB or 33ABA or 33AC.	NIL
25	Any amount of profit chargeable to tax under section 41 and computation thereof.	NIL
26	In respect of any sum referred to in clauses (a), (b), (c), (d), (e) or (f) of section 43B, the liability for which:– (A) Pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was (a) Paid during the previous year; (b) Not paid during the previous year. (B) Was incurred in the previous year and was (a) Paid on or before the due date for furnishing the return of income of the previous year under section 139(1); (b) Not paid on or before the aforesaid date.	Details to be given, if any
	(State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost, etc., is passed through the profit and loss account.)	Yes
27	(a) Amount of Central Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.	Relevant details to be reported
	(b) Particulars of income or expenditure of prior period credited or debited to the profit and loss account.	NIL
28	Whether during the previous year the assessee has received any property, being share of a company not being a company in which the public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2)(viia), if yes, please furnish the details of the same.	No
29	Whether during the previous year the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib), if yes, please furnish the details of the same.	No
30	Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque [Section 69D].	NIL

31	*(a) Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year (i) Name, address and permanent account number (if available with the assessee) of the lender or depositor; (ii) Amount of loan or deposit taken or accepted; (iii) Whether the loan or deposit was squared up during the previous year; (iv) Maximum amount outstanding in the account at any time during the previous year; (v) Whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an account payee bank draft. *(These particulars needs not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)	Not Applicable
	(b) Particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year :— (i) Name, address and permanent account number (if available with the assessee) of the payee; (ii) Amount of the repayment; (iii) Maximum amount outstanding in the account at any time during the previous year; (iv) Whether the repayment was made otherwise than by account payee cheque or account payee bank draft.	Details to be given, if any
	(c) Whether the taking or accepting loan or deposit, or repayment of the same were made by account payee cheque drawn on a bank or account payee bank draft based on the examination of books of account and other relevant documents (The particulars (i) to (iv) at (b) and comment at (c) above need not be given in the case of a repayment of any loan or deposit taken or accepted from Government, Government company, banking company or a corporation established by a Central, State or Provincial Act)	Details to be given, if any

<table>
<tr><td>32</td><td>(a) Details of brought forward loss or depreciation allowance, in the following manner, to the extent available:
<table>
<tr><td>Serial Number</td><td>Assessment Year</td><td>Nature of loss/ allowance (in rupees)</td><td>Amount as returned (in rupees)</td><td>Amount as assessed (give reference to relevant order)</td><td>Remarks</td></tr>
</table>
</td><td>NIL</td></tr>
<tr><td></td><td>(b) Whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79</td><td>No</td></tr>
<tr><td></td><td>(c) Whether the assessee has incurred any speculation loss referred to in section 73 during the previous year, If yes, please furnish the details of the same.</td><td>NIL</td></tr>
<tr><td></td><td>(d) Whether the assessee has incurred any loss referred to in section 73A in respect of any specified business during the previous year, if yes, please furnish details of the same.</td><td>NIL</td></tr>
<tr><td></td><td>(e) In case of a company, please state that whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73, if yes, please furnish the details of speculation loss if any incurred during the previous year.</td><td>NA</td></tr>
<tr><td>33</td><td>Section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10A, Section 10AA).</td><td>Details to be provided, if any</td></tr>
<tr><td></td><td>
<table>
<tr><td>Section under which deduction is claimed</td><td>Amounts admissible as per the provision of the Income-tax Act, 1961 and fulfils the conditions, if any, specified under the relevant provisions of Income-tax Act, 1961 or Income Tax Rules,1962 or any other guidelines, circular, etc., issued in this behalf.</td></tr>
</table>
</td><td></td></tr>
<tr><td>34</td><td>(a) Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes please furnish:
1. Tax deduction and collection Account Number (TAN)
2. Section
3. Nature of payment
4. Total amount of payment or receipt of the nature specified in column (3)
5. Total amount on which tax was required to be deducted or collected out of (4)
6. Total amount on which tax was deducted or collected at specified rate out of (5)
7. Amount of tax deducted or collected out of (6)
8. Total amount on which tax was deducted or collected at less than specified rate out of (5)
9. Amount of tax deducted or collected on (8)
10. Amount of tax deducted or collected not deposited to the credit of the Central Government out of (6) and (8)</td><td>Details to be provided</td></tr>
</table>

<table>
<tr><td></td><td>(b) Whether the assessee has furnished the statement of tax deducted or tax collected within the prescribed time. If not, please furnish the details:
<table>
<tr><td>Tax deduction and collection Account Number (TAN)</td><td>Type of Form</td><td>Due date for furnishing</td><td>Date of furnishing, if furnished</td><td>Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported</td></tr>
</table>
</td><td>Details to be provided</td></tr>
<tr><td></td><td>(c) Whether the assessee is liable to pay interest under section 201(1A) or section 206C(7). If yes, please furnish:</td><td>Details to be provided</td></tr>
<tr><td></td><td>
<table>
<tr><td>Tax deduction and collection Account Number (TAN)</td><td>Amount of interest under sections 201(1A)/206C(7) is payable</td><td>Amount paid out of column (2) along with date of payment.</td></tr>
</table>
</td><td></td></tr>
<tr><td>35</td><td>(a) In the case of a trading concern, give quantitative details of principal items of goods traded:
(i) Opening stock;
(ii) Purchases during the previous year;
(iii) Sales during the previous year;
(iv) Closing stock;
(v) Shortage/excess, if any.</td><td>Not Applicable</td></tr>
<tr><td></td><td>(b) In the case of manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products:
A Raw materials :
(i) Opening stock;
(ii) Purchases during the previous year;
(iii) Consumption during the previous year;
(iv) Sales during the previous year;
(v) Closing stock;
(vi) Yield of finished products;
(vii) Percentage of yield;
(viii) Shortage/excess, if any.</td><td>Not Applicable</td></tr>
</table>

	B Finished products/By-products : (i) Opening stock; (ii) Purchases during the previous year; (iii) Quantity manufactured during the previous year; (iv) Sales during the previous year; (v) Closing stock; (vi) Shortage/excess, if any.	Not Applicable
36	In the case of a domestic company, details of tax on distributed profits under section 115-O in the following form:– (a) Total amount of distributed profits; (b) Amount of reduction as referred to in section 115-O(1A)(i); (c) Amount of reduction as referred to in section 115-O(1A)(ii); (d) Total tax paid thereon; (e) Dates of payment with amounts.	Not applicable
37	Whether any cost audit was carried out, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the cost auditor.	Not Applicable
38	Whether any audit was conducted under the Central Excise Act, 1944, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the auditor.	Not Applicable
39	Whether any audit was conducted under section 72A of the Finance Act,1994 in relation to valuation of taxable services, Finance Act,1994 in relation to valuation of taxable services, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the auditor.	No
40	Details regarding turnover, gross profit, etc., for the previous year and preceding previous year: 1. Total turnover of the assessee 2. Gross profit/turnover 3. Net profit/turnover 4. Stock-in-trade/turnover 5. Material Consumed/finished goods produced	Not Applicable
	(The details required to be furnished for principal items of goods traded or manufactured or services rendered)	
41	Please furnish the details of demand raised or refund issued during the previous year under any tax laws other than Income-tax Act, 1961 and Wealth Tax Act, 1957 along with details of relevant proceedings.	At Head Office

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Audit of Profit and Loss Account

CA Gautam Shah, CA Vinit Jain

The bank branch statutory auditors issues audit report giving opinion that the Profit and Loss account gives a true and fair view of the Profit or Loss of the branch for the year under audit. Hence verification of the accuracy of the numbers appearing in the Profit and Loss account ensuring that there is no material misstatement is the primary responsibility of the branch auditor. The auditor states in his audit report that he has done his audit in accordance with the Standards of Auditing and hence the auditor need to ensure compliance with all audit procedures & documentation as per Standards of Auditing.

Branch auditor can plan the audit of Profit and Loss account in following manner –

1) Obtaining complete list of RBI Master Directions, Circulars, Notifications
2) Going through the Guidance Note on audit of Banks, 2018 edition & other relevant materials issued by the WIRC / ICAI
3) Obtaining Closing Circulars/instructions issued by the Bank
4) Obtaining the accounting policies of the Bank and understanding the same. Ensuring that the policies are in sync with the Accounting Standards issued by the ICAI and there is no change in the policies followed vis-a-vis the previous year
5) Ensuring obtaining schedule of charges, authority matrix
6) Obtaining Reports of Revenue Auditors/ Concurrent or Internal Auditors – last year MOC or LFAR to ensure any issues noted which impacted the Profit and Loss account
7) To obtain reason for variance under each line item from branch management. Review the reasoning provided by them which will help in designing further audit process

The Auditor should check following specific areas–

I. INCOME

1. Application of interest on all types of loans. The auditor should see the flagged accounts where interest is not charged.
2. Appropriateness of Rate of interest- Correct Rate of interest as per sanctioned terms. Especially, in case of advance against Fixed Deposit of third party, the interest should be changed additionally.
3. Manually checking of Interest: The auditor should not blindly rely on system calculating the interest and should verify month-on-month interest by calculating manually.
4. Debit Freeze: The auditor should verify that, in case if there is debit freeze activated in loan account, the interest is run at the Back-end and is reflecting under interest accrual account.
5. Concessions given to the borrower in the rate of interest on loans should be seen. Whenever rates are revised, the impact thereof on the concessions needs to be seen more carefully.
6. In case of NPA accounts, the interest is to be recognised as income only on realisable basis. It should be realised out of fresh and genuine credits and not from fresh sanction of loans.
7. Penal interest should be verified. The penal interest is on account of delay in submission of stock statements, non-compliance of the terms of sanction, incomplete documentation, non-renewal of facilities after due date, etc.

8. Temporary overdrafts (TOD) in saving bank accounts or current accounts. Similarly, excess drawings in cash credit accounts attract additional interest.

9. Manual intervention: The auditor should strictly verify the income and expense accounts where there is human intervention.

10. Loan Processing charges: The auditor should confirm that the Bank has charged Loan Processing fees on *pro-rata* basis.

11. New Products may not be Leakage free: Auditors should thoroughly verify the newly introduced asset products which may be prone to errors resulting into revenue leakage.

12. Fraudsters to leverage technology: Auditor should verify the leakages relating to weaknesses in a process of identifying a fraud concerning operational and accounting issues.

13. Other operational charges on the following accounts should also be checked-
    - Cheque book charges
    - Minimum balance charges
    - Commitment charges on the advances not utilised
    - Cheque return charge
    - Stop payment charges
    - Ledger folio charges
    - ATM usage charges
    - Debit/Credit issuance charges

14. Commission and exchange should be checked –
    - DD/TT/MT
    - Balance Certificate charges
    - Solvency certificate charges

15. Other income
    - Sale of old newspaper.
    - Insurance referral commission.
    - Interest on investment, if any.
    - Locker rent–recovery of locker rent and position of outstanding locker rent

16. Thorough scrutiny and ensuring the correctness of debiting the charges in income account

17. Auditor should verify excel based computations such as interest, commission, Drawing Power, etc.

    In all the above cases, the auditor should not only verify the calculations but also see whether they are applied and accounted for properly. Apart from this, the auditor should carry out certain analytical procedures like calculation of ratios and comparison with earlier period. This will ensure the correctness of income. In case of major deviation or in case of no/less deviation even after there is impulsive market situation, the auditor should ask for an explanation and satisfy himself

II. EXPENSES

For expenses, it is not enough to have appropriate account debited but the amount debited should also be proper. For all expenses, the auditor should see the sanction by appropriate authority, proper documentation and correctness in accounting. The auditor may also have a proprietary angle which he may use judiciously.

The areas covered could be the following–

1 Interest paid on different types of deposits: Auditor should ensure that interest paid on deposits are as per the stipulated card rates in case of Term deposits and fixed rate in case of Saving account as per Banks policy.

2. Reversal of interests paid or interest on premature deposits: Auditor should ensure the genuineness of reversal of interest on premature deposits.

3. Tagging of accounts: Auditor should ensure proper tagging of deposit accounts especially in case of current accounts and deposits from Bank which may result in paying interest on current account and paying additional premium for Bank deposits.

4. Provisions and Payments to employees: Auditor should ensure that there are no ghost employees in the branch.

5. Billing, Duplication & Reconciliation: Auditor should verify non entry/data entry errors, transactions which are of voluminous nature with the vendors to ensure proper billing and avoiding duplication of same expense.

6. Spot checks and revenue leakage on mail acceptance: Auditor by way of personal interviews should ensure whether there are any cases of spot checks or sharing of password with others which may help to authorise the undue expenses.

7. Sensitive Stationeries: Auditor should verify the stationery and ensure the genuineness of the use of old cheque books, Demand drafts, etc.

8. Inoperative accounts: Auditor should thoroughly verify the process of activating the inoperative accounts.

9. Timely renewal of agreements: Auditor should verify that all the warranty/service related agreements are timely renewed, failure of which may lead to burden of extra cort to bank.

10. Establishment expenses

11. Rent for premises

12. Goods and Services Tax/ Service tax payments and payment of other taxes

13. Professional fees, legal fees, etc.

14. Printing and Stationery expenses

15. General charges account

16. Salaries & provisions for Leave encashment benefits are done at HO and passed in the Bank books. Branch has no control over this centralised posting and the Branch auditor may just make appropriate disclosures in this regard as done in the previous year.

17. Other items of Income that need to be checked are –

    a) Income from Investments which are usually centralised or at few select branches –

    b) Commission from Letters of Credit / Guarantees which as per bank policy consistently adopted would be accounted upfront and duly amortised monthly or quarterly as the case may be. Auditor to ensure that the Income pertaining to future periods which if collected is amortised correctly.

18. Auditor should specifically check the accuracy of interest subvention claimed by the Bank as per Government sponsored Education, Housing & other applicable schemes.

19. Auditor should note that shortfall in assets like cash or receipt of fake notes needs a provision in the accounts.

20. Similarly old debit balances in reconciliations, suspense or inter office adjustments need to be appropriately provided.

21. Any shortfall in deposits or non-refundable deposits or deposits with missing original security receipts need appropriate provisioning on a case to case basis.

22. Regulators may charge Branches/banks on violation of Regulatory norms like non-compliance with KYC

23. AML guidelines/Delayed or inaccurate submission of MIS returns etc. by levying a penalty which apart from an expense is a significant reputational risk.

No doubt the volume of transactions at the branch level is huge and they are of repetitive nature. Therefore the audit should be done on test check basis. The sampling should be done logically. Selection of transaction should be such that it should cover all types of transactions and it should have a proper time spread so as to ascertain whether there is any possibility of revenue leakage. In such situation, as mentioned earlier, the other techniques like ratio analysis, comparisons etc. should be used. In case of any divergence the matter needs to be checked thoroughly so that there is no detection risk in audit. The auditor should also see that the provisions for all expenses have been made and the application of interest is calculated and applied to all the accounts. The auditor should scrutinise the ledger account to see that there is no abnormal entry in the books.

In case if leakage is found out, he should ensure that the amount has been properly recovered and reported to delegated authority.

Finally the presentation in the Profit and Loss account is also very important. The balances in particular account should be mentioned at appropriate column or row in the final profit and loss account.

In general, the auditor should be aware of the situation in which he is auditing. He should have sound knowledge of statutory or regulatory requirements. He should apply his general commercial knowledge and be vigilant during the course of audit to arrest the income leakage.

Audit in CBS Environment

CA Nitant Trilokekar

Core Banking is *sin qua non* for any geographically disbursed business. Multinational companies and those having PAN India presence have all seen the benefit of Core Systems. It is true that the Core system was technically possible only after development of peer to peer system communication where the servers could communicate with other servers. Until then this was not possible. It may seem an ordinary accepted feature today but one day it was the stumbling block due to absence of such a 'handshake'. It is also well known that core systems were introduced in India by Banks. This was in the early 1990s. Later, the new private Banks initiated this at their very set up.

1. **Bank Branch Audit in Core Banking System (CBS) Environment**

   Most of the Banks have moved to CBS environment. What was earlier the prerogative of the Private Sector Bank and large public sector Banks, is filtered down to the large co-operative Banks, District level co-operative Banks and small co-operative Banks. Sometimes, mere payment/clearing system of the clearing house becomes a trigger move to a CBS environment to ensure that the clearing house electronic transfer automatically reaches the accountholder. All persons exposed to the branch like its depositors, borrowers and the auditors are affected by this. *Information Technology implications should not be seen only in isolation to report under Jalani Committee recommendations since technology is all pervasive affecting the Branch Auditor's opinion in most critical manner.*

2. **Core Banking defined**

   Instead of a server at each branch, there is one server for all the branches. The server is kept in a place called the Data Centre (DC). In case of failure of this server/site, there is a Backup site and if the site is in another location (another city) preferably in a different seismic zone, it is called the Disaster Recovery Centre (DRC). It is not uncommon to see the DRC to be located in a different continent in case of multinational Banks. A lot of care is therefore taken at the Data Centre but that not being in the scope of the statutory Auditor, it is not a subject matter of discussion here. Traditionally, the networking was by way of leased lines as the primary network. In case this network failed, the other back-up network was dial up Integrated Services Digital Network (ISDN) where the connection was automatically dialled up. Later other modes such as wireless (Radio frequency), VSAT (Very Small Aperture Terminal) and VPN (Virtual Private Network over the Internet), Cloud, came into popularity.

3. **Statutory Auditor and System Auditor of DC and branch**

   The Statutory auditor is not expected to be a technical expert to understand the system or the software. But it is a fact that most of the Banking operations are done through the computer. Since the CBS is the neurological network of the Bank, the branch auditor can ill afford to ignore the existence of the system. On the contrary, if the auditor is able to use the system, he/she will be able to improve his/her own efficiency. If the Branch has been subjected to a Systems audit, the Statutory Auditor can peruse the report to gain insight. He must ensure that any reliance of this report is only as per the policy of Institute of Chartered Accountants of India (ICAI) on dependence of work of an expert, because some system audits are known to be executed by non-Chartered Accountant (CA) firms.

Any Auditor may be complacent at his own peril if he mistakes presence of computer or the brand of the application software for accuracy and the desired results since the following issues have been noted:

1. **Final Accounts may not be representative of the Books of Accounts**

   This unbelievable alarming statement is unfortunately true. This issue would fall more into the realm of fundamental duty of the auditor. This issue is often neglected, as the statutory auditor dives into the matters of Borrower classification and items of Long Form Audit Report (LFAR). Once this issue is revealed post audit, it would be quite difficult for any auditor to defend himself. This complex situation can be simplified on the basis of the plausible reasons, also being areas branch auditor should concentrate:

a. **When all departments are not computerised: (This is the weakest part of core banking)**

When some departments are not computerised, the vouchers are manually fed into the core system. Such departments may range from Lockers to Treasury and Foreign Exchange. In such cases, the vouchers are entered at the end of the day. If any of the day's vouchers are not entered resulting in a compensating error, no-one is wiser since the trial balance tallies. One need not emphasise here that some scams have unearthed due to such features.

i. **When most departments are computerised but by different applications:**

This is not an uncommon situation. But, different applications does not always mean problem. How the different applications feed their data into the core system is the crux of the issue. System Auditors are better placed in the evaluation of such matters. Reference to the System Audit report therefore is recommended. Sometimes, the communication between the application and the core system is affected preventing entry upload. No warning is given even though it should be there. The books of that department show a figure quite different from that shown in the General Ledger leading to the crucial situation of Final Accounts not being in agreement with the Books of Account.

Foreign Exchange Department needs special mention here since many staff members are not transferred. They stay at their post committing intentional or unintentional errors to be discovered only after their transfer or retirement. Discovery of such issues by a vigilant auditor is never ruled out. Such department activity may be computerised but some transactions may not be connected to the core directly. In such cases, the Bank has two options:

Either post a voucher at the end of the day in the core

Or

Link by a text file to the core

Each of the above options are fraught with high risk. Every auditor must be convinced of the internal control of the whole system.

In case of voucher posting: How is the Bank ensuring the transactions are recorded on the same day is the most important question. The statutory auditor has visited the Bank at the end of the Financial year. It is not enough to have recorded the transactions by the end of the year but also on the very day the transaction has taken place. Another issue is of the revenue implications. It may be done by the subsystem or manually. How the Bank ensures this is another internal control issue.

Upload by TXT file: If the text file option is used, internal control issues crop us to ensure what is done to prevent manipulation of data since ordinary editors of the computer like 'notebook' can open the file and permit changes with no evidence of such changes. Any answer of 'strict manual control' is never sufficient unless there are system locks. Next is the control to ensure file upload is either not skipped or uploaded twice. It will be surprising to hear the rudimentary status of controls.

The auditor should be convinced BEYOND DOUBT about the internal control otherwise report it.

ii. When new channels like Automated Teller Machine (ATM) are added:

New channels linked recently are sometimes not tested substantially. These may be linked directly but have issues of their own. An example of ATM itself will clear the point. In any Bank, the books are closed for the day and re-opened almost immediately. Day closure is done any time from 5 pm to 10 pm. Assume that a customer has withdrawn cash on 31st of March at 7 pm when the books were closed at 5 pm. This withdrawal is shown on April 2. If you had verified the cash at 5 pm on March 31 even of the ATM you would find such a situation as correct. But when the posting is done on April 2, there is implication on revenue since the savings accounts are paid interest on daily basis. The customer gains interest of 2 days in this situation and more during long Bank holidays. If the application has interest calculation on 'as of' basis then perhaps the interest loss will not occur.

2. Borrower Health Classification

Accurate classification of health of the borrowers of the branch has become the most important aspect of statutory Branch audit. This has serious implications on the Balance sheet of the Bank in terms of provisioning. Many application systems have a special routine or report or even separate software which does the work of classification of borrowers. Blind acceptance of such report will tantamount to non-performance by the Branch Auditor. It is preferable for the Branch auditor to test the system. What the system skips for classification of non-performing accounts (NPA) or what is incorrectly classified as NPA is of concern to the Branch auditor. Branch Auditor will thus have to sample test the system to assure him the accuracy of the classification as detailed below:

- Compare the previous year NPA list with current. Identify and seek reasons why the upgraded accounts are upgraded and whether the reasons are justified as per rules permitted by the regulatory authority Reserve Bank of India (RBI).
- Take the report from CBS system (as opposed to the Borrower classification system which is a different application in some Banks) which gives indications of non-performing accounts in form of a few combination of reports like:
  - List of loan accounts in arrears – if the report permits, get those accounts where more than 2 installments are in arrears. (since 3 installments in arrears is defined as NPA) This will permit you to study the borderline cases and identify some which the system may not have downgraded.
  - The above report does not include Cash Credit (CC) and Overdraft (OD) accounts. This is because these accounts are continuous and there is no concept of 'installment'. What most systems will report will be CC and OD accounts which are overdrawn. Branch auditor will be able to identify the accounts which are overdrawn as on March 31 and a scrutiny of the accounts will confirm the date from which these accounts were 'continuously' overdrawn. If this period exceeds 90 days then the account needs to be classified as NPA. A check on classification of accounts to confirm such accounts are classified as non-performing will be adequate. A random check of earlier months will help isolate cases where accounts are continuously overdrawn but brought in order artificially for the year end.
  - Report of accounts not renewed /reviewed for more than a year is one of the statements to be submitted in LFAR. This list helps

confirm whether these accounts are included in the NPA list.

- Report of stock statements in arrears: A report of Stock/Debtors statements not submitted to the Bank for a period exceeding a user specified number of months should be generated and reviewed. If you specify the period of three months which is the trigger to downgrade the borrower's account, this will be a ready list to validate the NPA list of the branch.

- Report on overdue Bills Purchased and Bills discounted: This is another powerful report for verification of classification. The importance of this report is that while the other facility of the borrower may be in order, this department may be accidentally ignored. Since one NPA account forces all facilities to the borrower to be downgraded, this oft-ignored feature should be emphasised by the Branch Auditor.

Intervention of the Bank's Data Centre and their professionals to make a customised query is not always needed.

3. Risk Classification

Risk classification of accounts has direct bearing on the risk based Capital Adequacy of the Bank. There is often a misunderstanding that the Branch or Branch audit will not have impact on the Risk Based Capital adequacy because it will be done at the Head office and checked by the Main Auditor. It is mere logistics that the Main Auditor will not have intimate knowledge of the various accounts of the Branch. Even under Core Banking, if we were to assume full data availability, the sheer number of accounts make the task difficult today. The auditor of this note does subscribe to an advanced application to help achieve this but such software is yet to be designed. Therefore the Branch auditor needs to ensure that the accounts risk classification even of the Savings and the Current account are done to his satisfaction. RISK CLASSIFICATION NEED NOT BE AUTOMATIC. THERE ARE MANY MANUAL ACTIONS STILL PREVAILENT.

Risk classification also has impact on KYC (Know Your Customer) norms. KYC has become a very sensitive point even with the RBI Auditors stressing on it. KYC ACTIONS ARE OUTSIDE THE CORE BANKING SYSTEM BUT UPDATION IS IN THE SYSTEM.

For Risk Management, RBI directions state that banks should have a risk based approach which includes categorising customers as **low, medium and high risk category,** based on the assessment and risk perception. This is called the Anti-Money Laundering Standards (AML) risk assessment. It has to be noted that banks do not inform customers about their risk categorisation.

Risk categorisation should be undertaken based on parameters such as

- Customer's identity
- Social/financial status
- Nature of business activity
- Information about the clients' business and their location etc.

The directions also state that while considering customer's identity, the ability to confirm identity documents through online or other services offered by issuing authorities may also be factored in like in the case of identifiable documents like PAN, Aadhaar etc.

The directions also mention that the information collected from different categories of customers relating to the perceived risk, is non-intrusive and the same should be specified in the KYC policy.

Periodic review of Risk Categorisation

The RBI directions also state that Banks will undertake on-going due diligence of customers to ensure that their transactions are consistent with their knowledge about the customers, customers' business and risk profile; and the source of funds.

For example, the following activities should be monitored by the banks.

- Large and complex transactions including RTGS transactions, and those with unusual patterns, inconsistent with the normal and expected activity of the customer, which have no apparent economic rationale or legitimate purpose.

- Transactions which exceed the thresholds prescribed for specific categories of accounts.
- High account turnover inconsistent with the size of the balance maintained.
- Deposit of third party cheques, drafts, etc. in the existing and newly opened accounts followed by cash withdrawals for large amounts.

The extent of such monitoring should be aligned with the risk category of the customer which means that high risk accounts have to be subjected to more intensified monitoring. A periodic review of risk categorisation is also stated in the RBI directions (at least once in six months). The RBI directions specifically state the example of transactions of marketing firms, especially accounts of Multi-level Marketing (MLM) companies where a large number of cheque books are sought by the company and/or multiple small deposits (generally in cash) across the country in one bank account and/or where a large number of cheques are issued bearing similar amounts/dates.

Periodic Updation of KYC based on Risk Categorisation

The RBI directions on KYC clearly mention that the periodicity of KYC updation should be based on the risk profile of the customer. Periodic updation of KYC should be carried out

- At least once in every two years for high risk customers
- Once in every eight years for medium risk customers
- Once in every ten years for low risk customers

The periodic updation is also subject to the following conditions.

- Fresh proofs of identity and address shall not be sought at the time of periodic updation, from customers who are categorised as 'low risk', when there is no change in status with respect to their identities and addresses and a self-certification to that effect is obtained.
- A certified copy of the proof of address forwarded by 'low risk' customers through mail/post, etc., in case of change of address shall be acceptable.
- Physical presence of low risk customer at the time of periodic updation shall not be insisted.

4. Anti Money Laundering (AML) Application and its accurate representation

The Branch Auditor is the last sentinel to protect the Bank from abuse of this aspect. As the governing body – The Reserve Bank has amply reminded by issuance of various circulars, the Statutory Auditor needs to cover this aspect. Most CBS Banks have resorted to software application for AML reporting. This software application may be from the CBS application provider or a third party software. Whatever be the case, the common feature of concern is that this module or application is an 'afterthought' as the AML guidelines came in force more than two decades after CBS. The fundamental feature of this module/application is that it 'reads' data from CBS and processes it for its report. This feature of 'reading' is important because many Banks boast NIL cases. This is usually because of 'mapping' error. This module looks at the wrong places and comes back with no cases to report which is misconstrued as NIL returns. Auditor can also scrutinise the 'white listing' of cases where the branch is better suited to remove the cases of suspicious transactions based on some rules of deposit and withdrawal which are also specified by the Reserve Bank of India. The reasons for not considering the transaction as suspicious is within the realm of the branch, by identifying Retail cash business of account holder like petrol service station or grocer etc. The classification rules are set normally at the Data Centre which the Branch Auditor need not concern with. But the reasons and replies definitely are of his concern to ensure these are logical and do not undermine the objectives of AML. Low AML training of Bank staff emphasises the intervention of the Branch Auditor for AML audit.

5. Revenue Accuracy assurance

When most Banks, even the co-operative Banks have evolved to CBS, a topic of discussion like Revenue leakages seems *prima* *facié* redundant because the involved computer servers are the latest generation of machines having fourteen floating decimal point! Perhaps one may have to reconcile time period of this discussion being that of transitory to the destination of perfection, until which, we shall have to recognize the feature of imperfection, thus adjusting our audit plan to the inevitable verification of revenue accuracy even in the presence of the formidable machines and their magnificent chips. If one were to attempt a classification of the revenue errors, one might see a range of errors with severity to make most of us lose sleep or re-calculate every computer print. Analysis will show that **operational or user error is the major cause** and in very few cases, the software coding may be the cause of the error.

- **Interest not levied on a particular product of the Bank**: e.g. Advance against Mutual Funds. All advances made under the new product will suffer the same fate. Since interest and all charges run are executed at the Data Centre, if one account is skipped, all accounts will be skipped at least for the branch. The source of the error is most likely at the time new product is set up by the Data Centre. Mapping of the account (technical jargon) may not be done to the interest procedure. This means that the interest or charges procedure which is activated manually by the Data Centre does not have this product in its list.

- **Non-responsiveness of rate to increase of PLR/TLPLR/WCPLR etc.** When the rate sanctioned for an account are linked to Prime lending rates - PLR (say 1% over PLR) then the intention & expectation is that any change in the PLR will change the rates of ALL such accounts. Some accounts or group of accounts do not respond to the changes in the rates leading to under/ over recovery of interest. Two possible reasons causing such a situation may be:

  - The user has not opened the account correctly in the interest section.
  - Account converted from legacy system may not carry the PLR link feature of the new system. Ideally, this should have been detected under conversion audit and corrected.

- **Installment holiday miscalculates the total Equal Monthly installments (EMI)**

  Where the borrower is eligible for EMI holiday (e.g. housing loan under construction or education loan) and the calculation of EMI is done manually there is a possibility of over or under recovery. Under recovery in such cases lead to 'self caused' NPAs. It is also not uncommon to note over-recovery where the loan accounts reach credit balances. This is usually a manual error caused by lackadaisical supervision at the time of account opening which is the time of EMI calculation.

- **Error in varying interest rate in a single advance account:** OD against Bank's own fixed deposits may not always be right. E.g. 12% up to ` 2 lakh & 14% between 2 lakh and 4 lakh. Since the manual calculation is a simple procedure, one expects it to be in the software with ease. Reality however dictates its success contingent on the caliber of the programmers. A sample audit will be in good stead. Under or over recovery is the result. Normally, the borrower would be the first to object in case of over recovery.

In conclusion

One hopes to reach the level of perfection until which this transitory phase shall be the irony of our audit activity where we have to re-check on our ` 200 calculator whether the ` 20 lakh computer has done its calculation correctly! In conclusion, though computers deliver accurate results, it is only because of a combination of user accuracy with that of the programmer. Auditors may be able to manage with the right reports of the system itself and a bit of sample testing to perform their given task.

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Audit Report & Certificates (Including Basel III & Ghosh & Jilani)

CA Vinod M. Karandikar

In the current scenario banking industry is facing numerous challenges in the financial & accounting sectors. Effective bank audit has assumed tremendous importance in the banking industry ever since it is established. Bank audit is an important tool for all banks for better optimisation of its overall management.

Banking industry function as generally understood involves mobilisation of deposits and its deployment across various sectors of the economy in the form loans & advances. However in recent times banking industry has experienced multifunctional growth besides acceptance of deposits & its deployment as loans & advances. Banking industry is a backbone of economy & therefore its proper monitoring assumes utmost importance.

In India banking sector is broadly divided into Government owned banks, district banks, urban co-operative banks, private sector banks etc. Various banks are expanding fast not only in size of business but by way of geographical spread as well. Various regulatory requirements are specified for all such banks & various forms of audits assume great importance to ensure compliance with such regulatory requirements. Audit is an important mechanism to ensure proper monitoring over the functioning of the bank.

Bank branch audit is a yearly task & over the years has necessitated proper planning due to various factors, which includes:

- Time allotted for completion of audit is very limited & entire verification task including submission of report need to be ensured before specified date.
- Increase in instances & newer techniques of fraud.
- Total computerisation of entire functioning & various activities are recorded by the computer programmes.
- Spread of core banking platform, inter connectivity & e-commerce banking.
- Different banks use varied hardware with various features.
- Various types of software developed by different vendors and many a times developed as per specific requirements of a particular bank. Sometimes such software also differs in features amongst the different branches of the same bank.
- Banking industry is experiencing high rate of growth of NPAs & it is necessary to keep track on stringent & changing norms of income recognition & asset classification.
- Auditors are also required to keep track of various internal circulars issued by the bank in the various areas of functioning as well as regulatory guidelines.

Statutory auditors are appointed by RBI in association with ICAI, to empanel Chartered Accountants for the assignment. Statutory auditors are not expected to look after the routine areas of banking transactions. Such transactions are expected to be verified by concurrent/internal auditors. However statutory auditors are expected to go through report of concurrent/internal auditors to help them to form their opinion. Statutory Audit mainly looks after verification of loans & advances, proper identification & classification of advances & compliance with income recognition norms, verification of CRR, SLR etc. and other statutory compliance as per latest applicable RBI circulars. It is often termed as Balance Sheet & Profit & Loss account audit. The audit is most important even for the bank as this task decides among other important things – the NPA! NPA and its provisioning affect the profits of the Bank and hence the Balance Sheet and Profit and Loss Account and finally the distribution of dividend to shareholders.

Thus the statutory bank branch audit is an important activity to ensure no fraud is being committed – the overall aim is to ensure fair and just banking practice.

Though the audit of a bank is like the audit of any other entity, the main difference is the dependency of extensive number of stakeholders on the report of the Statutory Auditor/opinions expressed by them. Besides regular reports that are required to be given, statutory auditor has to provide specific reports/certificates to comply with the requirements of various stakeholders.

Above referred report/certificates are basically required to be submitted by Central Statutory Auditors. However Central Statutory Auditors are required to rely on report/certificates issued by Branch Statutory Auditors.

This article makes an attempt to throw light on important aspects to be kept in mind while submitting various audit reports & certificates.

BANK BRANCH AUDIT REPORT

Important Factors

- Audit Report format is as prescribed under the Banking Regulation Act, 1949.
- Though generally the specimen format is provided by the Bank, auditor should draft it properly to give proper reference for all observations & qualifications.
- All Standards on Auditing (SA) for the conduct of the Audit and issue of the Audit Report are equally applicable to Bank Audit.
- Statutory Audit Report, LFAR, other reports & certificates are independent. Therefore cross referencing for any comments or qualifications should not be done. The report is independent & standalone report & therefore all critical issues to be addressed in this report.
- Auditor need to keep in mind the matters specified under the paragraph 'Auditors' Responsibility'. Auditor need to keep in mind standards on auditing issued by ICAI while conducting the audit. For deciding on audit procedures, he also needs to evaluate internal control. He is also required to evaluate appropriateness of accounting policies, accounting estimates & overall presentation of the financial statements. Guidelines issued by ICAI contemplating situations wherein statutory provisions require different or additional reporting in the audit report & how to incorporate such matters in the audit report are also to be kept in mind.
- ICAI has also prescribed audit report format specifically for bank branch audit report, keeping in line with the requirements of the revised SA 700.
- Auditor is also required to ensure that adequate information, records & documents are made available to enable him to form his opinion. If that not be the case, auditor needs to highlight the fact under the head modification/disclaimer of opinion if in his judgment his opinion is likely to be vitiated due to non-availability of information/documents. In the extreme case where the auditor is required to issue a qualified report it would be necessary on his part to substantiate the facts and reasons for giving a qualified report.
- Other matters paragraph in the branch audit report require auditor to give information in the prescribed format for MOCs under different heads of income, expenditure, assets, liabilities, NPAs, classification of advances, Risk Weighted Assets & other matters with number of entries.

LONG FORM AUDIT REPORT (LFAR)

Following important points to be kept in mind

- LFAR is an additional audit report to be submitted to the management in the prescribed format.
- The format is first prescribed in 1985 by RBI and amended subsequently as per the reporting requirement. Every year the format of LFAR is prescribed by the Bank.
- The format is devised in such a way so as to point out lacunae in the operations & internal control mechanism of the Bank.
- As the LFAR & statutory audit report are independent and different reports, cross referencing for any comments or qualifications should not be done.
- RBI has prescribed two format of LFAR viz. LFAR for the Bank as a whole & LFAR for branches of the Bank.

- As LFAR is in a questionnaire format, answer to all questions should be given clearly. Wherever required auditor is required to give additional information relevant to the question.
- LFAR is neither a substitute for the main audit report nor it is deemed to be a part of the audit report.
- Any adverse comment in LFAR need not necessarily result in qualification in the main audit report.

As there is a separate chapter on LFAR in this Manual, reporting requirements under various clauses is not discussed in this write up.

TAX AUDIT REPORT (U/S. 44AB OF THE INCOME-TAX ACT)

- Form 3 CA – Audit Report & Form 3 CD – statement of particulars
- Information in most of the clauses is pre filled by the Bank in the printed format provided.
- As some of the items are applicable only at Head Office Level, only few clauses require reporting on the part of branch auditor.

As there is separate chapter on TAX AUDIT in this Manual, reporting requirements under various clauses is not discussed in this write up.

CERTIFICATES

Besides audit report, branch auditor is required to issue various certificates in the various functional areas of the Bank. Some important certificates & areas of verification are discussed in the following paragraphs:

✓ **PMRY (Prime Minister Rojgar Yojna)**

Reserve Bank of India has issued circular describing therein scheme to provide employment to educated unemployed youth of economically weaker sections. The schemes aim at assisting the eligible youth in setting up self-employment ventures in Industry, service & business sectors.

Each Bank should obtain certificate from statutory auditors certifying the correctness of claims made by the Bank in respect of the subsidy under PMRY scheme.

Check points for the auditor are:

- Eligibility Norms – Age, Education, Annual Family Income, residency in the local area, previous loan repayment status – whether defaulter?, restriction on one member of family
- Eligible Activities
- Relaxation of PMRY norms for certain states
- Project Funding – project preparation, components of project cost, components of project cost, subsidy and Margin Money
- Subsidy ceiling

For details branch auditor is expected to go through the master circular issued by the Reserve Bank of India.

✓ **DICGC CLAIMS**

In recent years most of the banks have discontinued on this & generally no amounts are claimed or received. However, in such cases auditors are expected to issue NIL certificates.

Wherever such claims are required to be certified, check points are:

- Whether appropriate claims have been lodged with DICGC?
- Whether claims received are appropriated to respective account?
- Whether in recovered accounts, proportionate claims have been refunded to DICGC?
- Actual claim letters in the relevant format & dates of submission of claims
- Statement of claims settled received from DICGC
- Year wise break up of outstanding claims

✓ **CERTIFICATE FOR CASH AND BANK BALANCES**

- Certificate is required to arrive at CRR/ SLR position for the Bank to ensure verification with the compliance norms

- Branch auditors are required to certify the same for 26 non-reporting Fridays' of the year
- Since in current times all banks are on CBS platform, many banks are not asking for such certification from branch auditors
- Cash balance to include cash in ATM, if attached to the branch
- Bank balances where reconciliation items have not been accounted for should be considered in the bank balance and suitable MOC to be passed

✓ **CERTIFICATE OF INVESTMENT HELD**

- This certificate is required in connection with investments held by the branch on behalf of HO/Central Office
- Balances are required to be cross checked with GL head
- Auditors are also expected to physically verify certificates and confirm the amount with GL balance
- If investments are held in D-mat form the same also need to be verified
- Valuation & provisioning required, if any also need to be reported

✓ **SEGMENT REPORTING**

- All banks are required to do proper disclosure of business & geographical sector reporting
- Branch auditors are expected to verify such disclosure is done properly, reasonably & consistently
- Branch auditors are required to keep in mind AS 17 issued by ICAI while carrying out such verification. Auditors are expected to go through the notes of accounts to understand basis on which segments are identified and understand from the management whether there is any change in the classification criteria during the current year
- Business segment is usually considered as 'Primary Reporting Format' & geographical segment as 'Secondary Reporting Format'
- The business segments will be 'Treasury', 'Corporate/Wholesale Banking', 'Retail Banking' & 'Other Banking Operations'
- 'Domestic' & 'International' segments will be geographic segments for disclosure
- Format for disclosure under segment reporting as prescribed by AS 17 is as under
- Part A : Business Segments

(` in crore)										
Business Segments →	Treasury		Corporate/ Wholesale Banking		Retail Banking		Other Banking Operations		Total	
↓Particulars	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous year	Current Year	Previous Year
Revenue										
Result										
Unallocated expenses										
Operating profit										
Income taxes										
Extraordinary profit/ loss										
Net profit										
Other Information:										
Segment assets										
Unallocated assets										
Total assets										
Segment liabilities										
Unallocated liabilities										
Total liabilities										

- **Part B : Geographic Segments**

						(` in crore)
	Domestic		*International*		*Total*	
	Current Year	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*
Revenue						
Assets						

✓ **CERTIFICATE ON RISK WEIGHTED ASSETS FOR BASEL-CRAR**

- Banks are required to maintain a minimum prescribed % of Capital to Risk-Weighted Assets Ratio on an ongoing basis
- The details of credit risk weights for various on-balance sheet & off-balance sheet items, based on the degree of credit risks and methodology of computing the risk weighted assets for the credit risks as well as the procedure for calculating capital charge prescribed by the Reserve Bank of India
- Branch auditors are expected to be aware of detailed guidelines issued by RBI on CRAR
- At branch level generally preprinted format with risk weights assigned to various GL heads is available. GL amounts are reported against such items
- Auditors are expected to verify not only correctness of GL amount reported but as well as confirm that risk weights assigned are in line with latest RBI circular
- Certificate issued by branch auditors are considered by Central Statutory Auditors for certification of CRAR for bank as a whole

✓ **CERTIFICATE ON NPAs**

- Branch auditor should be completely aware of RBI guidelines for 'Asset Classification & Income Recognition'
- He should also be aware of provisioning requirements based on asset classification
- If auditor disagrees with the classification done by the branch, he should clearly bring out the fact with proper justification note. He is also required to give the complete details of the same in the statement of MOCs in the format prescribed
- Auditors are expected to verify up-gradation done by the branch vis-à-vis classification done earlier
- Auditors are expected to properly verify new slippages during the year
- Auditors are expected to verify proper accounting of recoveries done in NPA accounts during the year under audit
- Auditors are expected to verify the statement of movement in NPAs – Gross NPAs and Net NPAs

✓ **CERTIFICATE ON AMOUNTS TRANSFERRED TO DEAF**

- As per RBI guidelines inoperative deposits of more than 10 years to be transferred to RBI under Depositor Education and Awareness Fund
- Auditors should verify that saving bank interest is properly provided for by the branch on all the deposit accounts from the date they became inoperative till the date of transfer to DEAF
- Amounts claimed by depositors from DEAF to be test checked with reference to KYC compliance
- On the date of transferring the amount to the fund, the bank should maintain customer-wise details verified by the concurrent auditors, including payment of up to date interest accrued, that has been credited to deposit account till the date of transfer to the Fund, with respect to interest bearing deposits. With respect to non-interest bearing deposits and other credits transferred to the Fund, customer-wise details, duly audited should be maintained with the Bank. The concurrent auditors should also verify and certify that, as per the bank's books, the returns have been correctly compiled by the bank in the monthly and yearly returns submitted to RBI. The above returns shall also be verified by statutory auditors at the time of annual audit and an annual certificate shall be obtained from statutory auditors and forwarded to

RBI, certifying that the returns have been correctly compiled by the bank

- Auditors are expected to be well versed with the RBI guidelines as updated from time to time and verify compliance thereof.

✓ **CERTIFICATE WITH COMPLIANCE WITH ASSETS LIABILITY MANAGEMENT (ALM) NORMS**

Banks and financial institutions provide services which expose them to various kinds of risks like credit risk, interest risk and liquidity risk. Assets Liability Management models enable banks to measure and monitor risk, and provide suitable strategies for their management. An effective Assets Liability Management Techniques aims to manage the volume, mix, maturity, rate sensitivity, quality and liquidity of assets and liabilities as a whole so as to attain a predetermined acceptable risk/reward ratio. It is aimed to stabilise short-term profits, long-term earnings and long-term substance of the bank. The parameters for stabilising ALM systems are : Net Interest Income (NII), Net Interest Margin (NIM), Economic Equity Ratio.

Banks use Real Time Information System to gather the information about the maturity behaviour of loans and advances made by all the branches of the bank.

Bank's liquidity management is the process of generating funds to meet contractual or relationship obligations at reasonable prices at all times. Liquidity Management is the ability of bank to ensure that its liabilities are met as they become due. Standard tool for measuring and managing net funding requirements, is the use of maturity ladder and calculation of cumulative surplus or deficit of funds as selected maturity dates is adopted.

All assets and liabilities to be reported as per maturity patterns into 8 maturity blocks:

i. 1 to 14 days

ii. 15 to 28 days

iii. 29 days and up to 3 months

iv. Over 3 months and up to 6 months

v. Over 6 months and up to 1 year

vi. Over 1 year and up to 3 years

vii. Over 3 years and up to 5 years

viii. Over 5 years

Branch auditors are expected to follow detailed guidelines of the RBI to provide the certificate at branch level. As the entire information required for certification may not be available at branch, branch auditor is required to follow proper checks & word his certificate properly.

✓ **CERTIFICATE ON COMPLIANCE OF GHOSH & JILANI COMMITTEE RECOMMENDATION**

➢ **Ghosh Committee Recommendations**

High level committee on Frauds & Malpractices in Banks under the Chairmanship of Shri A Ghosh was set up by RBI to enquire into various aspects of fraud and malpractices in bank with a view to reduce such incidences.

These recommendations were summarised by RBI for the purpose of reporting & implementation by the bank, in a 'Yes' or 'No' format. Recommendations were further categorised into (i) applicable to controlling offices like, Regional and Central Offices, (ii) applicable to Head Office and (iv) applicable to Treasury Operations.

The main objective of the report was to ensure existence of proper systems in bank so as to provide for

- Safety of Assets,
- Compliance of laid down procedures,
- Accuracy and completeness of accounting and other records,
- Proper segregation and rotation of duties and responsibilities of staff,
- Measures of prevention of frauds and,
- Timely detection of frauds and malpractices and taking corrective actions.

- **Jilani Committee Recommendations**

  Working group was set up by RBI to review the internal control & inspection & audit systems in banks under the Chairmanship of Mr. Rashid Jilani. The purpose was to review the efficiency & adequacy of internal control & inspection & audit systems in banks with a view to strengthening the supervision system, both on-site & off-site, and ensuring reliability of data.

  Jilani Committee made various recommendations for strengthening internal control, inspection & audit systems in banks under three broad categories based on areas of operations of the Banks:

  - EDP Environment in Banks
  - Inspection/Internal Audit in Banks
  - Other Miscellaneous Matters

  Bank management is required to prepare this report on implementation of Jilani Committee Recommendations (25 questions to be answered in implemented/not implemented format) & the auditor is supposed to verify the answers given by the branch.

  Some of the recommendations of Jilani Committee are to be implemented by the banks at the branch office level, whereas some others are applicable to the regional/zonal/head office level. However some recommendations find applicability at all levels.

Key questionnaire relating recommendations of Jilani Committee are listed below

Sr. No.	Recomm-endation No.	Nature of Recommendation	Implementation Status at Branch
1	**39**	Follow up on major/serious irregularities detected during concurrent audit immediately taken up with the HO. A time bound action programme for rectification to be drawn up and closely monitored. Fraudulent transactions to be reported to Vigilance/Chief of Inspection/Audit etc.	
2	**44**	Auditors to get majority of irregularities rectified during their stay at the branches concerned and guide them as well.	
3	**45**	Immediate action to be taken to plug gaps in serious irregularities/ revenue leakages which have surfaced due to loopholes in existing procedures, abnormal deviations from laid down procedures/norms in consultation with the departments concerned by issue of fresh guidelines.	
4	**53**	Appropriate control measures should be devised and documented to prevent the computer system from attacks of unscrupulous elements. All aspects of security, reliability, and accessibility are ensured before introduction of EDP application in place of manual system by having pilot parallel runs.	
5	**54**	Various tests to be carried out to ensure that EDP applications have resulted in consistent and reliable system for inputting, processing and generation of output of data.	

Central Statutory Auditors have reported in the past that the reports received from branches on Ghosh & Jilani Committee recommendations are not properly verified by auditors & that they are replica of previous reports. The auditor is supposed to verify the correctness of the reports prepared by the branch – in case of negligence, the auditor may be held accountable.

✓ BASEL III NORMS

The purpose of introduction of BASEL norms was for the protection of depositors & shareholders by prescribing rules for measuring capital adequacy & thereby evolving a common language to assess the quality of assets & liabilities of the banks & evolving methods of determining regulatory capital & ensuring efficient use of capital.

In banks, capital is one of the critical factors which decide its financial soundness. Banking Industry is stated to be based on three pillars:

1. Minimum Capital Requirements
   - Credit Risk
   - Operational Risk
   - Market Risk
2. Supervisory Review
   - Gives regulator tool for dealing with other risks like Systemic Risk, Pension Risk, Concentration Risk
3. Market Discipline
   - Set of disclosure Requirements

Apart from enhancing the shareholders' value, the bank's management is equally responsible to ensure that the bank's financial standing is not crippled by irrational decisions, led by market factors. A sufficiently justifiable capital level is fair yard stick for a stakeholder, including regulator, to assess the overall financial position of the bank. Also from the bank's perspective, there is always a cost of capital. Therefore banks try to leverage by maintaining sufficient capital only. It is important for the bank to maintain sufficient capital for foreseeable future; else it will impact the future growth of the business plans.

The RBI has issued a circular number DBOD.No.BP. BC.98/21.06.201/2011-12 dated May 2, 2012 on the subject of 'Guidelines on Implementation of Basel III Capital Regulations in India'. *Vide* this circular; the RBI has prescribed the final guidelines on Basel III Capital Regulations. The main features of these guidelines are:

- Guidelines to be effective in a phased manner from April 1, 2013 & will be fully implemented as on March 31, 2019.
- Capital requirements for the implementation of Basel III guidelines are lower during the initial period & higher during the later years.
- Liquidity Coverage Ratio is introduced in a phased manner with a minimum capital requirement of 60% from January 01, 2015 & minimum 100% on January 01, 2019.
- The banks are required to disclose capital ratios under Basel III from the quarter ending June 30, 2013.

It is also necessary to keep in mind amendments in Basel III Capital Regulations to master circular, 2014.

Major changes compared to Basel II norms are:

1. Increase in minimum Capital Adequacy Ratio
2. Concept of Capital Conservation Buffer
3. Countercyclical buffer
4. Stringent norms for sub-classification in Tier I and Tier II
5. To be implemented in phased manner

BASEL III norms are expected to:

- Improve the quality, consistency & transparency of the capital base – all elements of capital required to be disclosed along with a detailed declaration to the published accounts. This requirement will improve the market discipline under pillar 3 of the Basel framework.
- Enhancing Risk Coverage
- Capital Conversion Buffer

The audit report/certificates as discussed in the above paragraphs are required to be printed on the letterhead of the firm & are to be signed in the personal name of the partner by mentioning firm name, membership number & firm's registration number. Proper reporting dates also need to be ensured.

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Audit of Foreign Exchange Transactions in Branch

CA. Kuntal Shah & CA. Dhananjay J. Gokhale

Introduction

With the opening of Indian economy in 1990, and subsequent reforms undertaken by government of India, the Indian economy is exposed to global markets to a greater extent. One of the natural fall-out of opening of economy is increased exposure of Indian entities to global economy which requires liberalised policies related to foreign trade. The Reserve Bank of India and Government of India has taken many measures to liberalize the economy and one of the measures being relaxation in the norms related to dealing in foreign currency. The exposure of Indian banks has witnessed multi-fold rise, thanks to the increased volume of foreign currency business the banks have clocked. Further, the Indian customers across banking sector are being exposed to the foreign currency in various roles as an importer or an exporter of goods and / or services and thus, the foreign currency transactions at the branch is no more being an uncommon part of branch operations. Frauds and abuse of systems in foreign exchange transactions are worrying part for banks. Fraud at Bank of Baroda (outward remittances have been made under the garb of Import Transactions), most recent fraud at Punjab National Bank (unauthorised SWIFT Messages for LOUs) etc. are classic examples of risks the banks are running with Foreign Exchange Transactions. The risk multiplies with the use of different systems and integration of those. Auditing under such environment is a tight rope walk for the auditors.

In this article, we will deal with various aspects related with the foreign currency transactions and regulatory compliance part associated with the same besides methodology of the said transactions.

There are three types of branches which can deal with foreign currency, viz., (1) Category A: Offices or branches maintaining independent foreign currency account in their own names; (2) Category B: Offices or branches not maintaining independent foreign currency account but having power to operates the accounts maintained abroad by their Head / Principal Office or any other link office; and, (3) Category C: All other branches / offices handling foreign exchange business through other offices or branches in category A or B.

There are various types of foreign currency transactions undertaken at the branch level such as – i) Transactions related to import and export of goods and services; ii) Credit facilities availed by borrowers in foreign currency; iii) Remittances and receipt of funds in foreign currency. Similarly, broadly at the branch level, the exposure of the branch can be divided into two part – one Deposits and secondly advances – Funded as well as Non-Funded.

Common terminologies used related to foreign currency transactions:

1. Bill of Entry

As per section 2(4) of The Customs Act, 1962, 'bill of entry' means bill of entry referred to in section 46. As per section 46 – 'The importer of any goods, other than goods intended for transit or transhipment, shall make entry thereof by presenting to the proper officer a bill of entry for home consumption or warehousing in the prescribed form'.

2. GR / PP / Softex Form / EDF

As per section 2(437) of The Customs Act, 1962, 'shipping bill' means shipping bill referred to in section 50. As per section 50 – 'An exporter of any goods shall make entry thereof by presenting to the proper officer in the case of goods to be exported in a vessel or aircraft, a shipping bill'.

There are certain types of declarations which are required to be submitted along with the shipping details, which are enumerated below:

<u>GR Forms</u>

In the case of exports of tangible goods through ports, GR form will be completed by exporter and the same will be certified by the customs department. One copy of GR form will be submitted to Authorised Dealer [AD].

SDF Forms

On account of introduction of electronic data interchange (EDI) system at certain Customs offices where shipping bills are processed electronically, the existing declaration in GR form is replaced by a declaration in form of Statutory Declaration Form (SDF). The SDF Form will be submitted along with shipping bill to concerned customs officer.

PP Form

In the case of export by Postal Forms PP forms will be used. Postal authorities will allow export of goods by post only if the original copy of the form has been countersigned by the Banker.

Softex Form

In the case of export of computer software SOFTEX form is used.

With a view to simplify the process RBI has introduced EDF (Export Declaration Form) to declare all type of export of goods through Non-EDI ports. (Change w.e.f. October 01, 2013)

In addition to above, under the 'Ease of Doing Business' initiative of the Government of India, certain export procedures have been relaxed. One of such process is discontinuation of SDF (Statutory Declaration Form) for Export Transactions. SDF declarations have now been subsumed under Shipping Bill.

3. Import Data Processing and Monitoring System (IDPMS) and Export Data Processing and Monitoring System (EDPMS)

Reserve Bank of India had constituted a Working Group (Chairman: Shri A. K. Pandey, CGM, FED) comprising of representatives from Customs, Directorate General of Foreign Trade (DGFT), Special Economic Zone (SEZ), Foreign Exchange Dealers Association of India (FEDAI) and select Authorised Dealer banks (AD banks), to suggest putting in place a comprehensive IT- based system to facilitate efficient processing of all import transactions and effective monitoring thereof. The Working Group had recommended development of a robust and effective IT- based system "Import Data Processing and Monitoring System" (IDPMS) on the lines of "Export Data Processing and Monitoring System" (EDPMS) in consultation with the Customs authorities and other stakeholders.

To track the import transactions through banking system, Customs will modify the Bill of Entry format to display the AD Code of bank concerned, as reported by the importers. Primary data on import transactions from Customs and SEZ will first flow to the RBI secured server and thereupon depending on the AD code shall be shared with the respective banks for taking the transactions forward. The AD bank shall enter every subsequent activity, viz. document submission, outward remittance data, etc. in IDPMS so as to update the RBI database on real time basis. It is therefore, necessary that AD banks upload and download data on daily basis.

4. Bill of Lading/Marine Transport Document/ Air Way Bill

A Bill of Lading is a document issued by the shipping company or its agent, acknowledging the receipt of goods for carriage which are deliverable to the consignee or his assignee in the same condition as they were received. Thus, a 'Bill of Lading' is an evidence of contract of carriage, a receipt for goods received by carrier and is a document of title of goods.

5. LIBOR (London Inter Bank Offered Rate)

LIBOR is a rate of interest at which banks lend / borrow from other banks in London wholesale money market for a short-term loan. The said LIBOR serves as a benchmark rate based inter-bank money market transactions.

6. NOSTRO Account

Nostro Account is an account maintained by a bank in India with a bank outside India and designated in currency other than Indian Rupee.

Nostro Mirror Account is an account maintained in the books of accounts of a bank in India, i.e., bank book maintained w.r.t. the Nostro Account in the books of account.

7. VOSTRO Account

Vostro Account is an account maintained by a bank outside India with a bank in India and designated in Indian Rupee.

8. **SWIFT System**

SWIFT is a acronym for Society for Worldwide Interbank Financial Telecommunications, a co-operative society owned by various banks worldwide. The SWIFT system enables the member bank to transact amount themselves quickly through secured messaging.

9. **SFMS System**

Structured Financial Messaging System (SFMS) is a secure messaging standard developed to serve as a platform for intra-bank and inter-bank applications. It is an Indian standard similar to SWIFT (Society for World-wide Interbank Financial Telecommunications) which is the international messaging system used for financial messaging globally.

IMPORT TRANSACTIONS

1. **Letter of Credit (LC)**

Goods can be bought and sold wherein consideration can be paid in various forms like in cash, cash against delivery of goods, cash against documents, cash against acceptance of bill of exchange etc. However, in case of International Sale transaction, there is a risk on the part of Seller w.r.t. realisation of sale proceeds and on the other hand, the buyer is concerned about the quality and quantity of goods imported; resulting in a conflict of interest and, to overcome this situation, both the parties resort to Documentary Credit.

Parties to LC

1. Applicant [Buyer]

The applicant is normally a buyer of the goods, who has to make payment to the seller i.e. beneficiary. The LC is initiated and issued at his request and on the basis of orders/contracts exchanged between the buyer and the seller.

2. Beneficiary [Seller]

The beneficiary is normally a seller of the goods, who has to receive the payment for having supplied the goods. A credit issued in his favour enables him, to obtain the payment from the Issuing bank or Advising Bank on surrender of stipulated documents duly comply the terms and conditions of the credit.

3. Issuing Bank

The issuing bank is the one which issues the LC at the request of the applicant in favour of the beneficiary. The issuing Bank is the one which creates a Letter of Credit and undertakes to make the payment on receipt of the complied documents from the beneficiary or through their banker. It is important to note here that the payment to the beneficiary is to be made by issuing bank irrespective of the fact that whether they receive the payment from the applicant or not for the complied documents they receive under their credit.

4. Advising Bank

The advising bank is one who advises the credit to the beneficiary at the request of the issuing bank thereby assuming the genuineness of the credit. It is normally situated in the county of the beneficiary. For advising the credit issued by another bank, there should be an agency arrangement between two banks.

5. Other Parties

Depending upon the country of Import, currency of the transaction, country of the supplier of goods etc., there will be more parties connected to the LC other than mentioned above, which are as follows:

i. Confirming Bank

The confirming Bank is the one which steps in the shoes of issuing bank over the responsibility of honouring the claim under the LC when required documents are presented to them within the validity of the credit established by the issuer.

ii. Reimbursing Bank

The reimbursing bank normally is the one who maintains with it the account of the credit opening bank. When the documents under the credit are negotiated by the beneficiary's banker or advising bank, they claim the negotiated amount from the named reimbursing bank in the Letter of Credit who pays the amount on receipt of the claim made within the validity date of the credit by debiting to the account of the opener against the authority held by them from the opener of the LC. The role of the reimbursing banker is to honour the claim of negotiating / paying banker provided sufficient funds are held in the account.

iii. Negotiating Bank:

The negotiating Bank is the bank who negotiates the documents submitted to them by the beneficiary under the credit either advised through them or restricted to them for negotiation. On negotiation of the documents they will claim the reimbursement under the credit and make the payment to the beneficiary provided the documents submitted are in accordance with the terms and conditions of the LC.

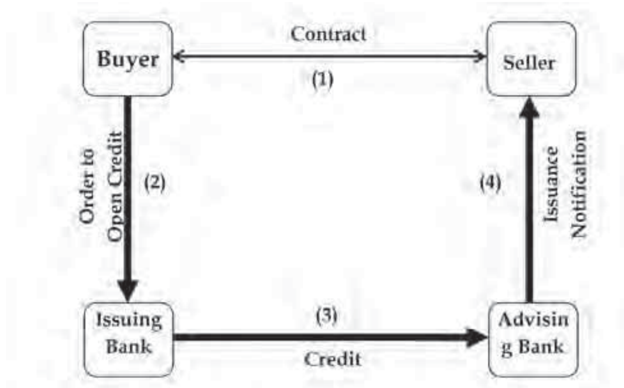
Few types of LC

1. Confirmed / Unconfirmed Letter of Credit
2. Transferable / Divisible Letter of Credit
3. Deferred Payment Letter of Credit
4. Revolving Letter of Credit
5. Anticipatory Letter of Credit
6. Stand by Letter of Credit

A Letter of Credit may be either revocable or irrevocable one. If nothing is specified, the LC will be deemed to be irrevocable one, wherein it cannot be cancelled before its expiry.

Steps in LC Opening Process

1. A contract will take place between a buyer and a seller
2. Buyer will order Issuing Bank to open a credit
3. Issuing Bank will issue the credit and will send to the advising bank
4. On receipt message for credit issuance advising Bank will notify the beneficiary.



Revenue aspect of LC Transaction

- Bank charges fees / commission for opening of Letter of Credit.
- The commission amount is collected upfront at the time of opening of LC.
- The commission so collected is for the entire tenure / duration of Letter of Credit.
- Income for unrealised period will be shown under Other Liability.

Accounting aspect of LC Transaction

- Letter of Credit is a Non-Fund based facility extended by the banks. Hence, there are no accounting entries for Letter of Credits which will have impact on Balance Sheet.
- However, a Contra Transaction will be initiated which will update the Contingent Liability / Assets accounts for Off-Balance Sheet items reporting.
- Moreover, Banks will enter LC Transactions in LC Register / LC Module in CBS.
- Bills under LC will be tracked and status will be updated under specific LC Ref. No.
- Outstanding Liability under particular LC will also be updated (either in Register / LC Module in CBS)

- In case of a devolvement of Bills under LC, the transaction will be recorded as Advance to customer transaction and thus will be brought into the Balance Sheet.

Compliance Aspect of LC Transaction

- In the event of devolvement of Bills under LC, the said facility will be converted to Fund Based Facility.
- From the said date, IRAC Guidelines issued by RBI will be applicable in determining Asset Classification.

Auditing Aspect of LC Transaction

- Verify the cases of Outstanding LCs as on 31st of March.
- Are there any LCs outstanding as per CBS beyond the Date of Expiry? If so what are the reasons for the same?
- Whether balance of Letter of Credits under Contingent Liability agrees with the outstanding Letter of Credit Liability? (Under BASEL Guidelines computation of Capital Adequacy Ratio [CAR] takes cognizance of Contingent Liabilities. Any excess amount appearing under Contingent Liability will impact Bank's CAR.)
- Whether the activity of collection of charges is system driven or manual? Select appropriate sample based on the review of process.
- Whether Charges so collected are inclusive of Service Tax / GST? If so, verify how the Service Tax / GST Liab. is determined and accounted?

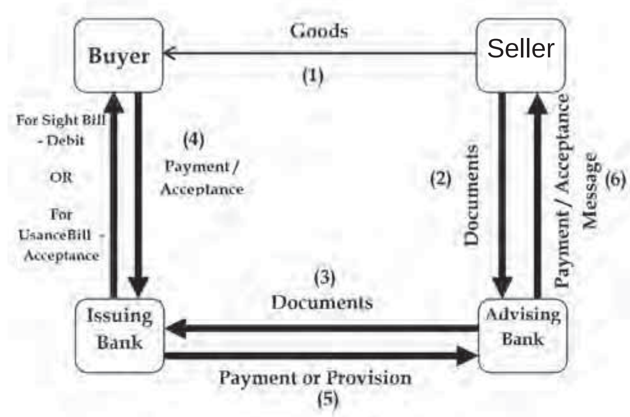
2. Import Bills under LC

Basics of Bills under LC

After establishment of LC, the foreign seller exports the goods to the named port at Buyer's country. Transport and other documents pertaining to the export will be routed through Advising Bank. Advising Bank in turn will send the documents to the LC issuing Bank. The set of documents will be called as Bill in banking parlance.

When the bills are received by the LC issuing Bank the documents will be scrutinized for its correctness as per the office copy of LC. If the documents are in accordance with the LC, the bill will be registered as non-discrepant bills. The Issuing Bank will inform the Customer; i.e., Buyer about the receipt of the documents.

Issuing bank as per the LC terms delivers the documents to Buyer either after receiving payment or acceptance of bill.



Revenue aspect of Bills under LC Transaction

- Bank charges fees / commission for handling bills under LC. The activity includes Lodgement, Liquidation / Realization, Devolvement (if any).
- Moreover, there are charges to the account of LC Applicant in case of discrepancies observed by Bank when the documents presented under LC are not in conformity with the terms and conditions of Letter of Credit Issued.

Accounting aspect of Bills under LC Transaction

- The bills are Lodged in CBS / recorded in Bills register under LC Ref. No.
- In case of CBS, the payment of Bill made through LC / Bill module in CBS which will update the outstanding Bill Liability and outstanding LC Liability.
- However, in case of non-payment / non-availability of sufficient balance on the due date of LC in Borrower's Account,

the Bank has to make the payment to the Beneficiary. It is known as devolvement of bill. In such a scenario, the bill amount will be crystallized and will be brought to the books by treating it as funded facility.

Compliance aspect of Bills under LC Transaction

If the debits arising out of devolvement of letters of creditor invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

Auditing aspect of Bills under LC Transaction

- Generate Bill Balancing Report for Bills under LC Transaction. It is preferable to have the said report generated for 31st March.
- Carry out physical verification of all outstanding bills appearing under Bill Balancing Reports. Special attention should be given to outstanding bills under "Lodgement" status for availability of Transport Documents. (Transport documents alongwith other documents are handed over only after payment in case of Sight LC or only after acceptance of Bill of Exchange in case of Usance LC.)
- Generate list of cases of Devolvement of Bills under LC from CBS. Verify the accounts in which the said amount is debited.
- Whether the activity of collection of charges is system driven or manual? Select appropriate sample based on the review of process.
- It is observed that charges for discrepancy memo are manual. If so, verify whether the charges have been properly collected or not.
- Compliance of Service Tax / GST on the Charges so collected and accounting thereof.

3. Import Bills Under Collection Basis

Basics of Import Bills under Collection

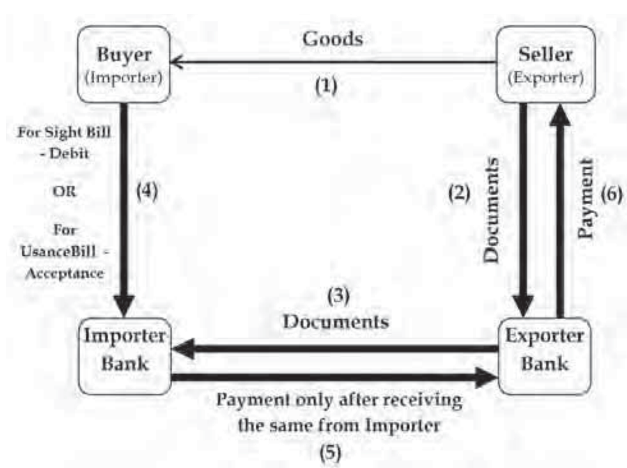
Import Bills can be received on collection basis. It means the Foreign Seller will send the import documents to its banker. The banker will in turn send the documents to the Banker of Importer with certain terms and conditions. The Importer's Bank will follow the instruction mentioned in the bill schedule and deliver the documents to the buyer.

In this type of transaction Importer's Banker is dealing only as mediatory. i.e. in case the Importer does not pay the bill amount the Importer's bank will notify the Exporter's Bank and will act as per Exporter's Bank instruction.

Difference between Import Bills under LC and on Collection basis

In the case of bills under LC, if the Importer does not pay the bill amount on due date, the LC issuing bank has to make payment to the advising bank as the LC issuing bank has added their confirmation to the transaction by issuing LC. However, in the case of Import Bill under collection the Importer's banker is not assuming any liability as no confirmation is added to the transaction.

The benefit from the transaction under bills of collection is that it is less costly than the LC transactions. However, an element of risk is involved on the part of exporter for payment. However, the exporter can feel secure as the documents are not delivered to the buyer without payment or acceptance. Hence, the buyer will not be able to take delivery of goods.



Revenue aspect of Import Bills on Collection

- Bank charges fees / commission for handling bills on Collection.
- Generally, it is observed that in case of Forex Transactions handled through CBS, the charges are collected by CBS. However, the auditor should carry out walkthrough process of collection of charges.

Accounting aspect of Import Bills on Collection

- The bills are Lodged in CBS / recorded in Import Bills on Collection register
- In case of CBS, the payment of Bill made through Bill module in CBS. CBS will update the outstanding Bill Liability on realization event.
- Only contra transaction for Contingent Liability is created for Import Bills on Collection.

Compliance aspect of Import Bills on Collection

- Import Bills under collection must form part of Contingent Liability.
- Lodgement, Realization and Closure of Bill should be carried out through Bill module under CBS.

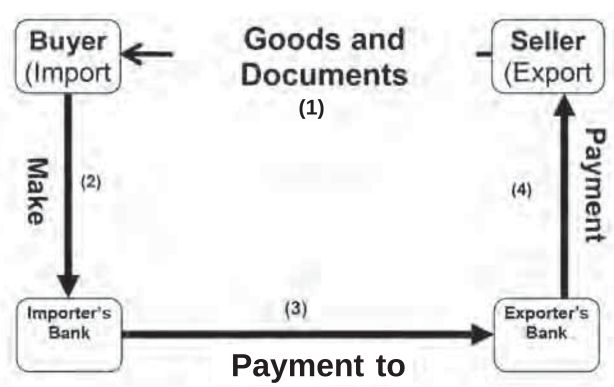
Auditing aspect of Import Bills on Collection

- Generate Bill Balancing Report for Import Bills on Collection Transaction. It is preferable to have the said report generated for 31st March.
- Carry out physical verification of all outstanding bills appearing under Bill Balancing Reports. Special attention should be given to bills under "Lodgement" status for availability of Transport Documents. (In normal course, Transport documents along with other documents are handed over only after payment in case of Sight Bill or only after acceptance of Bill of Exchange in case of Usance Bill.)
- Verify whether total of Outstanding Import Bills on Collection as per Bill Balancing Report agrees with Bills for Collection under Contingent Liability?
- Whether the activity of collection of charges is system driven or manual? Select appropriate sample based on the review of process.
- It is generally observed that activity of collection of charges for discrepancy memo is manual. If so, verify whether the charges have been properly collected or not.
- Compliance of Service Tax / GST on the Charges so collected and accounting thereof.

4. Direct Import Bills

In the case of Bills under LC or Bills for collection, the documents are being delivered to the respective banker and the custody of the documents will be with the banker until the amount of bill is paid or accepted. However, when the import is directly done by the Importer, the Importer will receive the **Documents and Goods** from the Exporter **directly**. The importer will approach to its banker for the payment of the import that he has made.

Importer's Banker will verify the genuineness and process the transaction. Typical process flow of Direct Import Bills is as follows.



Revenue aspect of Direct Import Bills

- Bank charges fees / commission for handling bills.

- Generally, it is observed that in case of Forex Transactions handled through CBS, the charges are collected by CBS. However, the auditor should carry out walk through process of collection of charges.

Accounting aspect of Direct Import Bills

- The bills are lodged in CBS / recorded in Direct Import Bills.
- In case of CBS, the payment of Bill made through Bill module in CBS. The account of the Importer will be debited and the funds will be remitted to foreign exporter through Nostro Account.

Compliance aspect of Direct Import Bills

- Whether prescribed guidelines (w.r.t. FEMA Guidelines) have been complied with for Direct Import Bills in excess of prescribed threshold.
- Whether Bill of Entry is obtained / Entry in IDPMS is verified before remittance under Direct Import Bills cases?
- Whether facility of Direct Import Bill is extended to ineligible importer? *(Master Directors on Import of Goods and Services Para No. C.6.1, C.6.2, C.6.3)*

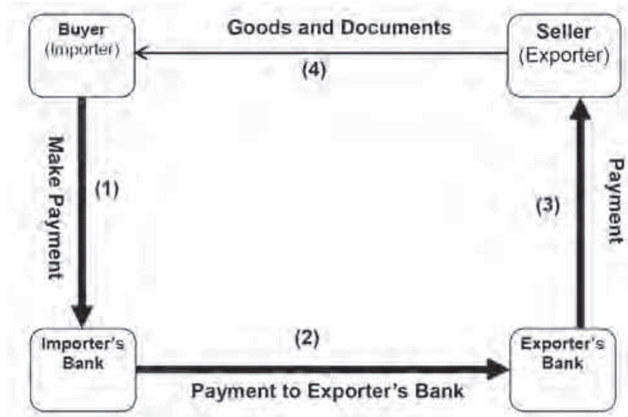
Auditing aspect of Direct Import Bills

- Generate Bill Report for Direct Import Bills Transaction. It is preferable to have the said report generated for the period from 1st April to 31st March or as per the period selected for audit.
- Whether the activity of collection of charges is system driven or manual? Select appropriate sample based on the review of process.

5. Advance Payment against Import

In the case of Advance Payment against Imports, the amount is remitted prior to Import. There is a risk on the part of Importer on receipt of goods. The bankers are also concerned for conclusion of transaction (i.e. receipt of Bill of Entry as evidence of Import).

The transaction is permitted subject to guidelines issued by RBI (Master Directions Import of Goods and Services). Typical process flow of Advance Remittance against Import is as follows.



Revenue aspect of Advance against Import

- Bank charges fees / commission for handling bills.
- Generally, it is observed that in case of Forex Transactions handled through CBS, the charges are collected by CBS. However, the auditor should carry out walkthrough process of collection of charges.

Accounting aspect of Advance against Import

- The bills are lodged in CBS / recorded as Advance against import with Purpose Code “S0101”.
- In case of CBS, the payment of Bill made through Bill module in CBS. The account of the Importer will be debited and the funds will be remitted to foreign exporter through Nostro Account.
- The bank will follow up for submission of Bill of Entry / updation through IDPMS for Import against which the Advance Remittance is effected.

Compliance aspect of Advance against Import

- There are various restrictions on Advance against Import transactions. For transactions exceeding USD 2,00,000 unconditional SBLC / BG from Foreign Bank is required. However, the said limit can be extended up to USD 50,00,000 with certain conditions and due diligence by bank. *(Refer Section III C.1 of Master Directions on Import of Goods and Services)*

- ORM (Outward Remittance Message) entry is required to be done under IDPMS for such cases. This will help is tracing and tracking the imports and advance remittances against import through Authorised Dealers.

Auditing aspect of Advance Remittance against Import

- Generate Bill Report for Advance Remittance against Import Transactions. It is preferable to have the said report generated for the period from 1st April to 31st March or as per the period selected for audit. Scrutinise cases of transaction beyond the prescribed limit for additional scrutiny. Also scrutinisemultiple transactions below the prescribed limit, however, on aggregate basis exceeding the prescribed threshold to ascertain whether any splitting of transaction is visible to avoid statutory reporting.
- Whether the activity of collection of charges is system driven or manual? Select appropriate sample based on the review of process.
- Whether prescribed guidelines (w.r.t. FEMA Guidelines) have been complied with for Advance Remittance against Import in excess of prescribed threshold.

6. Time Limit for settlement of Import Payments

The remittance against imports should generally be completed within six months from the date of shipment, except in cases where amounts are withheld towards guarantee of performance, disputes, financial difficulties, etc. *(Refer detailed guidelines at Para No. B.5 of Master Directions on Import of Goods and Services).*

7. Evidence of Import

For all physical imports through EDI ports, the Importer is required to submit the details viz., BoE Number, Port Code and date to trace the transaction through IDPMS. For cases wherein physical import is through non-EDI Port or through Post, Copy of Bill of Entry / Courier Bill of Entry is required to be submitted to the bank.

In case of import of goods by units under Free Trade Zone (FTZW) or SEZ, Exchange Control Copy (Ex–Bond) issued by Customs department is required to be submitted to Bank.

Refer to guidelines at Para No. C.7.2 of Master Directions on Import of Goods and Services for evidence of Import in lieu of Bill of Entry.

8. Follow-up of Import Evidence

AD Category – I banks are required to follow up for outward remittance made for import (i.e. unsettled ORM). In cases where relevant evidence of import data is not available in IDPMS on due dates against the ORM, AD Category – I bank shall follow up with the importer for submission of documentary evidence of import. Moreover, if BoE data is not settled against ORM within the prescribed period, AD Category – I banks shall follow-up with the importer for Import details updation.

In case an importer does not furnish any documentary evidence of import, within 3 months from the date of remittance involving foreign exchange irrespective of value, the AD Category – I bank should rigorously follow-up for the next 3 months, by using various modes of communications.

9. Merchanting Trade Transactions

For a trade to be classified as Merchanting Trade following conditions should be satisfied:

a. Goods acquired should not enter the Domestic Tariff Area, and

b. The state of the goods should not undergo any transformation.

Cases wherein the Goods have been bought from one country / outside DTA and sold at another country / outside DTA fall under Merchanting Trade. There are certain conditions which are required to be followed.

- Dealing in freely imported Goods in India

- Completion of entire transaction within 9 months
- Transaction should not involve FX outlay for more than 4 months
- The commencement of Merchanting Trade would be the date of shipment / export leg receipt or import leg payment, whichever is first. The completion date would be the date of shipment / export leg receipt or import leg payment, whichever is the last;
- Routing of both Import and Export Leg documentation from same banker
- Bank should ensure that Import Leg is extinguished by the payment received for the Export Leg
- Updation of Purpose Code “S0108” for the Import leg and “P0108” for Export Leg.
- Short Term Suppliers Credit and Buyers’ Credit is available for Merchanting Trade, to the extent the same is not backed by Advance Remittance for export leg (including Discounting).

Auditors Checklist

- Auditors should seek details of cases wherein conditions of Merchanting Trades have been violated by the customer. In such cases, whether the facility is still continuing? Moreover, whether the said non compliance is reported to RBI?
- List of outstanding cases under Merchanting Trade as on the date of Audit should be called for. In case the transaction appearing the under said report has already crossed the maximum time period the same should be reported under LFAR.
- In terms of FEMA guidelines defaulting Merchanting Traders, whose outstanding reach 5% of their annual export earnings, are required to be caution-listed. Check the compliance in this aspect.

Trade Finance Transactions

1. Export Financing

To boost up the Exports of the country, the RBI has directed banks to grant credit at a concessional rate. It helps Indian Exporter to procure raw material and can produce the goods to be exported. Export Financing can be in Indian Rupees [EPC] and in Foreign Currency [PCFC].

Banks provide finance for purchase, processing, manufacturing or packing of goods prior to shipment / working capital expenses towards rendering of services. It is also known as Pre-Shipment Credit Facility.

In addition to it, Banks provide finance to exporters by way of loan or advance post to Shipment stage by way of Export Bill Discounting, Export Bill Purchase, Advances against Export collection bills.

A. Pre-Shipment Credit to Exporters

Important Points:

- Export packing credit can be in Indian Rupees and in Foreign Currency.
- Maximum period for Packing credit is 360 days.
- EPC / PCFC is disbursed against specific orders, in one lumpsum tranche or against the requirement as per export orders.
- EPC / PCFC is also disbursed as per Running Account Facility where availability of Letter of Credit / Confirmed orders before disbursement are not insisted.
- Liquidation of EPC / PCFC will be by way of exports proceeds only. Liquidation by any other means than by way of exports will attract higher rate of interest as per Bank’s Policy.

Accounting Aspect

- Banks open separate Loan account in CBS for EPC / PCFC. It helps in monitoring the utilisation and liquidation.

- Bank at the request of the borrower may convert the amount of Pre-Shipment credit into Post-Shipment credit by discounting / purchasing the export bills.

Compliance Aspect

- End use of funds

  Banks should keep a close watch on the end-use of the funds and ensure that credit at lower rates of interest is used for genuine requirements of exports. Banks should also monitor the progress made by the exporters in timely fulfilment of export orders.

- Order Book Maintenance

  Banks maintain order book / register to track export orders *vis-a-vis* Export Credit extended.

- Liquidation Methodology

  If the liquidation of Export Credit is by other than the way of Export of Goods / Services within the maximum period of 360 days, the advance will cease to qualify for prescribed rate of interest for export credit ab initio. It means that the bank will have to collect the difference in concessional rate of interest and normal rate of interest. The rate of interest to be applied will be as per Bank's Policy.

Auditing Aspect

- Generate the list of EPC / PCFC accounts opened and maintained by the branch.
- Whether the liquidation of EPC / PCFC is as per RBI guidelines? If not, whether interest rate as per Bank's Policy is charged or not.
- Documents evidencing end use of funds should be verified.
- Whether genuineness of Export LC is confirmed before sanctioning EPC / PCFC?

B. Post-Shipment Credit to Exporters

Export Bills Discounted / Purchased

- Banks extend credits to Exporters by way of purchasing / discounting export bills. Banks also provide facility of advance against Exports on collection basis.
- Facility of discounting / purchase of bill is available in both Indian Rupee and in Foreign Currency.

Revenue Aspect

- Interest on Bill Discounting / Purchase is revenue for the bank.
- Bank also charges fees for export bill lodgement and claims courier and other charges for submission of Export Documents.

Accounting Aspect

In case of Discounting / Purchase in Foreign Currency,

- The rupee equivalent of the discounted value of the export bills will be payable to the exporter and the same should be utilised to liquidate the outstanding export packing credit.
- As the discounting of bills/extension of foreign exchange loans (DP bills) will be in actual foreign exchange, banks may apply appropriate spot rate for the transaction.
- The rupee equivalents of discounted amounts/foreign exchange loan may be held in the bank's books distinct from the existing post-shipment credit accounts.
- In case of overdue bills, banks may charge overdue interest as per the interest rate policy of bank from the due date to the date of crystallisation.

Compliance Aspect

- In case of overdue bills, IRAC Norms for overdue bills will be applicable and the advance will be subject to Asset Classification.

- Export Bills will be subject to maximum period of 365 days.

Auditing Aspect

- Generate a report on Export Bills purchased during the audit period.
- Generate a report on outstanding/ realised during the audit period.
- In case of overdue bills check whether the interest has been charged as per Bank's Policy.
- Verify whether the period of sanction is within the period prescribed by RBI i.e. 360 days.

2. Import Financing

Trade Credits

<u>Basics of Trade Credits</u>

Trade Credit is defined by RBI in Master Direction on External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers (RBI/FED/2015-16/15 FED Master Direction No. 5/2015-16 Dated January 01, 2016) as follows.

> *'Trade Credits' (TC) refer to credits extended for imports directly by the overseas supplier, bank and financial institution for maturity of less than five years. Depending on the source of finance, such trade credits include suppliers' credit or buyers' credit. Suppliers' credit relates to credit for imports into India extended by the overseas supplier, while buyers' credit refers to loans for payment of imports into India arranged by the importer from overseas bank or financial institution.'*

<u>Amount and Maturity of Trade Credit</u>

Banks are permitted to approve trade credit for import of non-capital and capital goods up to USD 20 million or equivalent per import transaction. Certain other restrictions are applicable based on the type of commodity and nature of transaction.

Maturity prescriptions for the non-capital goods is up to one year from the date of shipment or the operating cycle whichever is less, and for capital goods, the maturity period is up to five year from the date of shipment. For trade credit up to five years, the *ab-initio* contract period should be 6 (six) months. No roll-over/extension will be permitted beyond the permissible period.

<u>Interest Rates and cost of TC</u>

As per Master Circular issued by RBI, interest rate and other costs viz. arranger fee, upfront fee, management fee, handling/processing charges, out of pocket and legal expenses for TC cannot exceed the prescribed limits. The said limit is known as All-in-Cost ceiling.

As per current regulations the All-in-cost limit is 6 Months LIBOR (for respective currency) + 350 basis points.

<u>Issuance of Guarantee/Letter of Comforts (LoC) by Banks</u>

In case of companies other than in Infrastructure Sector, AD banks are permitted to issue Letters of Credit/guarantees/Letter of Undertaking (LoU) /Letter of Comfort (LoC) in favour of overseas supplier, bank and financial institution, up to USD 20 million per transaction for a period up to one year for import of all non-capital goods permissible under Foreign Trade Policy *(except gold, palladium, platinum, rhodium, silver etc.)* and up to three years for import of capital goods. The period of such Letters of credit/guarantees / LoU / LoC has to be co-terminus with the period of credit, reckoned from the date of shipment. Further, issuance of guarantees will be subject to prudential guidelines issued by the RBI from time to time.

<u>Mechanics of Trade Credit</u>

1. <u>Buyers' Credit</u>

   This facility is provided by overseas banks / foreign branches of Indian banks to the importers of capital goods and raw material through Indian Banks to its customers (importers) towards payment of imports in India. The overseas bank either (i) credits the amount of Buyer's credit in the NOSTRO account of the Indian bank and the Indian bank remits the funds to the overseas supplier of the importer for payment of import bill or (ii) remits the funds to the overseas supplier of the importer for payment of import bill of the importer.

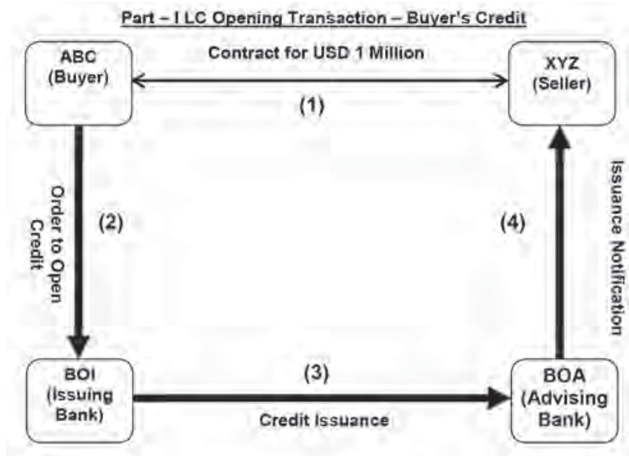
Let us understand the mechanics of Buyer's Credit with an example.

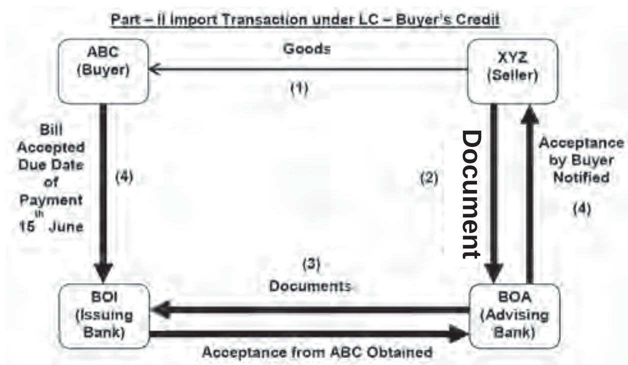
M/s ABC Co. Ltd., India wants to import goods worth USD 1 million from M/s XYZ of New York. For import M/s ABC has approached Bank of India to open an LC in favour of M/s XYZ of New York. Bank of India (BOI) (LC Issuing Bank) has opened an LC in Favour of M/s XYZ having Bank of America (BOA) as Advising Bank. The import transaction was concluded on 15th April. The due date of payment of Import Bill is 15th June.

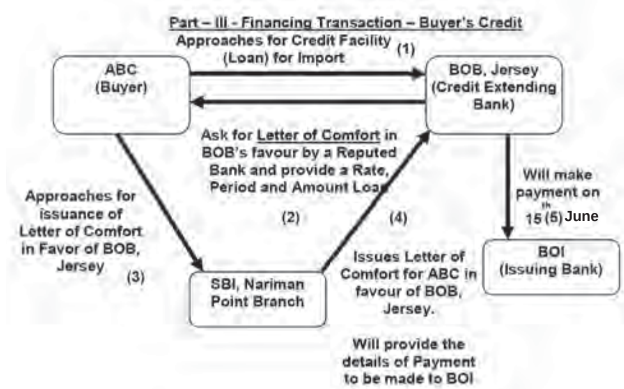
In between M/s ABC Co. Ltd. has approached Bank of Baroda (BOB), Jersey Branch for extending a credit for the amount of Import that M/s ABC has made. BOB has asked M/s ABC to obtain Letter of Comfort for its credit standing. Hence, on 11th May, M/s ABC approach State Bank of India, Nariman Point Branch, Mumbai (SBI) to issue a Letter of Comfort in favour of M/s ABC Co. Ltd.

Now on the due date i.e. on 15/06/06 M/s ABC Co. Ltd. has to retire the Import Bill. Hence, the SBI will request BOI (LC issuing Bank) to provide their Nostro Details and the SBI will forward the same to Credit Extending Bank (i.e. BOB, Jersey) so that the payment of Import Bills can be made on due date.

This will complete the transaction of Import. However, a new transaction will come into picture that is Trade Credit extended by Foreign Banker in favour of Indian Importer.







The typical flow of transaction of Buyer's Credit (with underlying import through LC transaction) is as follows:

1) The borrower imports goods from foreign supplier against Foreign Letter of Credit (FLC) drawn in favour of foreign supplier. *[The Buyer's Credit can be arranged for transactions of Import on Collection basis and Direct Import cases. In this example the Buyer's Credit with LC Transaction is discussed]*;

2) The borrower either through its Indian bank or on its own approaches foreign bank (or overseas/foreign branches / offices of Indian banks) for availing Buyer's Credit for payment to be made to the foreign supplier;

3) The Letter of Comfort is issued by Indian bank to the foreign bank on approval of terms and conditions through SWIFT message for the proposed Buyers Credit;

4) The foreign Bank (Lender of Buyer's Credit) remits funds to the NOSTRO Account of Indian bank which is handling import transaction, on the strength of the Letter of Comfort (LoC)/Letter of Undertaking (LoU) which is issued by the Indian bank in its favour;

5) The Indian bank remits the funds to foreign supplier through its NOSTRO Accounts;

6) The Indian bank subsequently retires and reverses the Letter of Credit in its book and passes another entry for creation of a non-fund based (contingent) liability of Letter of Comfort;

7) On the due date of Buyer's Credit, the Indian bank remits the funds (inclusive of interest) to the overseas bank and recovers the similar amount from its customer;

8) With respect to liability towards Letter of Comfort, the Indian banks are following the practice of accounting the same as "Contingent Liability".

The entries of the inward and outward remittances (specified in steps 3 and 4) are to be recorded in the books of account (NOSTRO Mirror Account) of the Indian bank.

Following documents are required to be verified by the statutory auditors during review of Buyers' Credit Transaction and its accounting treatment in the Indian bank's books.

1) (Loan) Agreement, if any, entered between the Indian importer (borrower), overseas bank (lender), the Indian bank (facilitator);

2) SWIFT messages originated by overseas bank specifying the terms of Buyer's Credit;

3) The calculation of contingent liability towards LoC / LoU is inclusive of interest accrued on the Buyer's Credit as on financial statement date;

4) Documentation/Agreement between overseas bank and Indian bank, and, any further confirmatory documents exchanged between overseas bank and Indian bank;

5) Review of documents specifying right of recovery against borrower, in case if the borrower defaults in repayment of Buyer's Credit;

6) Balance confirmations obtained from the overseas bank;

7) Charge created in records of RoC related to the security offered for Buyer's Credit vis-à-vis disclosure of Buyer's Credit in the financials of borrowers as secured / unsecured loan;

8) Acknowledgement of debt, if any, obtained from the borrower;

9) The calculation of drawing power for working capital finance availed by the borrower is net of the Buyer's Credit;

10) Form 15CA/Form 15CB compliance made by the borrower.

2. <u>Suppliers' Credit</u>:

Credit call in the case of Buyer's Credit transactions is taken on the Importer (Buyer). Hence, the creditability of buyer is taken into consideration while extending the Buyer Credit Transaction. The buyer can avail the credit for the payment of Import Liability by taking credit call on the supplier. That is to say the buyer can avail the supplier's credit for the Import Liability.

Let us understand the mechanics of Supplier's Credit with an example.

M/s ABC Co. Ltd., India wants to import goods worth USD 1 million from M/s XYZ of New York. For import M/s ABC has approached Bank of India (BOI) to open an LC in favour of M/s XYZ of New York. The LC issuing bank is BOI while the Advising Bank is BOA.

M/s XYZ (Exporter) is not willing to give any credit to M/s ABC and hence, it asks for SIGHT LC. However, on the other hand M/s ABC on the date of presentation of bills will not be able to discharge the Import Liability.

Hence, M/s ABC Co. Ltd. approaches BOA through its Banker i.e. BOI for extending a credit facility. BOA will provide a quote for extending credit facility. E.g. As per the norms the quote provided will be subject to a ceiling limit of LIBOR + .. basis points and for a maximum period of 180 days. (Let us assume that the quote provided by the BOA is LIBOR+ 40 basis points for 45 days).

M/s XYZ (Exporter) will send goods to M/s ABC (Importer) and documents to BOI (LC Issuing Bank) through its banker BOA. Being, a sight LC, the due date of the Bill will be at sight.

With predetermined arrangement with the BOA, the Importer will discharge its dues after 45 days. However, the BOA will pay the export bill amount to M/s XYZ (Exporter) by discounting the Export Bill. Due to this arrangement M/s XYZ will get the export proceeds as Sight Bill and M/s ABC can enjoy credit of 45 days.

The charges and rate of interest of discounting of export bill will be charged to M/s ABC (Importer) by the BOA.

Figure - I Arrangement of Credit and Opening of LC – Supplier's Credit

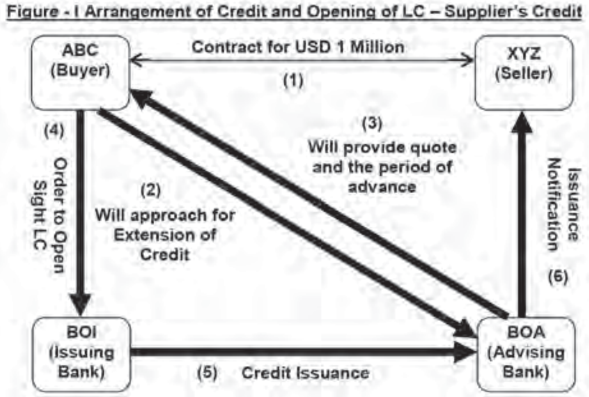
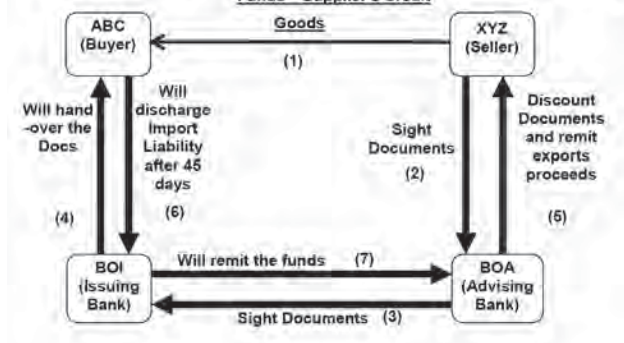


Figure - 2 Process of Movement of Goods and Documents and Remittance of Funds – Supplier's Credit



Revenue aspect of Trade Credit

- Bank issuing LoU / LoC / BG for Buyers' credit Transaction earns commission / charges as that of Letter of Credit.

Accounting aspect of Trade Credit

- Issuance of LoU / LoC / BG for Trade Credit is generally considered as Non-Funded facility by banks.
- From CBS perspective various banks adopts different mechanism to lodge LoU / LoC / BG transaction for TC.
- As LC in CBS

  Few banks treat it as Letter of Credit transaction and will lodge it under LC module of CBS with transaction information as Trade Credit.
- As BG in CBS

  It has also been observed that few banks treat it as Bank Guarantee and lodges the Trade Credit transaction under BG module of CBS. In such cases separate type of BG is used for reporting purpose.
- The important aspect is to ensure that the fields in CBS match with details reported in SWIFT Message sent for LoU/LoC. The LoU/ LoC is generally communicated through MT799 (Free Text Format) type SWIFT Message. The vital details are included as a text and not as separately identifiable fields.

Compliance aspect of Trade Credit

- TC transaction should be within the prescribed tenure.
- Interest Rate and other costs for TC transaction must be within the prescribed All-in-Cost ceiling.

- There are certain restrictions on availing TC for select commodities. Prescribed tenure in Master Circular issued by RBI for the said TC transaction must be adhered to. For instance, Trade credit for import of Gold, Diamonds, precious metals etc. is allowed for maximum period of 90 days (including usance) as against for other commodities wherein maximum tenor is prescribed at 365 days (for non-capital goods import)

Auditing aspect of Trade Credit

- Underlying transaction for Trade Credit is Import Transactions. Hence, it is important for the auditors to verify the Evidence of Import. Exchange Control Copy of Bill of Entry/Entry in IDPMS is the document which can be said to be Evidence of Import.
- Auditor should check Offer Letter issued by overseas lender and conformity of TC transaction with FEMA guidelines.
- Are there any cases of devolvement by borrower in remitting Trade Credit amount? In such cases Bank who has issued LoU / LoC / BG has to remit the funds on due date to Foreign Lender. Check are there any cases of such nature during Audit Period?
- Whether Fees/Charges for LoU/LoC/BG issuance is collected upfront?
- Whether liability for Fees/Charges collected for unexpired period is reversed and shown as Liability?

Nostro and Nostro Mirror Reconciliation

In the backdrop of the recent development in the Indian banking scenario, it would be pertinent to reiterate the importance of Nostro and Nostro Mirror Reconciliation. As the name suggests, Nostro is a foreign currency bank account which is maintained by an Indian bank outside India and Nostro Mirror is the bank book (ledger account) maintained by the said Indian bank as a per of its books of account. The banks are regularly reconciling the Nostro and Nostro Mirror accounts and are preparing reconciliation statement at periodic intervals. The auditor should verify the said Nostro Reconciliation Statement and also consider the following aspects while doing so:

1. The reconciliation statement prepared should provide entry-wise details of transaction which are outstanding, i.e., pending for reconciliation;
2. In many banks, the process of reconciliation is automated wherein the entries in Nostro and Nostro Mirror Accounts are matched based on certain pre-defined parameters. Further, there are instances wherein the matching of transactions is done manually. It is known as ‘Forced Matched entries’ besides there are entries which are being partially matched. An auditor should review the mechanism of auto-matching of entries and also should carefully test the forced matched and partially matched entries and the SoPs adopted by the bank w.r.t. the same and should get satisfied himself about the adequacy of the same with substantive checking.
3. In case if there are any entries which are appearing in the Nostro Account but are not accounted for in Nostro Mirror Account, the auditor should verify such entries in detail, unless there are wrong credit / debits given in Nostro account by the bank. In case of Buyers’ Credit, the banks are following the practice of treating the LoU / LoC as non-fund based contingent liability. The auditor should review the documents executed / available at the branch w.r.t. the buyers’ credit and many insist on balance confirmations of the counter parties involved in the said transactions. In case if the Buyer’s credit entries are routed through Nostro Account, the corresponding entries of the same should be passed in Nostro Mirror account instead of auto-reconciling the credits with debits in Nostro accounts which pertain to Buyers’ Credit.
4. In case of Vostro Accounts maintained with the bank, the account-holder would be transacting through Nostro Account. The credits in Nostro accounts received from the Vostro-account holder are required to be passed on to the Vostro account and the value dating of such entries needs to be verified by the auditor considering the adequacy of periodicity of the same.

Deposits

Following are the major types of special deposit accounts.

For Non Residents

FCNR(B) – Foreign Currency Non-Resident Account

NRE – Non-Resident External Account

NRO – Non-Resident Ordinary Account

For Residents

RFC – Resident Foreign Currency Account

RFC-D – Resident Foreign Currency (Domestic) Account

EEFC – Exchange Earners Foreign Currency Account

The typical characteristics and regulations applicable to accounts of Non-residents are given in following table:

Particulars	**Non-Resident (External) Rupee Account Scheme [NRE Account]**	**Foreign Currency (Non-Resident) Account (Banks) Scheme [FCNR (B) Account]**	**Non-Resident Ordinary Rupee Account Scheme [NRO Account]**
(1)	**(2)**	**(3)**	**(4)**
Who can open an account	NRIs and PIOs		Any person resident outside India for putting through *bona fide* transactions in rupees.
	Individual/entities of Pakistan and Bangladesh shall requires prior approval of the Reserve Bank of India		Individuals/ entities of Pakistan nationality/ origin and entities of Bangladesh origin require the prior approval of the Reserve Bank of India.
			Post Offices in India may maintain savings bank accounts in the names of persons resident outside India and allow operations on these accounts subject to the same terms and conditions as are applicable to NRO accounts maintained with an authorised dealer/ authorised bank.
Joint account	May be held jointly in the names of two or more NRIs/PIOs. NRIs/ PIOs can hold jointly with a resident relative on 'former or survivor' basis (relative as defined in Companies Act, 2013). The resident relative can operate the account as a Power of Attorney holder during the life time of the NRI/ PIO account holder.		May be held jointly in the names of two or more NRIs/ PIOs. May be held jointly with residents on 'former or survivor' basis.
Currency	Indian Rupees	Any permitted currency i.e. a foreign currency which is freely convertible	Indian Rupees
Type of Account	Savings, Current, Recurring, Fixed Deposit	Term Deposit only	Savings, Current, Recurring, Fixed Deposit

Period for fixed deposits	From one to three years. However, banks are allowed to accept NRE deposits above three years from their Asset-Liability point of view	For terms not less than 1 year and not more than 5 years.	As applicable to resident accounts.
Permissible Credits	Credits permitted to this account are inward remittance from outside India, interest accruing on the account, interest on investment, transfer from other NRE/ FCNR(B) accounts, maturity proceeds of investments (if such investments were made from this account or through inward remittance). Current income like rent, dividend, pension, interest etc. will be construed as a permissible credit to the **NRE account.** Care: Only those credits which have not lost repatriable character		Inward remittances from outside India, legitimate dues in India and transfers from other NRO accounts are permissible credits to NRO account. Rupee gift/ loan made by a resident to a NRI/ PIO relative within the limits prescribed under the Liberalised Remittance Scheme may be credited to the latter's NRO account.
Permissible Debits	Permissible debits are local disbursements, remittance outside India, transfer to other NRE/ FCNR(B) accounts and investments in India.		The account can be debited for the purpose of local payments, transfers to other NRO accounts or remittance of current income abroad. Apart from these, balances in the NRO account cannot be repatriated abroad except by NRIs and PIOs up to USD 1 million, subject to conditions specified in Foreign Exchange Management (Remittance of Assets) Regulations, 2016. Funds can be transferred to NRE account within this USD 1 million facility.
Repatriablity	Repatriable		Not repatriable except for all current income.
			Balances in an NRO account of NRIs/ PIOs are remittable up to USD 1 (one) million per financial year (April-March) along with their other eligible assets.
Taxabilty	Income earned in the accounts is exempt from income tax and balances exempt from wealth tax		Taxable
Loans in India	AD can sanction loans in India to the account holder/ third parties without any limit, subject to usual margin requirements. These loans cannot be repatriated outside India and can be used in India only for the purposes specified in the regulations.		Loans against the deposits can be granted in India to the account holder or third party subject to usual norms and margin requirement. The loan amount cannot be used for relending, carrying on agricultural/ plantation activities or investment in real estate.
	In case of loans sanctioned to a third party, there should be no direct or indirect foreign exchange consideration for the non-resident depositor agreeing to pledge his deposits to enable the resident individual/ firm/ company to obtain such facilities.		The term "loan" shall include all types of fund based/ non-fund based facilities.

	In case of the loan sanctioned to the account holder, it can be repaid either by adjusting the deposits or through inward remittances from outside India through banking channels or out of balances held in the NRO account of the account holder.		
	The facility for premature withdrawal of deposits will not be available where loans against such deposits are availed of.		
	The term “loan” shall include all types of fund based/ non-fund based facilities.		
Loans outside India	Authorised Dealers may allow their branches/ correspondents outside India to grant loans to or in favour of non-resident depositor or to third parties at the request of depositor for *bona fide* purpose against the security of funds held in the NRE/ FCNR(B) accounts in India, subject to usual margin requirements. The term “loan” shall include all types of fund based/ non-fund based facilities		Not permitted
Rate of Interest	As per guidelines issued by the Department of Banking Regulations		
Operations by Power of Attorney in favour of a resident	Operations in the account in terms of Power of Attorney is restricted to withdrawals for permissible local payments or remittance to the Account holder himself through normal banking channels.		Operations in the account in terms of Power of Attorney is restricted to withdrawals for permissible local payments in rupees, remittance of current income to the account holder outside India or remittance to the account holder himself through normal banking channels. While making remittances, the limits and conditions of repatriability will apply.
Change in residential status from Non-resident to resident	NRE accounts should be designated as resident accounts or the funds held in these accounts may be transferred to the RFC accounts, at the option of the account holder, immediately upon the return of the account holder to India for taking up employment or on change in the residential status.	On change in residential status, FCNR (B) deposits may be allowed to continue till maturity at the contracted rate of interest, if so desired by the account holder. Authorised dealers should convert the FCNR(B) deposits on maturity into resident rupee deposit accounts or RFC account (if the depositor is eligible to open RFC account), at the option of the account holder.	NRO accounts may be designated as resident accounts on the return of the account holder to India for any purpose indicating his intention to stay in India for an uncertain period. Likewise, when a resident Indian becomes a person resident outside India, his existing resident account should be designated as NRO account.
The typical characteristics and regulations applicable to accounts of residents are given in following table:			
Particulars	**Exchange Earners Foreign Currency (EEFC) Account**	**Resident Foreign Currency (Domestic) [RFC(D)] Account**	**Resident Foreign Currency (RFC) Account**
Who can open the account	Exchange Earners	Individuals	Individuals

Joint account	Jointly with eligible persons; or With resident relative(s) on 'former or survivor' basis.	Jointly with any person eligible to open	Same as EEFC
	Relative as defined under Companies Act, 2013 (viz. members of HUF, spouse, parents, step-parents, son, step-son, daughter-in-law, daughter, son-in-law, brother/ sister, step-brother/ step-sister)		
	Relative joint account holder cannot operate the account during the life time of the account holder		
Type of Account	Current only	Current only	Current/ savings/ term deposits
Interest	Non-interest earning	Non-interest earning	De-regulated (As decided by the AD bank)
Permitted Credits	1) 100% of foreign exchange received on account of export transactions. 2) Advance remittance received by an exporter towards export of goods or services	1) Foreign exchange received as payment/ service/ gift/ honorarium while on visit abroad or from a non-resident who is on a visit to India 2) Unspent amount of foreign exchange acquired from AD for travel abroad	1) Foreign exchange received by him as superannuation/ other monetary benefits from overseas employer 2) Foreign exchange realised on conversion of the assets referred to in Section 6(4) of FEMA
	3) Repayment of loans given to foreign importers	3) Gift from close relative	3) Gift/ inheritance received from a person referred to in Section 6(4) of FEMA

	4) Dis-investment proceeds on conversion of ADR/ GDR	4) Earning through export of goods/ services, royalty	4) Foreign exchange acquired before July 8, 1947 or any income arising on it held outside India with RBI permission
	5) Professional earnings like director's/ consultancy/ lecture fees, honorarium and similar other earnings received by a professional by rendering services in his individual capacity	5) Disinvestment proceed on conversion of shares into ADR/ GDR	5) Foreign exchange received as earnings of LIC claims/ maturity/ surrendered value settled in forex from an Indian insurance company
	6) Interest earned on the funds held in the account	6) Foreign exchange received as earnings of LIC claims/ maturity/ surrendered value settled in forex from an Indian insurance company	6) Balances in NRE/ FCNR(B) accounts on change in residential status
	7) Re-credit of unutilised foreign currency earlier withdrawn from the account		
	8) Payments received in foreign exchange by an Indian startup arising out of sales/ export made by the startup		

Permitted Debits	1) Any permissible current or capital account transaction 2) Cost of goods purchased 3) Customs duty 4) Trade related loans and advances	Can be used for any permissible current/ capital account transactions.	No restrictions on utilisation in/outside India.

(Source: FAQ – RBI website)

General Remittances and Approval Activities

Apart from the transactions discussed above, Banks undertake following types of transactions as well. Since, the said transactions are of the procedural nature, detailed discussion is not included herein above. However, auditor must acquaint himself with Master Circulars issued by RBI on the following transactions for compliance and other important guidelines.

1. Outward Remittances
2. Inward Remittances
3. Approval Activity with respect to
   - External Commercial Borrowing Transaction
   - Foreign Currency Convertible Bonds
   - Investment in Joint Ventures(JV), Wholly Owned Subsidiaries (WoS) abroad
   - Investment in India
   - Branch Office Remittances

Link to Master Directions issued by RBI:
https://www.rbi.org.in/SCRIPTs/BS_ViewMasterDirections.aspx

Summary of Important RBI Circulars Issued During FY 2017-18

CA. Nilesh Joshi

Sr. No.	Subject of Circular	Circular Reference	Summary
1.	Systems and Controls for Conduct of Government Banking	RBI/2016-17/271 DGBA.GAD. No.2646/31.02.007/2016-17 dated April 7, 2017	Banks should put in place ensure verification of various aspects of Government banking such as agency commission claims and pension payments as part of internal and concurrent audit. An illustrative checklist is provided with the circular.
2.	Revised Prompt Corrective Action (PCA) Framework for Banks	RBI/2016-17/276 DBS.CO.PPD. BC.No.8/11.01.005/2016-17 April 13, 2017	The provisions of the revised PCA framework will be effective from April 1, 2017 based on the financials of the banks for the year ended March 31, 2017. The framework would be reviewed after three years. The revised framework is given in annexure to the Circular
3.	Prudential Guidelines – Banks' investment in units of REITs and InvITs	RBI/2016-17/280 DBR.No.FSD. BC.62/24.01.040/2016-17 dated April 18, 2017	As indicated therein, it has been decided to allow banks to participate in Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) within the overall ceiling of 20 per cent of their net worth permitted for direct investments in shares, convertible bonds/ debentures, units of equity-oriented mutual funds and exposures to Venture Capital Funds (VCFs) [both registered and unregistered], subject to the following conditions: 1. Banks should put in place a Board approved policy on exposures to REITs/ InvITs which lays down an internal limit on such investments within the overall exposure limits in respect of the real estate sector and infrastructure sector. 2. Banks shall not invest more than 10 per cent of the unit capital of an REIT/ InvIT. 3. Banks should ensure adherence to the prudential guidelines issued by RBI from time-to-time on equity investments by banks, Classification and Valuation of Investment Portfolio, Basel III Capital requirements for Commercial Real Estate Exposures and Large Exposure Framework, as applicable.

Sr. No.	Subject of Circular	Circular Reference	Summary
4	Disclosure in the "Notes to Accounts" to the Financial Statements – Divergence in the asset classification and provisioning	RBI/2016-17/283 DBR.BP.BC. No.63/21.04.018/2016-17 dated April 18, 2017	The circular amends the additional disclosure in Notes of accounts of banks: To ensure greater transparency and promote better discipline with respect to compliance with IRAC norms, it has been decided that banks shall make suitable disclosures as per Annex, wherever either (a) The additional provisioning requirements assessed by RBI exceed 15 per cent of the published net profits after tax for the reference period or: (b) The additional Gross NPAs identified by RBI exceed 15 percent of the published incremental Gross NPAs1 for the reference period, or both. The above disclosures, shall be made in the Notes to Accounts in the ensuing Annual Financial Statements published immediately following communication of such divergence by RBI to the bank. Any contravention / non-compliance of the above instructions shall attract penalties under the Act.
5.	Additional Provisions For Standard Advances at Higher than the Prescribed Rates	RBI/2016-17/282 DBR.No.BP. BC.64/21.04.048/2016-17 dated April 18, 2017	The circular mandates to make additional provisions at higher rates in respect of advances to stressed sectors of the economy as per approved policy by Board, based on evaluation of risk and stress in various sectors. As the telecom sector is reporting stressed financial conditions, and presently interest coverage ratio for the sector is less than one, Board of Directors of the banks may review the telecom sector latest by June 30, 2017, and consider making provisions for standard assets in this sector at higher rates so that necessary resilience is built in the balance sheets should the stress reflect on the quality of exposure to the sector at a future date. Besides, banks should also subject the exposure to the sector to closer monitoring.
6.	Guidelines on compliance with Accounting Standard (AS) 11 [The Effects of Changes in Foreign Exchange Rates] by banks - Clarification	RBI/2016-17/281 DBR.BP.BC. No.61/21.04.018/2016-17 dated April 18, 2017	Previously it has been observed that banks have been recognising gains in profit & loss account from Foreign Currency Translation Reserve (FCTR) on repatriation of accumulated profits / retained earnings from overseas branch(es) by treating the same as partial disposal under AS 11. Now it has clarified that the repatriation of accumulated profits shall not be considered as disposal or partial disposal of interest in non-integral foreign operations as per AS 11 "The Effects of Changes in Foreign Exchange Rates". Accordingly, Banks shall not recognise in the profit and loss account the proportionate exchange gains or losses held in the foreign currency translation reserve on repatriation of profits from overseas operations.

Sr. No.	Subject of Circular	Circular Reference	Summary
7.	Risk Management Systems – Role of the Chief Risk Officer (CRO)	RBI/2016-17/294 DBR.BP.BC. No.65/21.04.103/2016-17 dated April 27, 2017	In order to bring uniformity in approach for Risk Management Systems and roles & responsibilities of Chief Risk Officer, the RBI has advised a roles & responsibility matrix for CRO.
8.	Compliance with Ghosh Committee Recommendations	RBI/2016-17/284 Ref. DBS.CO.PPD. BC.No.9/11.01.005/2016-17 dated April 20, 2017	The circular made following key amendments to the earlier guidelines: 1. The compliance to the Ghosh Committee recommendations need not be reported to the ACB. 2. Banks are advised to ensure that: i) Compliance to these recommendations are complete and sustained; and ii) These recommendations are appropriately factored in the internal inspection/audit processes of banks and duly documented in their manual/ instructions, etc.
9	Timelines for Stressed Assets Resolution	RBI/2016-17/299 DBR.BP.BC. No.67/21.04.048/2016-17 dated May 5, 2017	RBI has reiterated that lenders must scrupulously adhere to the timelines prescribed in the Framework for finalising and implementing the CAP. To facilitate timely decision making, it has been decided that, henceforth, the decisions agreed upon by a minimum of 60 per cent of creditors by value and 50 per cent of creditors by number in the JLF would be considered as the basis for deciding the CAP, and will be binding on all lenders, subject to the exit (by substitution) option available in the Framework. Lenders shall ensure that their representatives in the JLF are equipped with appropriate mandates, and that decisions taken at the JLF are implemented by the lenders within the timelines.
10	Recording of Details of Transactions in Passbook/ Statement of Account	RBI/2016-17/326 DBR.No.Leg. BC.76/09.07.005/2016-17 dated June 22, 2017	The circular advising banks to avoid inscrutable entries in passbooks/ statements of account and ensure that brief, intelligible particulars are invariably entered in passbooks/ statements of account with a view to avoiding inconvenience to depositors. It has been decided that banks shall at a minimum provide the relevant details in respect of entries in the accounts as indicated in the Annexure of circular. Banks shall also incorporate information about 'deposit insurance cover' along with the limit of coverage, subject to change from time to time, upfront in the passbooks.

<table>
<tr><th>Sr. No.</th><th>Subject of Circular</th><th>Circular Reference</th><th>Summary</th></tr>
<tr><td>11</td><td>Individual Housing Loans: Rationalisation of Risk-Weights and Loan to Value (LTV) Ratios</td><td>RBI/2016-17/317 DBR.BP.BC. No.72/08.12.015/2016-17 June 7, 2017</td><td>The circular amend the LTV ratios, risk weights and standard asset provisioning rate for individual housing loans sanctioned on or after the date of this circular (i.e. 7 June, 2017).

<table>
<tr><td>Outstanding loan</td><td>LTV ratio (%)</td><td>Risk Weight (%)</td><td>Standard Asset Provision (%)</td></tr>
<tr><td>Up to ` 30 lakh</td><td>≤ 80
≥ 80 and ≤ 90</td><td>35
50</td><td>0.25</td></tr>
<tr><td>Above ` 30 lakh and up to ` 75 lakh</td><td>≤ 80</td><td>35</td><td></td></tr>
<tr><td>Above ` 75 lakh</td><td>≤ 75</td><td>50</td><td></td></tr>
</table></td></tr>
<tr><td>12</td><td>Investment in plant and machinery for the purpose of classification as Micro, Small and Medium Enterprises – documents to be relied upon</td><td>RBI/2017-18/21 FIDD. MSME & NFS. BC.No.10/06.02.31/2017-18 dated July 13, 2017</td><td>Ministry of MSME, GoI, vide their Office Memorandum (OM) F. No. 12(4)/2017-SME dated March 8, 2017, have clarified that for ascertaining the investment in plant and machinery for classification of an enterprises as Micro, Small and Medium, the following documents could be relied upon:

(i) A copy of the invoice of the purchase of plant and machinery; or

(ii) Gross block for investment in plant and machinery as shown in the audited accounts;

or

(iii) A certificate issued by a Chartered Accountant regarding purchase price of plant and machinery.

Further, the Ministry has clarified that for the investment in plant and machinery for the purpose of classification of an enterprise as Micro, Small or Medium, the purchase value of the plant and machinery is to be reckoned and not the book value (purchase value minus depreciation).</td></tr>
<tr><td>13</td><td>Master Circular – Scheme of Penalties for bank branches based on performance in rendering customer service to the members of public</td><td>RBI/2017-18/76 DCM (CC) No.G-3/03.44.01/2017-18 dated October 12, 2017</td><td>The master circulars amends are as follows:-

The scheme of Penalties for bank branches including currency chests has been formulated in order to ensure that all bank branches provide better customer service to members of public with regard to exchange of notes and coins, in keeping with the objectives of Clean Note Policy.

Penalties to be imposed on banks for deficiencies in exchange of notes and coins/remittances sent to RBI/ operations of currency chests as per annexure of Master circular.</td></tr>
</table>

Sr. No.	Subject of Circular	Circular Reference	Summary
14	Submission of Financial Information to Information Utilities	RBI/2017-18/110 DBR.No.Leg. BC.98/09.08.019/2017-18 dated December 19th 2017	All financial creditors regulated by RBI are advised to adhere to the relevant provisions of IBC, 2016 and IBBI (IUs) Regulations, 2017 and immediately put in place appropriate systems and procedures to ensure compliance to the provisions of the Code and Regulations.
15	Relief for MSME Borrowers registered under Goods and Services Tax (GST)	RBI/2017-18/129 DBR.No.BP. BC.100/21.04.048/2017-18 dated February 7, 2018	As a measure of support to Micro, Small and Medium Enterprises entities in their transition to a formalised business environment, it has been decided that the exposure of banks to a borrower classified as micro, small and medium enterprise under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, shall continue to be classified as a standard asset in the books of banks and NBFCs subject to the following conditions: 1. The borrower is registered under the GST regime as on January 31, 2018. 2. The aggregate exposure, including non-fund based facilities, of banks and NBFCs, to the borrower does not exceed ₹ 250 million as on January 31, 2018. 3. The borrower's account was standard as on August 31, 2017. 4. The amount from the borrower overdue as on September 1, 2017 and payments from the borrower due between September 1, 2017 and January 31, 2018 are paid not later than 180 days from their respective original due dates. 5. A provision of 5% shall be made by the banks/NBFCs against the exposures not classified as NPA in terms of this circular. The provision in respect of the account may be reversed as and when no amount is overdue beyond the 90/1201 day norm, as the case may be. 6. The additional time is being provided for the purpose of asset classification only and not for income recognition, i.e., if the interest from the borrower is overdue for more than 90/1202 days, the same shall not be recognised on accrual basis.
16	**Resolution of Stressed Assets – Revised Framework**	RBI/2017-18/131 DBR.No.BP. BC.101/21.04.048/2017-18 dated February 12, 2018	The extant instructions on resolution of stressed assets such as Framework for Revitalising Distressed Assets, Corporate Debt Restructuring Scheme, Flexible Structuring of Existing Long Term Project Loans, Strategic Debt Restructuring Scheme (SDR), Change in Ownership outside SDR, and Scheme for Sustainable Structuring of Stressed Assets (S4A) stand withdrawn with immediate effect. All accounts, including such accounts where any of the schemes have been invoked but not yet implemented, shall be governed by the revised framework.

Sr. No.	Subject of Circular	Circular Reference	Summary
			1. Lenders shall identify incipient stress in loan accounts, immediately on default, by classifying stressed assets as special mention accounts (SMA) as per circular. 2. Lenders shall report to CRILC, all borrower entities in default (with aggregate exposure of ₹ 50 million and above), on a weekly basis, at the close of business on every Friday, or the preceding working day if Friday happens to be a holiday. The first such weekly report shall be submitted for the week ending February 23, 2018. 3. Implementation of Resolution Plan: The Resolution Plan (RP) may involve any actions / plans / reorganisation including, but not limited to, regularisation of the account by payment of all over dues by the borrower entity, sale of the exposures to other entities / investors, change in ownership, or restructuring. 3. Implementation Conditions for RP: If the resolution involves restructuring; then i. All related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are completed by all lenders; and ii. The new capital structure and/or changes in the terms of conditions of the existing loans get duly reflected in the books of all the lenders and the borrower.
			4. Timelines for Large Accounts to be Referred under IBC. In respect of accounts with aggregate exposure of the lenders at ₹ 20 billion and above, on or after March 1, 2018 ('reference date'), including accounts where resolution may have been initiated under any of the existing schemes as well as accounts classified as restructured standard assets which are currently in respective specified periods (as per the previous guidelines), RP shall be implemented as per the following timelines: 1. If in default as on the reference date, then 180 days from the reference date. 2. If in default after the reference date, then 180 days from the date of first such default. Revised Restructuring Norms:

Sr. No.	Subject of Circular	Circular Reference	Summary
			1. In case of restructuring, the accounts classified as 'standard' shall be immediately downgraded as non-performing assets (NPAs), i.e., 'sub-standard' to begin with. The non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring. In both cases, the asset classification shall continue to be governed by the ageing criteria as per extant asset classification norms. 2. Standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the lenders may be upgraded 3. For the large accounts (i.e., accounts where the aggregate exposure of lenders is ₹ 1 billion and above) to qualify for an upgrade, in addition to demonstration of satisfactory performance, the credit facilities of the borrower shall also be rated as investment grade15 (BBB- or better) as at the end of the 'specified period' by CRAs accredited by the Reserve Bank for the purpose of bank loan ratings. While accounts with aggregate exposure of ₹ 5 billion and above shall require two ratings, those below ₹ 5 billion shall require one rating. If the ratings are obtained from more than the required number of CRAs, all such ratings shall be investment grade to qualify for an upgrade only when all the outstanding loan / facilities in the account demonstrate 'satisfactory performance' (i.e., the payments in respect of borrower entity are not in default at any point of time) during the 'specified period' (as defined in paragraph 10 of the covering circular)

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Bank Branch Audit and GST

CA. Jayesh Gogri

1. Introduction

Section VIII of the Long Form Audit Report (LFAR) requires the auditor to comment on any other matter including taxes. Therefore, it may be essential for a branch auditor to know the important aspects of Goods and Services Tax (GST) related to banks such as: the activities which are liable to be taxed under GST, the value base on which GST needs to be paid, time at which the tax liability arises (Time of Supply), the State where the liability arises (Place of Supply), the set offs which can be claimed (Input Tax Credit – ITC) and relevant statutory records/returns which a bank is required to maintain/submit. **In this part of the compendium an attempt has been made to highlight some of the important aspects of banking sector connected to GST.**

2. Registration

A bank is required to obtain a separate GST registration in each of the State/Union Territory. Moreover, at the option of the bank, each separate business vertical can also have a separate registration. Depending upon the policy of the bank, a particular branch may or may not have a separate registration. However, in any case, it is a must that a branch is added to GST registration certificate as an additional place of business and a copy of such registration certificate pertaining to the respective branch is displayed at the prominent place. Moreover, display of GST number at the signboard is also a mandatory requirement. Chapter VI (Section 22 to Section 30) of the Central Goods and Services Tax Act, 2017 (CGST Act) and Rule 8 to Rule 26 of Central Goods and Services Tax Rules, 2017 (CGST Rules) would be relevant from the registration perspective.

If a separate registration is not obtained, branch auditor should ensure that data pertaining to the auditee branch has been suitably reconciled and taken into consideration for discharge of GST liability and adequate disclosures are made in GST returns. If the branch is the principal place of business in a State and if the registration of all the branches in a State are covered by the registration of such principal branch, it may be relevant to examine that no branch is left out to be covered as additional place of business in the registration. In such a case, it may also be relevant to examine if the GST liability including reverse charge, of all such branches in a State, has been adequately discharged and disclosed. Branch auditor of such principal branch may ask for a complete list of branches in a state/union territory and examine if the they are covered in the GST registration and subsequent compliances.

3. Applicability of GST and exemptions

Functions of banks can be divided into two parts:

- Major functions
- Other functions/ancillary services

Major functions	Other functions	
• Accepting Deposits • Granting Advances	• Discounting of bills and cheques • Collection of bills and cheques • Remittances • Safe custody of articles	• Safe Deposit Lockers • Issue of Letter of Credit • Issue of Guarantees

Besides the above functions, Banks now-a-days associate themselves in the following activities also either by opening separate departments or through separately floated independent subsidiaries:

- Investment Counselling
- Investment Banking
- Mutual Fund
- Project Appraisal
- Merchant Banking Services
- Taxation Advisory Services
- Executor Trustee Services
- Credit Card Services
- Forex Consultancy
- Transactions of Government Business
- Securities Trading
- Factoring
- Gold/Silver/Platinum Trading
- Venture Capital Financing
- Bank Assurance - Selling of Life and General Insurance policies as Corporate Agent

3.1. Applicability of GST on various functions of Banks

3.1.1 Interest

Activity, of accepting deposits and thereafter lending it to the borrowers, is the primary business of any bank. GST law, defines 'goods' and 'services' to exclude 'money' from their ambit. So, a pure transaction in money is out of the ambit of GST. However, the use of money for which any consideration is charged is considered to be a 'service'. Therefore, on reading the definition of service it appears that 'interest' which can be said to be a consideration for use of money, is liable to tax. However, exemption notification[1] grants exemption to services by way of extending deposits, loans or advances in so far as the consideration is represented (other than interest involved in credit card services) by way of interest or discount. In other words, effectively, there is no levy of GST on interest unless the same is with respect to credit card services.

As far as the interest on delayed payments is considered, there appears to be some anomaly due to specific provisions of Section 15(2) of CGST Act, relating to valuation. Clause (d) of Section 15(2) of CGST Act provides that interest or late fee or penalty for delayed payment of any consideration for any supply shall be added to the value of supply. One school of thought prevails that though the interest on loans is exempt, but interest on delayed payment is taxable due to abovementioned specific provisions. It may be noted that Section 15 deals with valuation of supply and not taxability of supply. Even if the value is enhanced on account of interest on delayed payments due to the provisions of Section 15(2), the exempt nature of interest by virtue of Notification no. 12/2017-Central tax (Rate) dated 28.06.2017 does not get altered and therefore, it appears such penal interest also remains exempt in case of loans/advances.

3.1.2. Income on account of service fees, commission, etc.

Banks provide various services to its customers and collect service fees in the nature of processing fees, cheque bounce charges, swap charges, conversion charges, valuation charges, loan statement charges, collection/repossession charges, etc. In absence of any exemption on payment of GST on such charges, GST shall be applicable. Similarly, commission and brokerage earned by the banks as a result of renegotiations or rescheduling of outstanding debts, on bills for collection, remittances and transfers, letters of credit and guarantees, letter of comforts, etc. are liable to GST.

1. Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017 (Serial No. 27)

3.1.3 Money changing services

Conversion of one currency to another is liable to GST. However, by virtue of exemption granted by a Notification[2] *inter se* sale or purchase of foreign currency amongst banks and/or authorised dealers of foreign exchange is exempted.

3.1.4 Sale of repossessed assets

Banks undertake auction of collateral assets where the customer defaults in payment of loans. Loan agreement entered into between bank and the customer contains the clause of auction of collateral assets.

A view prevails in the market that there are two transactions involved in auction of collateral. First, the customer loses rights and control over the collateral assets; which may be held to be 'disposal of assets' in accordance with Sr. No. 1 of Schedule I of CGST Act. Therefore, GST is chargeable on supply of such goods from the defaulting borrower to the bank if the defaulting borrower had availed ITC and the Second, from the bank to the auction buyer which is also leviable to GST. Banks may avail input tax credit of GST charged by the defaulting borrower subject to fulfilment of conditions of availment of input tax credit.

If the defaulting borrower is not registered with GST, bank may be regarded as a dealer of second hand goods and as per Rule 32(5) of CGST Rules the bank should pay tax only on the difference between sales and purchase value of such assets.

One more issue with regard to the above aspect is ascertainment of purchase value of such collateral assets at the end of the bank. Since the bank has not purchased such assets from the borrower but merely exercised its lien over such assets to recover its debts. Proviso to Rule 32(5)[3] lays down that purchase price in such cases would be the original purchase price of the borrower less depreciation of 5% per quarter till the final disposal by the bank. Moreover, in such cases, even RCM with respect to procurement from unregistered person is granted exemption which is explained in detail at Para 4.2 below.

3.1.5 Transactions between two branches of the same bank

Section 25(2) of CGST Act, 2017 states that a person who has obtained more than one registration, whether in one State or Union Territory or more than one State or Union Territory shall, in respect of each such registration, be treated as 'distinct persons' for the purposes of CGST Act. Thus, supply of goods or services between two branches of the same bank shall be chargeable to GST.

3.1.6 Sale of investments in securities

Sale of investments in securities is out of purview of GST in view of specific exclusion thereof from the definition of 'goods' under GST Law. Hence, GST is not chargeable on sale of securities.

3.2. Exemption from payment of GST

In respect of services, the Central Government has issued Notification No. 12/2017–Central Tax (Rate) dated 28.06.2017 ('Base exemption notification for services') so as to exempt prescribed supplies of services from payment of CGST, subject to certain conditions, as may be applicable. All the States should also issue notification to exempt SGST component. Similarly, Notification 2/2017 – Central Tax (Rate) dated 28.06.2017 has been issued in respect of exemption granted from payment of CGST on supply of goods.

Exemptions applicable to banking sector

3.2.1 Interest received on extending deposits, loans or advances

As per Entry No. 27 of base exemption notification for services, interest received by banks on account of deposits, loans or advances extended by the banking company is unconditionally exempt from payment of tax.

2. Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017 (Serial no. 27)
3. CGST Rules, 2017

That is, no condition shall be required to be fulfilled in order to avail the exemption.

The term interest has been specifically defined by way of an explanation inserted in the base exemption notification for services. As per the definition of interest, service fee, any other charge in respect of the money borrowed or debt incurred or any credit facility which has not been utilised, shall not be termed as interest. Accordingly, GST shall be applicable on such charges.

3.2.2 *Inter se* sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers

Any consideration charged for purchase or sale of foreign currency amongst banks and authorised dealers would be exempt from payment of GST. Such services were covered under negative list of services in the Service Tax regime as well.

3.2.3 Income earned by bank on account of payment made by cards by customers

Entry No. 34 of base exemption notification for services reads as under–

"Services by an acquiring bank, to any person in relation to settlement of an amount up to two thousand rupees in a single transaction transacted through credit card, debit card, charge card or other payment card service.

Explanation— For the purposes of this entry, "acquiring bank" means any banking company, financial institution including non-banking financial company or any other person, who makes the payment to any person who accepts such card."

Amount charged by the bank in cases where its customers settle an amount up to two thousand rupees in a single transaction by way of credit card, debit card, charge card or other payment card service is exempt from payment of GST.

3.3. GST applicability on other activities of banks

Indicative list of some of other activities and taxability thereof is summarised in the following table:

Sr. No.	Nature of services	Comments on taxability
1	Discounting of bills and cheques	Exempt if the consideration is in the form of discount *vide* Notification no. 12/2017-Central tax (rates) dated 28.06.2017
2	Collection of bills and cheques	Taxable
3	Remittances	Taxable
4	Safe custody of articles	Taxable
5	Safe Deposit Lockers	Taxable
6	Issue of Letter of Credit	Taxable
7	Issue of Guarantees	Taxable
8	Investment Counselling	Taxable
9	Project Appraisal	Taxable
10	Merchant Banking Services	Taxable
11	Taxation Advisory Services	Taxable
12	Executor Trustee Services	Taxable
13	Credit Card Services	Taxable
14	Forex Consultancy	Taxable
15	Securities Trading	Not taxable as securities are neither regarded as goods nor services under GST Law
16	Gold/Silver/Platinum Trading	Taxable

4. GST applicability on receipt of services under RCM

Under GST laws, there are two situations in which liability has to be discharged by the recipient of supply under RCM; namely, one where notified goods or services are procured by a person and another where the goods and services are procured from unregistered persons.

4.1. Notified goods/services

4.1.1 Notified Services

One of the notified service covered under RCM from the perspective of banks is recovery agent's services[4] when provided to a banking company or a financial institution or a non-banking financial company located in taxable territory.

Though the term 'recovery agent' is not defined under GST law, it appears that it would cover recovery agents appointed under Securities and Reconstruction of Financial Assets and Enforcement of Security Act, 2002 for recovery of due amounts. Bank branch auditor may distinguish between recovery agents and collection agents to verify if appropriate GST liability is discharged under RCM with respect to recovery agent's services.

4.1.2 Notified goods

Moreover, notified goods such as cashew nuts, not shelled or peeled, bidi wrapper leaves (tendu), silk yarn, supply of lottery etc. are covered under RCM[5] when purchased from specified persons. However, banks may not be procuring any such goods and therefore, they need not pay GST under RCM on goods.

Used vehicles, seized and confiscated goods, old and used goods, waste and scrap are also covered under RCM. However, RCM triggers only when such goods are supplied by Central Government, State Government, Union Territory or a local authority. Therefore, when any such goods are sold by banks, the same is not covered under RCM.

4.2. Procurement of goods/services from unregistered persons

If registered person procures goods/services from another person who is not registered under GST Laws, the recipient registered person is liable to pay GST under RCM.[6] From 01.07.2017, such RCM was applicable provided registered taxable person procures taxable goods/services from unregistered person or persons, aggregate value of which exceeds ` 5,000/- in a day. Such provisions of RCM in cases of procurement from unregistered persons is withdrawn from 13.10.2017 which is proposed to be reintroduced from 01.04.2018[7].

However, in cases of taxable person dealing in buying and selling of second hand goods wherein he discharges GST on outward supply as per Rule 32 (5) of CGST Rules i.e., on the difference of purchase and sale value (As discussed at Para 3.1.4 above), such taxable person is not liable to pay GST under RCM even if such goods are procured from unregistered person by virtue of specific exemption[8].

5. Types of GST

Though for normal purposes GST could be one tax. For all practical purposes, GST is divided into 4 major types:

- Central Goods and Services Tax
- State Goods and Services Tax
- Union Territory Goods and Services Tax
- Integrated Goods and Services Tax

4. Notification No. 13/2017 – Central Tax (Rate) dated 28.06.2017 (Sr. No. 8)
5. Notification No. 4/2017 – Central Tax (Rate) dated 28.06.2017
6. Notification No. 8/2017-Central tax (Rate) dated 28.06.2017
7. Notification No. 38/2017-Central tax (Rate) dated 13.10.2017
8. Notification No. 10/2017-Central tax (Rate) dated 28.06.2017

It is important to note that a branch collects and discharges appropriate type of GST. Failure of which can cause issues in terms of claiming refund of wrong tax paid and then again discharge of the correct tax.

For all inter-State transactions, IGST is payable and in case of intra-State transactions combination of CGST as well as SGST (UTGST in case of Union Territory) is payable. In order to ascertain whether a transaction is an inter-State or intra-state transaction, it is essential to determine two factors:

- Location of the supplier of goods/services
- Place of supply

5.1. Location of supplier and recipient

Location of supplier and recipient of goods is not defined under GST Acts. However, location of supplier and recipient of services is defined.

Normally, in all the cases, banks would have taken its GST registration and therefore, the place of supplier would be the place of business or the fixed establishment where the registration has been taken.

Location of recipient is also relevant in case of banking services. If the recipient has obtained registration, the place of such registration would be regarded as the location of recipient. In absence of such place, the location of the usual place of residence of the recipient would be relevant.

In case of banks, sometimes such persons who don't have any registration pose a bigger challenge in terms of identifying their 'usual place of residence', as, in many cases, such persons may have more than one place of residence. In such cases, normally banks are insisting for a declaration from unregistered persons stating that which is the precise place of 'usual residence' of such person.

5.2. Place of Supply of Banking services

5.2.1 Where location of supplier and location of recipient is in India

As per Section 12(12) of Integrated Goods and Services Tax (IGST) Act, 2017, the place of supply of banking and other financial services shall be the location of the recipient of services on the records of the bank.

However, if the location of recipient of services is not on the records of the supplier, the place of supply shall be the location of the supplier of services. Such scenario may arise if a walk-in customer comes for one-time services like issuance of a demand draft or pay order or currency conversion.

Based on above, banks need to look into the address of the recipient of services as available on its records to classify the transaction whether it is an inter-State or intra-State transaction and charge taxes accordingly.

5.2.2 Where either the location of supplier or location of recipient is outside India

As per Section 13(8) of IGST Act, 2017, the place of supply of services provided by a banking company to account holders shall be the location of such banking company.

Account holder is not defined, however, account is defined to mean an account bearing interest to the depositor and includes a non-resident external account and a non-resident ordinary account.

If there are any services provided by the banks to persons who are not falling in the above-mentioned clause, the general clause for place of supply of service shall be considered i.e., the location of recipient. However, where the location of the recipient of services is not available in the ordinary course of business, the place of supply shall be the location of the supplier of services.

6. Input Tax Credit (ITC)

GST paid on goods or services which are used for providing output services can be claimed as a deduction from the GST liability arising from the supply of banking and other services by banks. Such deduction is called as 'set off' or 'Input tax credit (ITC)'.

ITC is subject to various conditions as prescribed in Section 16 of CGST Act and is also subject to various restrictions as mentioned in Section 17 of the CGST Act. To avail ITC, all the following conditions should be satisfied cumulatively:

- Goods/Services to be used for business purposes
- Possession of tax paying document
- Returns by the bank should have been filed
- Actual receipt of the goods and or services in respect of which ITC is claimed. If goods are received in lots: ITC will be available only on receipt of last lots (Proviso to 16(2))
- Tax charged should be actually paid to the Government by the supplier of goods/ services
- Payment of value of goods/services and GST by the banker to respective supplier (other than supplies covered under RCM) should be made within 180 days

It may also be note that, as per Section 17[9] of CGST Act, ITC in respect of supplies which are used either for non-business purposes or for making exempt supplies, is not admissible. However, banks have been provided with an option to avail 50% of ITC on *ad-hoc* basis. If such option is chosen, banks need not maintain records for proving the ratio of exempt and taxable supplies and will be allowed 50% of the ITC even if the taxable supplies are not to the extent of 50%. Moreover, in any case, with respect to GST paid on branch transfer of services, full ITC will be allowed to the recipient branch of the bank.

Section 17 of CGST Act also puts restrictions on ITC in respect of the following items:

- Motor vehicles and other conveyances except specific circumstances where ITC is available, including *inter alia*, when such motor vehicles and other conveyances are used for making further taxable supply of such vehicles or conveyances
- Food and beverages, outdoor catering, beauty treatment, health services, cosmetic and plastic surgery etc.
- Membership of a club, health and fitness centre
- Rent-a-cab, life insurance and health insurance except where Government notifies the service which are obligatory for an employer to provide to its employees under any law for the time being in force.
- Travel benefits extended to employees on vacation such as leave or Home travel concession.
- Works contract services or other goods or services received for construction of Immovable property
- Goods or services used for personal consumption
- Goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples

An auditor may review the transactions to ascertain if the ITC has been availed correctly.

7. Records

Banks need to maintain and preserve the following records:

- Inward and outward supplies
- Input tax credit availed
- Output tax payable and paid
- Invoices, receipt vouchers, refund vouchers, payment vouchers, debit/credit notes

As banks work with huge number of account holders/customers, maintaining proper records as per GST provisions can be a challenge. Moreover, it is mandatory to maintain such records for a minimum period of 72 months from the due date of filing Annual return.

9. CGST Act, 2017

In case of electronic records, it is essential to ensure that appropriate backups are maintained and the same are retrievable in case of accidents.

As per Rule 47 of CGST Rules, a banking company can raise an invoice within 45 days instead of 30 days (in normal cases) from the date of supply of services. In case, the invoices are raised to branches, the same may be raised at quarterly intervals[10]. Moreover, for a bank, it is not mandatory to mention serial number and address of the recipient[11].

8. Returns

Banks have to prepare and submit various returns as under:

Return/ Statement	Description
TRAN-1	Credit of earlier laws to be carried forward to GST
GSTR-1	Monthly statement of outward supplies of goods or services
GSTR-2	Monthly statement of Inward supplies of Goods or Services
GSTR-3	Monthly return
GSTR-3B	Summary return for outward and inward supplies and payment of Tax
GSTR-6	Monthly return for an Input service distributor
GSTR-7	TDS return
GSTR-9	Annual return

As per Section 150(1)(e) of the CGST Act, it is provided that a Banking company has to furnish an information return, in respect of statement of accounts, details of payment of tax, other details of transactions, transactions related to a bank account, sale or exchange of goods or property or right or interest in a property etc. which are required to be maintained by them under any law for the time being in force, for such periods, within such time, in such form and manner and to such authority or agency as may be prescribed. However, till the date of preparing this write up, no such return has been prescribed so far.

9. Liability in respect of account holders

Banks are responsible for taking actiones against their customers if ordered by GST authorities. Such responsibilities include freezing/ defreezing bank accounts[12], paying the amount lying in balance of any account to the GST officer recovering tax[13]. Also, as discussed in the returns section, information may be required to be furnished by banks in respect of account holders.

Conclusion

Modern banks are very versatile and dynamic in their activities. Though, some of the important aspects have been covered in the above section, this part of the compendium does not proclaim to be an exhaustive encyclopedia on GST on Banking Sector. Auditors, should examine GST related provisions pertaining to specific facts of the branches allotted to them and then provide suitable comments in their Audit report. Moreover, the views expressed in this publication are general in nature and may not be construed as legal opinion expressed by the author.

10. Rule 47 of CGST Rules, 2017
11. Rule 54 of CGST Rules, 2017
12. Section 83 of CGST Act, 2017
13. Section 79 of CGST Act, 2017

Compliance of TDS during Bank Branch Audit

CA. Vaibhav Sangvi

WHAT IS TDS?

TDS stands for Tax Deducted Source. In TDS system, persons responsible for making payment for specified services such as commission, brokerage, professional consultancy etc. are required to deduct a fixed percentage from the amount.

Such deducted amount (which is called TDS) have to be deposited to the Government by the Deductor (person who is deducting tax) on behalf of deductee (person who is providing services) which deductee can claim as Income Tax Paid at the time of filing his Income Tax Return.

When any amount on which TDS is deductible is being paid or payable to a non-resident then TDS is deductible under section 195 and not under the respective TDS section.

WHEN TDS IS TO BE DEDUCTED

The incidence of deducting TDS depends on the nature of payment.

TDS is required to be deducted at the **time of actual payment only, not on due or accrual basis in following cases**

a) Salary

b) Payment of accumulated balance of Employee's provident Fund

c) Dividends

d) Winning from lottery or crosswords puzzle.

e) Winning from horse race

f) Payment in respect of life insurance policy to policy holder

g) Payment in respect of deposits under National Saving Scheme

h) Payment on account of repurchase of units by Mutual Funds or Unit Trust of India

i) Payment of compensation on compulsory acquisition of certain immovable property

AND At the time of credit of such income to the account of the payee or at the time of actual payment, whichever is earlier in case of all other payments (such as commission, profession fee, consultancy etc.) except the payments mentioned in above point.

TDS is required to be deducted from the beginning if it is likely that the total amount during the financial year will exceed the threshold limit.

NATURE OF PAYMENTS, THRESHOLD LIMITS AND RATES

The summary of the nature of transaction on which TDS is required to be deducted if the amount exceeds the threshold limit along with the applicable rates of TDS for commonly used payments is given at the end of the article.

Also while conducting Bank Branch Audit we would come across only certain type of expenditure which are discussed hereinbelow, however for general benefit we have provided with the entire table of chart applicable for TDS.

During the course of audit we need to understand the nature of expense whether the expense is, 'allocation of expense by the bank' or whether, it is 'expense is actually incurred by the branch'. If such an expense is 'allocation of expense by the bank' then the provisions of TDS will be looked in will be by Head Office. (E.g. Salary of the Branch Staff generally) However, if it is 'expense is actually incurred by the branch' then the provisions of TDS will be applicable at the Branch Level.(E.g. Rent paid for premises) We as auditors in such case need to audit such transactions.

PAYMENT AND RETURN FILING

Person deducting TDS have to deposit the amount of TDS to the Government and have to file quarterly returns with the details of the TDS deducted.

TDS Deposit

TDS deducted (salary or non-salary) is required to be deposited within 7 days from the end of the month in which TDS is *deducted*. However, TDS deducted in *month of March is required to be deposited on or before 30th April.*

Due date for deducting TDS under sections 194-IA & 194-IB – 30 days from the end of the month in which TDS is deducted.

TDS is required to be deposited using **below form/ challan**

TDS on Purchase of property (Section 194-IA) – Form 26QB

TDS on rent of property (Section 194-IB) – Form 26QC

Other TDS payment – Challan No./ITNS 281

TDS Return

Quarterly TDS return is required to be filed by Deductor. Different return forms are specified for filing return as follows:

Form	Nature of Payment	Deductee
24Q	Salary	(Resident or Non-Resident)
26Q	Other than Salary	Resident
27Q	Other than Salary	Non-Resident, Foreign Company or Not Ordinarily Resident
26QB	Immovable Property	Resident
26QC	Payment of Rent	Resident

Quarterly due dates for different forms

Quarter	Due Date 24Q, 26Q & 27Q
Apr. to Jun.	31st July
July to Sep.	31st Oct.
Oct. to Dec.	31st Jan.
Jan. to Mar.	31st May

Forms 26QB & 26QC – It is challan cum TDS statement which is required to be filed within 30 days from the end of the month in which TDS is required to be deducted.

TDS CERTIFICATE

TDS Certificate shows the amount of tax which has been deposited by Deductor. Deductor is required to issue TDS certificate to the deductee within specified time limit given in below table. *TDS certificate have to be generated online using Traces websites only.*

TDS Certificate	Nature of Payment	Due date for issuance
Form 16	TDS on Salary	On or before 31st May of the financial year immediately following the financial year in which Tax is deducted
Form 16A	Other than Salary	15 days from the due date of furnishing TDS return
Form 16B	Purchase of Immovable Property (Section 194-IA)	within 15 days of turning return cum challan in Form No. 26QB
Form 16C	TDS on rent (Section 194-IB)	within 15 days of turning return cum challan in Form No. 26QC

PENALTY PROVISIONS

Various penalties are applicable on the deductor under TDS which are as follows:–

A) Interest on late payment of TDS to Government

Interest is chargeable on short payment/late payment of TDS. Following are the points dealing with the same There can be following scenarios:–

1. **When TDS is not deducted**

   Interest at the rate of 1% per month or part thereof, for the period from the date on which TDS is deductible/collectible to the date on which TDS/TCS is actually deducted/collected.

2. **When TDS is deducted but payment is made lately**

   Interest at the rate of 1.5% per month or part thereof, for the period from the date on which TDS is actually deducted/ collected to the date on which such TDS/ TCS is actually paid.

Calendar month is considered in calculating interest therefore if you delay payment by one day, you have to pay interest for two months. For example, if TDS is deducted in month of November and deposited on 8th December then you have to pay interest for 2 month i.e. November and Decembert. Total interest payable shall be 3%.

B) Penalty on late/wrong filing of TDS return

1. **Late filing fee of ` 200 per day under section 234E**

   a) Penalty of ` 200 per day shall be payable for any delay in furnishing the TDS statement.

   b) The total late filing fees should not exceed the total amount of TDS reported in the return.

2. **Penalty ranging ` 10,000 to ` 1,00,000 under section 271H**

   a) Delay in filing TDS statement for more than a year from the due date of filing of such TDS return – If the TDS statement is not filed within one year from the due date of furnishing of TDS return, then a minimum penalty of ` 10,000 (which can go up to ` 1,00,000) can be levied. The penalty under this section will be **in addition** to the late filing fee under section 234E.

   b) Furnishing incorrect details in the statement filed like PAN, Challan and TDS Amount etc. – Section 271H also cover cases of filing incorrect TDS/TCS return. Similarly, minimum penalty of ` 10,000 (which can go up to ` 1,00,0000) can be levied.

C) Penalty on late issuing of TDS Certificate

Penalty of ` 100 per day shall be payable for any delay in issuing TDS certificate. The total late issuing fees should not exceed the total amount of TDS reported in the return.

REQUEST FOR NON-DEDUCTION OR LOWER DEDUCTION

You can ask the tax deductors to not deduct tax if your income is below the basic exemption limit. There are two ways for doing this:-

1. **Filing Form-15G/15H**

   An resident individual or HUF can file a declaration in Form 15G/15H for non-deduction of TDS. In this declaration, deductee declares that his income is below the basis exemption limit during a particular financial year so no TDS should be deducted. Deductee is required to file this declaration for each financial year.

   Note – Form 15G is applicable to individual and Form 15H is applicable to senior citizen.

2. **Application in Form 13 to Assessing Officer**

   Any person can apply for a certificate for non-deduction or lower deduction of TDS to his Assessing Officer. If satisfied, Assessing office will issue a certificate to the deductee.

   Let us now quickly go through some of the common TDS provisions which are frequently required while conducting Bank Branch Audit.

Section 194A : INTEREST FROM A BANKING COMPANY

1. This Section is *applicable ONLY to a resident*. Thus, the provisions of section 194A are not applicable in case of payment of interest to a non-resident.

2. Payments made to non-residents are also covered under TDS mechanism. However, tax in such a case is to be deducted as per Section 195.

3. Section 194A deals with deduction of TDS on interest other than interest on securities like Interest on Fixed Deposits, Interest on Loans and Advances other than banks.

Threshold limit for deduction of TDS

The Deductor shall deduct TDS if the amount of such interest paid or credited OR is likely to be paid or credited in a financial year, exceed

1. 10,000 where the payer is

a. Banking company or any bank or a banking institution

b. Co-operative society engaged in the business of banking

c. Post office (on deposit under scheme framed and notified by Central Government).

2. 5,000 in any other case

Rate of TDS

1. 10%, if PAN is furnished
2. 20%, if no PAN is furnished
3. No surcharge, education cess or SHEC shall be added to the above rates. Hence, tax will be deducted at source at the basic rate.

Section 194C : Payment to Contractors

Section 194C states that any person responsible for paying any sum to the resident contractor for carrying out any work (including the supply of labour), in pursuance of a contract between the contractor and the following persons:

1. The Central Government or any State Government
2. Any local authority
3. Any corporation established by or under a Central, State or Provisional Act
4. Any company
5. Any co-operative society
6. Any authority constituted in India by or under any law, engaged either for the purpose of dealing with and satisfying the needs for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both
7. Any society registered under the Society Registration Act, 1980 or under any such corresponding law to the Act in any part of India
8. Any trust
9. Any university or deemed university
10. Any firm

Meaning of the term "work" for the purpose of Section 194C

The expression, "work" in this section would include

a. Advertising

b. Broadcasting and telecasting including production of programmes for such broadcasting or telecasting

c. Carriage of goods and passengers by any mode of transportation, other than railways

d. Catering

e. Manufacturing or supplying of a product according to the requirement or specification of a customer by using the materials purchased from such customer, But does not include manufacturing or supplying of a product according to the requirements or specifications of a customer by using the materials purchased from a person, other than such a customer.

Meaning of the term Sub-Contractor as per Section 194C

A "sub-contractor" would mean any person:

a. Who enters into a contract with the contractor for carrying out, or

b. For the supply of labour for carrying out the whole or part of the work undertaken by the contractor under a contract with any of the authorities or

c. For the supply of, whether wholly or partly, any labour which the contractor has undertaken to supply in terms of his contract with any of the authorities mentioned under this section.

When does TDS under Section 194C need to be deducted

The person responsible for making payment to resident contractor/sub-contractor should deduct TDS,

- Either at the time of crediting such sum to the account to the payee or
- At the time of payment thereof in cash or
- By an issue of a cheque or by any other mode, whichever is earlier.

When does TDS under Section 194C NEED NOT BE DEDUCTIBLE

1. Contract amount below specified limits

a. Amount of any single sum credited or paid doesn't exceed ` 30,000

b. Aggregate amount of such sums credited or paid doesn't exceed and doesn't likely to exceeds ` 1 lakh

2. Payment or credit to transporter for transportation

If recipient is a transport operator and he furnishes PAN to the deductor then TDS is not to be deducted. Such deductors will be required to intimate these PAN details to the Income Tax Department in the prescribed format. **However from 1st June, 2015 only transport operators who owns ten or less goods carriages at any time during the financial year is allowed such exemption. Transport operator has to furnish a declaration to this effect to the person paying him to get such exemption.**

3. Personal purposes

Payment by an individual or HUF to a resident contractor for personal purposes is not subject to TDS.

4. **Payment is made to bank** listed in the Second Schedule to the RBI Act excluding foreign bank for

a. Bank guarantee commission

b. Cash management service charges

c. Depository charges on maintenance of DEMAT accounts

d. Charges for warehousing services for commodities

e. Underwriting service charges

f. Clearing charges (MICR charges)

g. Credit card or debit card commission for transaction between the merchant establishment and acquirement bank – Notification no. 56/2012, dated 31st December, 2012

5. Payment is made for purchasing products according to the payer's requirement or specification. If the product is manufactured using material purchased by the payer then TDS is required to be deducted.

Rate of TDS

Sr. No.	Nature of Payment	TDS Rate if PAN available	TDS Rate if PAN not available
1	Payment / Credit to resident individual or HUF	1%	20%
2	Payment/Credit to any resident person other than individual / HUF	2%	20%
3	Payment/ credit to Transporters	NIL	20%

Note:- No Surcharge, Education Cess, and SHEC shall be added. Hence, TDS shall be deductible at basic rates.

Point to be noted

- In case of contract of manufacturing or supplying product, TDS shall be deductible on the value excluding the value of material, if such value is mentioned separately in the invoice. If not mentioned separately then TDS shall be deducted on the whole amount of invoice.

Section 194H : Commission or Brokerage

1. Section 194H is for income tax deducted on any income by way of commission or brokerage, by any person responsible for paying to a resident.
2. Individuals and Hindu Undivided Family who were covered under section 44AB are also required to deduct TDS.
3. Section 194H does not include insurance commission referred to in section 194H.

TDS under Section 194H need to be deducted

- TDS under Section 194H will be deducted at the time of credit of such income to the account of the payee or to any other account.
- Whether called suspense account or by any other name at the time of payment, of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

Meaning of Commission and Brokerage

Commission or brokerage includes any payment

a) Received or receivable,

b) Directly or indirectly, OR

c) By a person acting on behalf of another person

TDS on commission or brokerage includes

a) For services rendered (not being professional services), or

b) For any services in the course of buying or selling of goods, or

c) In relation to any transaction relating to any asset, valuable article or thing, except securities

THRESHOLD LIMITS AND RATE

a) TDS is required to be deducted only when the aggregate of the amounts of such income credited or paid or likely to be paid or credited during the financial year exceeds ` 15,000 at the rate of 5%.

b) No surcharge, education cess or SHEC shall be added to the above rates. Hence, the tax will be deducted at source at the basic rate.

c) The rate of TDS will be 20% in all cases if PAN is NOT quoted by the deductee.

TDS NOT REQUIRED TO BE DEDUCTED IN FOLLOWING CASES

a) TDS is not required on brokerage or commission payable by BSNL or MTNL to their public call office franchisees.

b) If commission is paid by employer to its employee, then such commission is liable to TDS under Section 192 – TDS from Salary and not under this section.

c) TDS on Insurance Commission shall not be deducted under this section but under Section 194D.

d) Bank guarantee commission.

e) Depository charges on maintenance of DEMAT accounts.

f) Cash management service charges.

g) Charges for warehousing services for commodities.

h) Underwriting service charges.

i) Clearing charges.

j) Commission on Debit or credit card for transactions between the merchant establishment and acquirer bank.

Section 194-I : TDS on Rent

a) The person (not being an Individual or HUF) who is responsible for paying of rent is liable to deduct tax at source.

b) in case the aggregate of the amount of rent credited or paid or likely to be credited or paid during the financial year exceeds ` 1,80,000/-

c) Also, individuals and/or HUFs who are subject to tax audit are also under an obligation to deduct the tax at source.

Meaning of ‘Rent’ in reference to Section 194-I

1) ‘Rent’ means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any:

   a. Land or

b. Building (including factory building) or

c. Land appurtenant to a building (including factory building) or

d. Machinery or

e. Plant or

f. Equipment or

g. Furniture or

h. Fittings

whether or not any or all of the above are owned by the payee–Explanation (i) to Section 194-I. Sub-letting is also covered.

2) If the landlord collects security or advance payment at the time of letting out a building to a tenant on the condition that the deposit will be refunded at the time of vacating the building, then such a receipt is not in the nature of income and, therefore, no tax is to be deducted at source u/s. 194-I.

3) However, advance rent (not in the nature of refundable security deposit) paid is, subject to tax deduction. Moreover, where any such rent is credited to 'suspense account' or to any other account shall also be liable to deduct tax at source.

What Payment is Covered u/s. 194-I?

1. Income from letting out of factory building

a) Where a factory building is let out, the rent received generally is income from business in the hands of the lessor or the owner of the factory. Only in a few cases it is income from property in the lessor's hands.

b) But such payment also, which is business income in the hands of the lessor and for which he will necessarily be paying advance tax and finally be returning the rental income, will be subject to tax deduction at source or TDS.

c) This is an unnecessary burden on both taxpayer and the tax administrator, because collection of tax will take place as TDS from the lessor without much delay.

2. Rent includes service charges

a) Service charges payable to business centres are covered under the definition of rent, as they cover payments by whatever named called.

3. TDS requirement where building and furniture, etc., let out by separate persons

a) In case where building is let out by one person, and furniture, fixtures, etc., are let out by another person, then the payee is required to deduct tax under Section 194-I only from the rent paid/credited for the hire of building.

4. TDS requirement where rent not payable on monthly basis

a) Section 194-I does not mandate that the tax deduction should be made on month-to-month basis.

b) Therefore, if the crediting of the rent is done on quarterly basis then deduction at source will have to be made on the quarterly basis only. Where the rent is paid on yearly basis deduction also will have to be made once a year on the basis of actual payment or crediting.

Thus, the Rent agreement is to be referred for knowing the periodicity when the rets to be paid.

5. Payments to hotels for holding seminars including lunch

a) Where hotels do not charge for use of premises but charge for catering/meal only, then provisions of Section 194-I would not apply. However, Section 194-C would apply for catering part.

Liablity to Deduct TDS u/s. 194-I

a) The person (not being an Individual or HUF) who is responsible for paying any income to resident by way of rent is liable to deduct tax at source.

b) As per Budget 2017,individual/HUF (not covered under Tax Audit) paying rent to a resident exceeding ` 50,000 per month are also liable to deduct TDS @ 5%.This amendment will be effective from 01.06.2017.

c) In case the aggregate of the amount of such income credited or paid or likely to be credited or paid during the financial year by the aforesaid person to the account of, or to payee exceeds ` 1,80,000/-.

d) Tax is required to be deducted at source at the time of credit of 'income by way of rent' to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier.

Rate of TDS

Sr. No	Nature of Payment	Rates of tax deduction
1	Rent of plant and machinery	2%
2	Rent of land or building or furniture or fitting	10% (5% if rent exceeding ` 50,000 / month is paid by individual/ HUF who are not liable for tax audit)

TDS IN SOME CONDITIONS

a) **Security Deposits** – If deposit is refundable at the time of vacating the premises then TDS is not required to be deducted. If it is non-refundable then TDS is required to be deducted. If the deposit carries interest, TDS is required to be deducted under section 194A from such interest.

b) **No tax deduction if payee is Government/ Local authorities** – Tax is not required to be deducted if the rent is to be paid to Government. Also TDS is not required to be deduct if rent is paid to statutory/local authorities if it satisfied conditions of Circular No. 699, 30th Jan.,1995.

OTHER POINTS

1. No surcharge is applicable except where rent is payable to a foreign company and the amount exceeds ` 1 crore.

2. No Education Cess is to be levied on TDS on rent.

3. If the receiver of rent does not furnish his PAN to the tenant then TDS is required to be deducted @ 20%.

4. If the municipal taxes, ground rent etc. are borne by the tenant, no tax would be deducted on such amount.

5. **If there are co-owners in the rented property then limit of ` 1,80,000 will be calculated separately for each co-owner.**

Section 194J – TDS on Professional or Technical Fees

Any person (other than individual or HUF who is not liable to audit under section 44AB) who is responsible for paying to a resident

1. Fees for professional services

2. Fees for technical services

3. Royalty

4. Any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192 to a director of a company

5. Non-Compete fees as referred under section 28(va)

It is to be noted that if professional or technical services is provides by an employee to his employer then such amount is not covered under Section 194J but covered under section 192 i.e. TDS on salary.

RATE OF TDS

a) TDS is to be deducted under this section at the **rate of 10%.** If the recipient of income doesn't furnish his PAN to deductor then TDS is to be deducted @ 20%. No surcharge, education cess or SHEC shall be added to the mentioned rates. Also TDS is to be deducted on fees excluding the GST component.

b) **From 1st June 2017** TDS is to be deducted at the **rate of 2%** where the payee is engaged only in business of operation of **call centre.**

c) Tax is to be deducted at the time of credit of such income to the account of the payee or at the time of payment whichever is earlier.

TDS NOT REQUIRED TO BE DEDUCTED IN FOLLOWING CASES

1. If payment is made by an Individual or HUF exclusively for personal purposes, then tax is not required to be deducted.
2. **Assessee** can apply to Assessing Officer for no TDS or TDS at lower rate under Section 197.
3. No tax is required to be deducted where the amount of such sum or the aggregate of the amounts of such sums credited or paid or likely to be paid or credited during the financial year does not exceed
   a) 30,000 in case of fees for professional services or
   b) 30,000 in case of fees for technical services or
   c) 30,000 in case of royalty or
   d) 30,000 in case of sum referred under section 28(va)

The amounts are calculated for each of the above categories separately.

MEANING OF PROFESSIONAL SERVICES COVERED UNDER SECTION 194J

Professional services means services which are notified by the board under section 44AA and sports person, coaches and trainers, event manager, anchors, film artists.

These also include

- Accounting Charges
- Advocate/Lawyers/Legal Fees
- Audit Fees

MEANING OF TECHNICAL SERVICES COVERED UNDER SECTION 194J

Technical services mean any consideration for rendering services of managerial, technical, consultancy nature. But does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head Salaries.

TDS ON CERTAIN PAYMENT TO DIRECTOR COVERED UNDER SECTION 194J

The payment of remuneration to whole time director or managing director will be considered as salary under section 192 and thus liable for TDS under this section.

While payment of sitting fees, fees for attending meetings etc. paid to any director (whether whole time director/managing director or any other director) is considered as payment of professional fees under section 194J. TDS is required to be deducted at the rate of 10% and no threshold limit of ` 30,000 applies to this. Therefore even if the payment is less than ` 30,000 TDS is required to be deducted.

SUMS REFERRED TO IN SECTION 28

1. As per Clause (va) of Section 28 (added by the Taxation Amendment Act w.e.f. 13-07-2006), any amount, whether received or receivable, in cash or in kind shall be taxable under the head PGBP, if such payment is under an agreement for:–
   a) Not carrying out any activity in relation to any business; or
   b) Not sharing any know-how, patent, copyright, trademark, licence, franchise etc.

   This payment is also termed as **Non-Compete fees** in general business terms.
2. **Royalty** for the purpose of this section means consideration for:
   a) Transfer of rights with respect to an invention, secret formula, model, design, trade mark or a patent.
   b) Use of an invention, model, patent, etc.
   c) Sharing any information related to use of an invention, patent, formula, etc.
   d) Use or right to use equipment for industrial, scientific or commercial purposes.
   e) Transfer of rights related to literary work, scientific findings, films or video tapes for the purpose of radio broadcasting,

no consideration for sale, exhibition or distribution of the same.

3. **Specific Cases**

TDS deduction is also applicable under Section 194J on certain specific cases, decided by the case laws and circulars of the department:

a) Medical services rendered in hospitals.

b) Professional fees charged by film artists from advertising agencies.

c) Amount given to recruitment agencies and HR Consultancy.

d) Payment made by companies to share Registrars.

TDS ON REIMBURSEMENT OF EXPENSES

a) TDS is also to be deducted on the amount of reimbursement of expenses if such amount is mentioned in the same bill in which professional or technical fees is mentioned.

b) If a separate bill is raised for such expenses then no TDS is required to be deducted on such amount.

Circular No. 715 dated 8th Aug 1995 and ITO vs. Dr.Willmar Schwabe India (P) Ltd. [2005]

Section 195 – TDS on payment to non-resident

PERSONS RESPONSIBLE FOR DEDUCTING TDS

a) Any person responsible for paying to a non-resident, not being a company or to a foreign company, any interest (other than under sections 194LB,194LC or 194LD) or any sum chargeable to tax other than salary.

b) If the payment made is in the nature of salary then TDS to be deducted under section 192 and not under this section.

However if interest is payable by the Government or public sector bank or a public financial institution deduction of tax shall be made only at the time of payment.

RATE OF TDS

There is no threshold limit. It means that tax is required to be deducted irrespective of amount of payment.

The rate of TDS is the rates which is in force under chapter. Incase payee not having valid PAN, then TDS rate as per rate prescribed Chapter XVIIB or 20% whichever is higher will apply. However DTAA provisions are also to be considered. If there is Double Tax Avoidance Agreement (DTAA) between India and country of residence of payee then such provisions will apply.

TDS amount is to be increased by surcharge if the payment is made to a foreign company exceeding ` 1 crore. EC and SHEC are to be added to the amount of TDS in case payment is made to a non-resident or a foreign company.

Assessee can apply to Assessing Officer for no TDS or TDS at lower rate under section 197.

Interest earned on NRO Savings Account / NRO Fixed Deposit is subject to Tax deduction at source w.e.f. Aug 09, applicable TDS rates are:

Interest on Deposit	Tax Rate	Surcharge	Education Cess	Total
NRO	30%	-	3%	30.90%

As per section 206AA introduced by Finance (No. 2) Act, 2009 w.e.f. 01.04.2010, every person who receives income on which TDS is deductible shall furnish his PAN Number to the deductor, failing which TDS shall be deducted at the maximum marginal rate or 30.90% whichever is higher.

The interest on NRO Accounts/Deposits transactions would be covered by the said rule.

ADDITIONAL POINTS

1. **TDS ON SERVICE TAX AND TDS ON GST**

a) Since Service tax and GST were both applicable during the previous financial year 2017-18 we would come across both these components for the before 1st July, 2017 and post 1st July, 2017.

b) As per **circular No 1/2014 (issued by CBDT) TDS** had to be deducted on the amount paid/payable without including service tax component.

c) After GST was implemented, ***CBDT has clarified through Circular No. 23/2017 that if GST on services has been indicated separately in the invoice, then no tax would be deducted on GST component. (GST includes CGST, SGST, IGST, UTGST.)***

TDS / TCS RATES FOR F.Y.2017-18

Section	Nature of Payment	Threshold Limit of Payment		01-04-2017 to 31-05-2017	01-06-2017 onwards
192	**Income from Salary**	**Senior Citizen (60 Years)**	**` 3,00,000**	**Average rate of Tax + Education Cess (Surcharge if Salary > 50 Lakh)**	**Average rate of Tax + Education Cess (Surcharge if Salary > 50 Lakh)**
		Super Senior Citizen (80 Years)	**` 5,00,000**		
		Others	**` 2,50,000**		
192A	Premature Withdrawal from EPF (wef 01.06.2015) (*If PAN not furnished Rate of TDS at Maximum Mariginal Rate of 34.608%)	` 50,000		10%	10%
193	* Interest on Securities	` 5,000		10%	10%
194A	**Interest from a Banking Company**	**` 10,000 per annum**		**10%**	**10%**
194A	***Interest other than from a Banking Company***	***` 5,000 per annum***		***10%***	*10%*
194B	Winning from Lotteries & Cross Word Puzzles	` 10,000 per annum		30%	30%
194C	Transporters with valid PAN & to whom 44AE applicable	-		0%	0%
194C	**Payment to Contractors; Sub-Contractor; Advertising Contractors (including other transporters)**	**` 30,000 per contract (or)** **` 1,00,000 per annum**		**Individual / HUF 1%** **Others 2%**	**Individual / HUF** **1% Others 2%**
194D	Insurance Commision	` 15,000		Resident:5% Domestic Company:10%	Resident:5% Domestic Company:10%
194DA	Payment under life insurance policy (including Bonus)	` 99,999 per annum		1%	1%
194E	Non-resident Sportman or Sports Association	—		20%	20%

Section	Nature of Payment	Threshold Limit of Payment	01-04-2017 to 31-05-2017	01-06-2017 onwards
194EE	Out of deposit under NSS	` 2,499	Individual or HUF 10% Other NA	Individual or HUF 10% Other NA
194G	Commission on Sale of Lottery Tickets	` 15,000	5%	5%
194H	*****Commission/ Brokerage***	***` 15,000 per annum***	***5%***	***5%***
194-I	*****Rent on Plant / Machinery***	***` 1,80,000 per annum***	***2%***	***2%***
194-I	*****Land or building or furniture or fitting***	***` 1,80,000 per annum***	***10%***	***10%***
194-IA	Payment or transfer of Non -agricultural immovable property	` 50,00,000 & above	1%	1%
194-IB	Rent payable by an individual or HUF not covered u/s. 194-I	` 50,000 per month	-	5%
194J	**Fees for Professional / Technical Services**	**` 30,000 per annum**	**10%**	**2% (For Call Centre) 10% (For Others)**
194LA	Compulsory Acquisition of immovable Property	` 2,50,000	10%	10%

*** Only for Debenture in which the public are substantially interested**

**** Other than Individual or HUF except those covered u/s. 44AB**

Notes

1. Surcharges & Education Cess

Type of Payment	Surcharge	Rate	Education Cess (3.00%)
Salary (Resident & Non-resident)	Up to 50 Lakhs	Nil	Yes
	50 Lakhs to 1 Crore	10%	
Salary (Resident & Non-resident)	> 1 crore	15%	Yes
Other Payments to Residents	No	Nil	No
Other Payments to Non-Residents			
Payment to Non-Residents (other than Cos)	Upto 1 crore	Nil	Yes
	> 1 crore	10%	
Payments to Foreign Co.	Upto 1 crore	Nil	Yes
	> 1 crore	2%	
	> 10 crore	5%	

INTEREST ON DELAY IN DEPOSIT OF TAX AFTER DEDUCTION

Stage of deduction	Rate per month or part of the month
From date when deductible till actual deduction	1.00%
From date of deduction till payment	1.50%

TDS RATES FOR NON-RESIDENTS U/S. 195 OF INCOME-TAX ACT, 1961

	Nature of Payment	Co.	Others
1.	Long Term Capital Gains u/s. 115E	NA	10%
2.	Other Long Term Capital Gains (excluding u/ss 10(33), 10(36) & 10(38))	20%	20%
3.	Short Term Capital Gains u/s. 111A	15%	15%
4.	Investment income from Foreign Exchange Assets	NA	20%
5.	Interest payable on moneys borrowed or debt incurred in Foreign Currency	20%	20%
6.	Royalty & Fees for technical services u/s. 115A		
	- Agreement 1st June, 1997 to 31st May, 2005	20%	20%
	- Agreement on or after 1st June, 2005	10%	10%
7.	Winnings from Lotteries, Crossword Puzzles and Horse Races	30%	30%
8.	**Any Other Income**	**40%**	**30%**

SURCHARGE & EDUCATION CESS

Type of Payment	Surcharge	Rate	Education Cess (3.00%)
Payment to Non-Residents (other than Cos)	Upto 1 crore	Nil	Yes
	> 1 crore	15%	
Payments to Foreign Co.	Upto 1 crore	Nil	Yes
	> 1 crore	2%	
	> 10 crore	5%	

INTEREST ON DELAY IN DEPOSIT OF TAX AFTER DEDUCTION

Stage of deduction	Up to 30th June, 2010 (Rate per month or part of the month)	From 1st July, 2010 (Rate per month or part of the month)
From date when deductible till actual deduction	1%	1%
From date of deduction till payment	1%	1.5%

Audit Documentation in Bank Branch Audit (Including Tax Audit)

CA. Pankaj Tiwari

- **Role of audit documentation in general audit [SA-230]**
  - The Standard on Auditing(SA)-230 deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. These audit documentation provides an evidence of the auditor's basis for a conclusion and also provides an evidence that the audit was planned and performed in accordance with SA's.
  - The audit documentation serves a number of additional purposes including the following:
    - Assisting the engagement team to plan and perform the audit
    - Enabling the engagement team to be accountable for its work
    - Retaining a record of matters of continuing significance to future audits
    - Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements
  - In the recent year, the Quality Review Board (QRB) has issued various reports on its finding with regards to the compliance of technical standards (Accounting Standard, Standard on Auditing etc.) after review of the audit documentation/ audit working papers of several audit firms. The report *inter alia* includes several critical observations with respect to the compliance of audit documentation. These observations are discussed in the later part of the paper.

- **Role of audit documentation in Bank Branch Audit (BBA)**
  - The importance of the audit documentation become more significant in the Bank Branch Audit due to the onerous responsibility on the branch auditor. The branch auditor is expected to complete the audit of any size of the branch in the maximum seven days. This creates lot of challenges on the part of the branch auditor to complete the statutory audit along with the audit documentation.
  - The documentation of the audit work done by the branch auditor also becomes more important as the Statutory Central Auditors' (SCA's) place heavy reliance on the work done by the bank branch auditor (BBA).
  - The documentation of work done in bank audit is very important considering as the same is open to the inspection by quality review board, peer review and other regulators.
  - In the recent year, the quality review board has reported certain observation specifically relating to bank audit such as:
    - *Working for Provision of NPA's are not available in respect of the branches allocated to the firm;*
    - *Computation of NPA for the Bank was not documented and without adequate documentation it was not clear how the assets were identified as standard or otherwise.*
    - *Long Form Audit Reports annexures were not linked to work papers wherever possible.*

- *In LFAR, there were unreconciled differences, wherein it was stated that pending final clearance the overall impact on the account in the opinion of the management of the company will not be material/ significant. However, how this assertion was validated/evaluated by the firm was not documented.*

- *In respect of classification of NPA on receivables, the Audit Firm did not have in their file, the veracity of the classification of NPAs.*

▪ The above observation raised a significant doubt on the work performed by the Bank Branch Auditor/ Statutory Central Auditor. These types of the observation also raise lot of concern on the quality of the audit work and its impact on the reliance placed by the other auditors.

• **Key areas of documentation in Bank Branch Audit**

In the bank branch audit there are several areas where the auditor need to prepare audit documentation, however following are the key areas where the auditor should prepare the audit documentation with more diligence:

a. Documentation for appointment formality & planning

- It has been observed in various review reports that there is lack of audit documentation as far as planning of any audit is considered. It has also been seen that the auditor does not keep proper documentation with respect to the appointment formality.

- Like for e.g., in case of a new appointment the branch auditor should obtain the No-Objection Certificate from the previous auditor. The branch auditor should also ensure that the Code of Ethics are complied with before commencing the audit assignment.

- Generally, the appointment letter from the banks comes at very last minute and the auditor should take utmost care in completing the appointment formalities to avoid any non-compliance or any lapses in the same.

- The list of minimum documents to be kept in the audit file is separately given in Annexure to this paper.

b. Documentation while doing verification of advances

- This is one of the most significant areas of bank audit and takes approximately 50% of the total time spent in the audit. This process starts with selection of the samples to verify the sanctioning and disbursement process of the advances and completes with the reporting on large advances in the LFAR.

- The documentation in this stage requires the auditor to include all the steps performed at various stages. The auditor should start documenting the sample selection process or the key points kept in mind while selecting the sample for verification of documents.

- In documenting the sample selection process the auditor should also include whether he/ she has selected certain sample based on comments made in the Inspection Report, Concurrent Reports etc.

- The auditor should prepare a comprehensive checklist which covers the requirement for various type of facilities sanctioned and disbursed by the bank. This checklist should also include the various regulatory parameters prescribed by the RBI like for e.g. while verifying whether the housing loans are permitted within the prescribed LTV ratio, the audit team should also mention the actual ratio as well rather than stating Yes or No. The above checklist should be based on the latest guidelines issued by the RBI as well as based on their internal credit instructions.

- The auditor should ensure that the above comprehensive checklist should be containing more about the characteristics tested during the audit instead of reply in the form of Yes or No. Since the SA-230 requires identifying the characteristics of specific items tested so as to identify any inconsistencies or deviations. Like for e.g.:

Audit Process	Auditor's Reply	SA-230 requirement
Whether the loan has been sanctioned by an appropriate sanction authority?	~~Yes~~	Yes, by Mr. Satish Singh (AGM-Credit) on 11th September, 2017

- The auditor should also include their specific observation on these sample selected for verification along with the management responses. Post receipt of the replies from the branches, it is advisable for the auditor to include its concluding remark on these observations. The remarks should clearly state that whether these replies are to the satisfaction of the auditor or being taken to branch audit report or LFAR.

- The observation under the checklist should be linked to the comments in the LFAR wherever possible.

c. **Documentation while verifying IRAC Norm (Non-Performing Assets)**

- This is second most critical area any bank branch audit wherein the auditor spends at least 30% of the total time. The audit process at this stage again involves sample selection and specific testing based on the auditor judgment. Like for e.g., an auditor may do 100% verification of all the Non-Performing Accounts more than ` 5 crore and do a test check verification for all the loans below such threshold limit.

- The auditor should also prepare a complete working for the NPA computation. In all the Public Sector Bank (PSB) an auditor is expected to certify various annexure on Non-Performing Assets (NPA). While certifying these annexures the auditor should ensure that the figures reported in these annexures are reconciling with the working prepared by the team.

- The auditor should also include details of Valuation Reports, Financial Statements etc., considered while computing the NPA Provision. The auditor may take the photocopies or the scan copies of these reports for the future reference.

- The auditor may sometime apply his/her professional judgement either in identifying an account as NPA or in evaluating the adequacy of the provision. The auditor should adequately document these judgments and prepare a proper note for the same. The auditor also obtain specific representation required from the Branch Management on any of these issues.

- In certain cases, the auditor may identify an account as NPA or suggest certain additional provisioning on the advances. The auditor should prepare a proper working for the same and keep this in the audit record.

- The auditor should document the discussion with the branch manager on the NPA accounts more particularly on high value advances.
- In many of these PSB's the identification and provisioning on the NPA's are through system, as per of the documentation the auditor is advised to compute the date of NPA based on the IRAC Norms and compare the same with the system date. The auditor should also keep the relevant system screen shot whenever necessary keeping the client confidentiality in mind.

d. Documentation for other areas of audit & Certification of Annexures

- The audit of advances and the non-performing assets are the core areas of the audit in the bank branch audit. However, the auditor is also expected to audit the other areas of the bank to certify the true and fair view on the whole financial statement.
- The auditor should obtain adequate audit evidence for the other areas as well like for e.g. Cash Balance certificate along with Cash Balance Register, ATM balance, Fixed Asset verification reports etc.
- The auditor should also carry out the scrutiny of the Balance Sheet and Profit & Loss account to see any unusual item or any unusual trends. The auditor should direct its team member to carry out the variance analysis of the significant items of financial statement and should document the reason for the same. The auditor should also document the reason for any significant variation and should assess whether the same need to be brought to the attention of the bank's management.
- In most of the PSB's, the auditor has to certify various annexures pertaining to different areas such as Priority Sector Advances, Sensitive Sector Advances etc. Some of these annexures are directly relied upon by the Statutory Central Auditor (SCA's) at the time of issuing the consolidated certificate or for other provisioning purpose. The branch auditor should ensure that these annexures/ certificates issued by the auditor are properly supported with the documentary evidences. The auditor should carry out the audit of Priority Sector advances/ Sensitive sector advances on test check basis to check the correct classification of these advances.
- In certain cases, the branch auditor is required to issue certain certificate for certain benefits where there is a possibility that due to lapses on the part of the bank the ineligible customer may have received certain benefits. Like for e.g., Interest Subvention claims to the farmers, the auditor should ensure that he/she has obtained appropriate documents to certify these certificate which at later stage may be subject to scrutiny by the Reserve Bank of India or any other Regulator.

e. Documentation for Auditor's Report, LFAR & MOC's

- This is also one of the critical stage of the bank audit wherein the auditor finally concludes on all the points and issues a final report on the financial statement of the bank.
- The auditor should prepare a complete list of all the issues identified during the course of

the audit across all the areas at the Branch. The auditor should incorporate the replies received from the branch management on each of these points.

- The auditor should include his/her conclusion on each of these points so as to indicate whether he/she is satisfied with the reply from the branch management or the issue need to be included in the auditor's report or the same will be reported in the LFAR.

- The above Master Sheet will help the auditor to have a complete control on all the points/observation raised and the way the same have been concluded. The format of the master sheet can be as follows:

Query No.	Area of Operation	Observation of BBA	Branch Reply	Conclusion	Reference point in LFAR/AR

- The branch auditor is also required to issue a Long Form Audit Report (LFAR), wherein the auditor is required to state many factual information like for e.g. Cash Retention Limit etc. It has been observed that the Branch Auditors do not keep the supporting documents for these comments in the LFAR. Hence it is advisable to the branch auditor to prepare a complete set of audit documentation for the LFAR.

- The auditor is also required to comment upon the advances beyond a certain threshold limit. These annexures are normally prepared by the bank's management; the auditor is required to give his/her comments. The auditor should keep the appropriate audit evidences for these comments and should also keep the supporting evidences for the same.

- In the PSB branch audit, the audit adjustment entries are passed through Memorandum of Changes (MOC's) wherein the auditor need to suggest the changes like for e.g., Classifying an Account as NPA, Additional Provisioning on NPA Accounts, correction in the returns etc. These MOC's are normally dealt at Regional/Zonal office level.

- The auditors should keep all the appropriate documents/ relevant supporting for each MOC's suggested at the Branch. Like for e.g., if the MOC suggest classifying an account as NPA, the auditor should clearly document the reasons for the same. These evidences will be helpful to the auditor in replying any query either from the Head office/Regional office or by SCA's at later stage.

- During the course of verification of security documents, the auditor may have observed that the security values are not appropriately accounted which require certain additional provisioning. It has been observed that the auditor suggests the MOC's for the same however fails to produce any proper working paper or supporting document for these additional provisioning.

f. Documentation for Tax Audit u/s. 44AB

- As part of the bank branch audit, the auditor is also required to carry tax audit u/s. 44AB of Income-tax Act,1961. The format of the tax audit report and the relevant annexures are provided by the Head office to these branches.

- Out of the various clauses as per Form 3CD report, there are only

5 to 6 clauses are required to be audited at the bank branch level. Like for e.g. reporting u/s 40A(2)(b) under clause 23, CENVAT Credit details under clause 27 are not applicable at the bank branch audit.

- The auditor should clearly identify the areas/ clauses which need to be verified at the branch audit level and the auditor should prepare its audit documentation for those areas. The clauses which are not applicable to the bank branch, the auditor should include its remarks against each of these clauses.
- One of the important clauses to be verified at the bank branch level is clause 34 pertaining to compliance of TDS provisions. The auditor should prepare its own work paper to certified the information reported under this clause.
- In cases where in the opinion of the auditor, the branch management has not complied with the TDS provision the auditor should keep relevant necessary documents as part of it working paper.

g. Conclusion

- The audit documentation for any audit is incomplete without obtaining the management representation letter. The branch auditor should obtain specific representation on the matters identified during the course of the audit. It has been observed that sometime the branch auditor does not obtain management representation at all or sometime obtain the representation on the matter which is significant audit area.
- The audit documentation is said to be the insurance paper for the audit firm and should be prepared with more diligence and care. The auditor should prepare these documentations on timely basis preferably during the course of the audit rather than after the end of the audit.
- At the end it is very famous saying which goes as follows:

> ***"The skills of an accountant can always be ascertained by an inspection of his working paper."***
>
> **Robert H. Montgomery**

Wish you all a very Happy Season of Branch Auditing!!!!!!!!!!!!

Illustrative List of minimum required documents in Bank Branch Audit file

Stage of Audit		Minimum documents for Audit Documentation	Yes/No
(A)	**Appointment formality & Planning**	— Appointment letter from bank — Reply to appointment letter — NOC received from previous auditor — Partner/Proprietor declaration submitted to bank — Audit programme indicating the areas Allocated [Bank Branch Audit Programme in the GN on Bank Audit Can Be Considered as base] — Details of Team Member indicating the experience [to reflect the proper mix of Junior and Senior Staff] — Agenda of Meeting with Branch Manager and Minutes of Meeting with the Manager	
(B)	**Verification of Advances:**	— Loan book as on Cut-off Date along with List of New files sanctioned — Sample Selection work paper [indicating the various parameter adopted for selecting the samples] — Comprehensive Checklist of Verification of Advances — Issue Memorandum- Advances shared with Branch Manager	
(C)	**Verification of Non-Performing Assets**	— List of NPA Accounts as on Cut-off date — Sample Selection work paper [indicating the various parameter adopted for selecting the samples] — NPA Provision Work paper — List of Diversion observed and List of Cases with inadequate Provision — Issue Memorandum- Advances shared with Branch Manager	
(D)	Other Areas of Audit & Certification of Annexures	— Cash Balance/ ATM Balance/ Bank Balance with Other Bank certificates — Analytical Review of major items of Balance Sheet and Profit & Loss Account — Work paper listing Various Annexures/Certificates issued along with the work done and nature of audit evidences obtained against each of these certificates — Fixed Asset Verification Report — Issue Memorandum- Other Areas shared with Branch Manager	
(E)	Auditors' Report, LFAR & MOC's	— Master Sheet for all the query/observation raised in Branch Audit — Audit Evidences for the information/facts stated in LFAR — List of MOC's suggested at the Branch along with Supporting working/documentary evidences	
(F)	Tax Audit u/s 44AB	— Working Paper/documentary evidence for verification of various clauses in Tax Audit report — Audit Evidence/documents supporting the comments made in the Tax Audit Report — List of Clauses not applicable/applicable at Head Office along with auditor's comments.	
(G)	Final Annexures and Other Reports	— Final Signed Copy of the Financial Statement along with Auditors' Report — Signed copies of various annexures and certificates — Management Representation Letter	

Practical Guide for Statutory Bank Branch Audit for the First Timers

CA. Shilpa Shinagare

Steps before Commencing the Audit

- The acceptance to be conveyed along with all the documents and undertakings called for by the bank only after intimating the previous Statutory Auditors and seeking their NOC on E-mail followed by the hard copy.
- RBI master circular on IRAC norms to be read and kept handy–hard as well as soft copies.
- Bank's branch closing circular copy to be taken on record and needs to be studied thoroughly.
- WIRC statutory bank branch audit booklet along with Guidance note needs to be read and kept handy.
- Finacle Option Menu list needs be kept handy.
- E-mail ID and Contact Nos. of branch officials, MEF expert panel to be kept handy.
- Work allocation sheet to be prepared as per the practical exposure of the audit staff.
- Enough stationery like note pads, green Ink pens, pencils, erasers, calulators, laptop, charger, working paper file, seal, stamp pad etc. to be carried.
- The appointment letters, consent letters with other documents and correspondence to be carried in a separate file
- The list of initial requirements like various audit report files, registers, finacle reports etc. needs to be e-mailed before hand to the branch so that on the day of visit to the branch the requirements would be ready and time can be saved in collecting the requirements on day 1.
- Ask for designated minimum 2 computers with audit login before starting the audit itself. This should be one of the requirements while calling for various reports and files.

Steps on the First Day at the Branch

- Spend some time on Day 1 to interact with the branch head on the business mix, thrust area of advances, major advances i.e., Advances over ` 5 Crore and ` 1 Crore etc. Various audits conducted during the audit period, the audit ratings, staff strength, concurrent audit applicable or not, control over long outstanding entries in suspense and sundry, Govt. business if any handled by the Branch, On site ATM if any, lockers if any, Trainings undergone by the staff, Any major thing which as a branch head he would like to discuss, fraud if any reported during the year in the branch etc. This will give you grip and feel of the branch.
- Get yourself introduced to the staff so that co-ordination and authority can be established which is must for the smooth and speedy conduct of the statutory audit.
- Go through the quarter end closing circular, internal audit report, concurrent audit reports, system audit report, RBI report, revenue audit Reports and previous Statutory Audit Reports and jot down the observations which you also need to comment upon or needs to be enquired w.r.t. LFAR etc.
- Migration audit file to be enquired into if the branch has been migrated to CBS platform during the audit period.

Steps for audit of Advances and NPA related matters

- The entire GL with sub-heads can be asked to be converted into Excel with opening and closing balances and transactions during the year. This will give you accounts where balances are constant and needs to be enquired into. This is Trial Balance scrutiny.
- Last year MOCs and its effect in books subsequent to completion of audit whether

given or not to be seen along with copy for our record

- Potential NPA or mock run report for last 3 months needs to be called for.
- The asset classification wise and facility wise advance portfolio converted in excel along with security Value and date of identification of NPA is to be asked for. The entire IRAC norms exercise will be easy if this excel sheet is analysed using Excel Tools. Major work is reduced and you will find errors like No security value entered or same primary or collateral value is entered or collateral is there but primary value is not entered etc., which can be enquired into. The whole provision is based on security value so ensuring this is very important.
- Quarter to quarter movement of NPA with NPA as of 31st March of previous year to be compared. This will give you link to advances which are upgraded or restructured or written off during the audit period.
- Then call for NPA movement statement sent to controlling offices on monthly basis and scrutinise them as well for the recoveries etc.
- Excel sheets for valuation not done or overdue for more than 3 years, pending stock statements for more than 6 months, expired insurance policies, pending stock audits , accounts pending for review/renewal beyond 6 months. These are the Technical reasons for which advance needs to be classified as NPA. Hence go through the concurrent audit or CCIS reports or system generated MIS reports from Finacle.
- Debit balances in SB/CA and CC Accounts report and TOD/TOL daily reports to be scrutinised.
- Exception report for last 3 months to be reviewed without fail since these reports capture the unusual transactions and the details like accounts pending for review, overdue instalments etc.
- CC accounts to be verified for interest debits and total credits for the end of the quarter. This is one of the reasons for identifying and classifying NPA in sticky or problematic accounts This exercise can be correlated with the accounts getting NPA for the technical reason as well.
- Incase of CC accounts, cash deposits at the year end or transfers from other accounts on last day and Re-transfer on the next day during the last quarter under review are generally accommodation entry to bring those accounts out of NPA classification and hence needs to be enquired into.
- CC accounts with no credits in the accounts for the last quarter also needs to be classified as NPA so check that.
- Term loans to be scruitinised with repayment options and by exploring (i.e., cntrlt E) in repayment option to see interest and principal outstanding. The loans overdue report generated from Finacle MIS reports or exception reports if capturing these overdue instalment entries or CCIS report if capturing this overdue instalment/Interest needs to be verified. LAOPI option can be used to get the interest and principal break up for the same.
- Gold loans to be physically verified randomly for availability of security and the documentation to be verified as per the bank's internal circular.
- Loan or OD against third party TDR to be specifically verified.
- Documents related to frauds if any reported during the audit period to be gone through.
- Physical verification of primary and collateral security as per the valuation reports or documents to be done by the staff without fail for the accounts identified by Excel Tools especially.
- Time barred documents where no Acknowledgment of Debt (AOD) or Debit Balance Confirmation (DBC) document is obtained also needs to be commented upon.
- NPA sets to be signed by the statutory Auditor first needs to be checked wrt. opening balances as on 1st April of the audit period.

The audited gross and net NPA fig as of 31st March of previous year should be the opening balance as of 1st of April of the audit period.

- Bank Guarantees and LCs devolved if any etc. to be verified. Bank Guarantees and LCs issued, LOUs issued, corresponding liability vouchers passed for the same in CBS or not w.r.t. SWIFT messages transmitted/originated from SWIFT directly.
- Major advances sanctioned during the year to be verified and commented upon.

Steps for audit related to Cash and housekeeping matters

- Verification of Cash and ATM Cash for on-site ATM to be done
- ATM reconciliation and Inter bank and branch reconciliation files to be seen. The remarks from the concurrent and internal audit files can be noted and enquired regarding this.
- Cash retention limit and cash insurance policy details needs to be called for.
- Physical verification of sensitive stationery needs to be done by the staff from the ISRA i.e., Inventory Status Report generated from Finacle. The double lock and employee Location inventory stock should be matched and cross tallied.
- Furniture and Fixed Assets statement to be scritinised and additions and deletions or inter branch or inter unit transfers to be enquired and verified with the indents and delivery challans. This is important to ensure since the depreciation would be charged on these items in HO books.
- Statutory payments related to staff to be verified since there is a certification to that effect.
- Account Opening forms ESP Current Accounts opened and closed within a short span to be randomly verified.
- RTGS and NEFT report generated from MIS reports to be scrutinized and enquired into for regular transfers and end use of funds.
- Suspense and sundry ledgers to be scrutinised for long outstanding entries and entries having impact on assets of the branch. The jotting report or balancing report can be generated for the long outstanding entries and the same needs to be verified from the previous quarterly closing returns as well. MSGOIRP option is used to generate the date wise outstanding report mostly.
- Interest subvention scheme heads to be verified since there is a certification to that effect.
- ECGC premium paid or pending ledger and reports to be verified since there is a certification to that effect.
- Claims acknowledged as debts and pending are to be verified since there is a certification to that effect.
- CTR and STR reports, soft and hard copies to be seen and confirmed prior to the submission to the controlling offices.
- Overdue term deposits figures to be compared with the previous year and noted down.
- Other items related to housekeeping issues and LFAR to be verified.

Steps for audit related to Profit and Loss Account & Balance Sheet

- Trend analysis or comparative analysis of income and expenses in the profit and loss accounts needs to be done and the deviations if any to be enquired into and commented upon.
- Closing provisions wrt. expenses and prepaid expenses whether booked or not to be verified. Reversal of provisions and prepaid expenses also needs to be ensured.
- TDS ledgers to be scrutinised and expenses to be identified where TDS is not deducted by the branch or deducted but not deposited or deducted but late deposited since tax audit report will cover all these points.
- Window Dressing w.r.t. deposits and advances to be analysed on various dates like 31.3.2017, 1.4.7, 8.4.17, 31.3.18,1.4.18, 8.4.18. Trend

analysis to be seen w.r.t. deposits, Advances and NPAs.

- The reasons for the sudden spurt or reduction in the advances or deposits to be enquired into and commented upon.

Steps for compiling the Main Report & LFAR etc.

- Take previous year statutory audit report with LFAR and ask the staff at office to compile the old details, send the observations on daily basis to them to make changes or if the audit staff does it online at the branch itself will save time in submission of audit report and LFAR.
- Review the entire work, discuss the observations online with the branch staff and the branch head.
- Training to staff, Co-ordination within audit team, ongoing discussions with seniors in the team, collecting audit working papers and documentary evidences, taking management written representations in the standard format provided along with our own issues observed, taking TDS certificate from the branch officials etc., before signing the reports and statements is must.
- If required the issues can be discussed with the central statutory auditor for the Zone.
- Overlapping of the work to be strictly avoided.
- The date of visits by the partners and staff along with travelling and conveyance proofs to be recorded and preserved to claim the re-imbursements at the time of raising bill.
- The attendance certificate to be obtained duly signed and sealed by the branch head. This is required as a supporting for the claim reimbursements.

This practical guide is for the branches not having Forex and Treasury Operations. The list is endless but have tried to consolidate few important practical things for you all. Let's do the quality audit in the given deadline with proper audit planning and knowledge about certification work.

■■■

Check List: UCB Bank Branch Audit

CA Sunil Nagaonkar

- Members Registers in Form "I" & Statement in Forms "J1" & "J2" needs to be verified with respect to subscription paid by the members (whether fully or partly), nomination made, application is submitted in all respects, shares certificate issued, share transfer transaction etc.
- Verify whether there is any debit in any reserves account. (except education fund there should not be any debit in any reserve account)
- Check Deposit account opening forms with respect to RBI master circular on KYC.
- Check High value transaction in newly opened accounts.
- Verify overdue fixed deposits, whether interest is being charged @ savings bank deposits for the period from maturity till end of the financial year.
- ODFD more than 10 years, whether transfer to Depositors Education & Awareness Fund to the RBI.
- Check inoperative accounts converted into active, whether the proper procedure is followed for doing so.
- Scrutinise the annual information return (AIR) submitted to FIU-IND for truthfulness.
- Verify the master data for changes in the interest rates with it's a circular from head office.
- Check all loan documents with reference to (a) terms & conditions of sanction (b) legal opinion (c) remarks in credit appraisal report.
- Check all F. D. Loan accounts and cross verify it's in respect to fixed deposit matured or paid etc.
- Verify Stock statements with limit sanctioned, drawing power, stock shown in the financial statement, insurance policy etc.
- Verify Non-performing assets (NPA) classification from Overdue statement generated from CBS.
- Written acknowledgement from borrowers needs to be taken on test basis.
- Whether Investment is properly classified into HTM (Held Till Maturity), HFT (Held For Trading) & AFS (Available For Sale) according to the RBI circular.
- Whether Depreciation on Investment is properly provided and valuation is properly made.
- Physical verification of investment needs to be made with reference to actual receipts or lodgment certificates.
- Is there any overdue or matured investment.
- Verify collection of locker rent and scrutinise the locker unoperated.
- Whether Minutes of the Board Meeting and General Meeting is properly maintained. And agenda of the meeting is sent to the board members within the time limits as prescribed in bye laws.
- Subjects of Board of Directors meeting is properly set so as to cover the guidelines given in RBI circular on calendar of reviews.
- Check whether any income head is reverse.
- Do compare the expenses & income over the previous year.
- Check bank reconciliation.
- Prepare draft report and discuss the draft report to the management.
- Peculiar features of Urban Co-op. Banks Audit.

  1 Although the auditor appointment is made in General Body Meeting, the order of audit is to be generated from Maha Sahakar web site.

2 As per section 82 of MCS Act, every auditor has to comment on the audit rectification report prepared by banks.

3 Auditors Report is to be certified in “Form N1” as prescribed by MCS Rules.

4 Section 81 casts duty on the auditor to submit Special Report and also file FIR if auditor has come to a conclusion in his audit report that any person is **guilty of any offence** relating to the accounts or any other offences, he shall file a **Specific Report** to the Registrar within a period of 15 days from the date of submission of his audit report.

If the auditor finds that there are apparent instances of **financial irregularities** resulting into losses to the society caused by any member of committee or officer of the society or any other person, then he shall prepare Special Report and submit the same to the Registrar along with his Audit Report.

5 As per rule 69(9), on the completion of Statutory audit, the auditor shall award an audit classification letter to the society whose accounts he has audited.

The auditors have to award “A”, “B”, “C” “D” classification according to the marks allotted to particular bank. (Please refer Circular on CAMELS RATING for details)

6 According to rule 69(f), Registrar shall classify the societies and the auditors into 3 categories A Class, B Class & C Class Auditors for the purpose of audit. A Class auditor can conduct audit of all classes of societies (A, B, C Class Societies), B Class auditor can conduct audit of B & C Class societies. And C Class auditor can conduct audit of only C Class societies

7 Contents of Auditor report should be in Part A, B & C.

8 Draft audit report to be discussed with the management before final report is submitted.

9 The various audit questionnaires issued by the Registrar and to be followed by the Auditors during the audit. These forms have been prescribed by the Registrar.

- Form 4 is applicable to District Central Co-op. Banks
- Form 5 is applicable to Land Development Banks
- Form 7 is applicable to Urban Co-op. Banks

• Summary of Audit Reports

The auditor is required to submit following documents being part of audit report.

- Audit Memo Form No. 1
- Form Nos. 4, 5, 7 (whichever is applicable)
- Audit Memorandum (Audit Certificate) (Rule 69(3))
- Audit Report in Part A, B & C
- Financial Statements (Rule 69(3))
- NPA Proforma
- LFAR (Long Form Audit Report)
- One Page Proforma (As prescribed by RCS)
- Annexure – 3 years information
- CRAR Statement
- Audit Classification Mark sheet

Schedules

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आमच्या असंख्य ग्राहक, सभासद,
ठेवीदार, हितचिंतक यांना गुढी पाडव्याच्या
हार्दिक शुभेच्छा !
वारणा विकासाचे जनक
संस्थापक
सहकारमहर्षी
स्व. तात्यासाहेब कोरे
''आपल्या आकांक्षाच्या क्षितीजाला
'अर्थ' देणारी सुवर्णमहोत्सवी बँक''...
वारणा बँक...
सुवर्णमहोत्सवी बँक
बँकेमार्फत देणेत येणाऱ्या सुविधा
पॅन कार्ड वितरण सुविधा
रूपे एटीएम कार्ड
एस.एम.एस. सुविधा
फ्युचर जेनेराली मार्फत जनरल इन्श्युरन्स सुविधा
एल.आय.सी. मार्फत लाईफ इन्श्युरन्स सुविधा
विविध आकाराचे लॉकर्स सुविधा
सर्व शाखा कोअर बँकींग प्रणालीद्वारे संलग्न
संपूर्ण कार्यक्षेत्र महाराष्ट्र राज्य
वारणा मोबाईल ॲप
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24/7 Account Access
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View Recent Transactions
Cheque book Request
Check Balances
आता बँकींग आपल्या बोटांवर
आकर्षक कर्ज योजना
''आपले वाहन'' कर्ज योजना
टु व्हिलर-३६ महिने करिता ९.९०%
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''आपली वास्तू'' गृह कर्ज योजना
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व्याजदर
५० लाखापर्यंत १०.५०%
५० लाख व त्याहून जास्त ९.७०%
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व्याजदर
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व्याजदर : रू. १ कोटी पर्यंत १०.५०%
रू. १ कोटी व त्याहून जास्त
१०.००%
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