

**COMMON MISTAKES IN BANK BRANCH AUDIT
&
DRAFTING OF MOC**



By:

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Topics Covered



•Appointment formalities



•Verification



•Key Security Control



Balance Sheet Review



Profit & Loss Account Review



•Advances Review



•Memorandum of Changes (MOCs)



Related to Appointment Formalities

- **NOC to Previous Auditor of the Branch** – Mail is also ok – If details of previous auditor is not given appointment letter - to contact branch / appointing authority
- **Engagement Letters to each of the branch** – Same is to be acknowledge and signed by the branch manager
- **Understanding of Closing Circular issued by HO** – Audited Reports / Certificates & unaudited reports / certificates
- **Team Composition** – To contact branch to enquire about nature of business, quantum of advance, restructured advances, NPA, NFB business etc. At least two resources should be experience in bank audits
- **Knowledge of Banking Terminology** – Particularly to team members – Difference between Performance Guarantee & Financial Guarantee
- **Audit Plan** - Separate Audit Plan for General Branch & Specialised Branch e.g. Treasury, Forex, Service Branch etc.

Presentation on Common Mistake in Bank Branch Audit & Drafting of MOCs

Related to Verification



- **Accounting Policies followed by the bank** – Available in Closing instruction to auditors or to download annual report of the bank
- **Various Audit Report** – Risk Focused Internal Audit (RFIA), Concurrent Audit Reports, Previous Year Audit Report etc.
- **Supporting Documents** - verified during the audit
- **Statement of Advances with classification and various field** – with classification along with various fields duly filled such as security, sanction limits, date of sanction / renewal, outstanding balances etc.
- **Management Representation Letter**



Key Security Control Aspects

- **Knowledge of all surround software** – which are not integrated with CBS – Trade Finance Software, Financial Statement compilation software etc.
- **Authorised, Accurate and complete data is made available**
- **Charges calculated manually** – Accounted properly in the system and authorised
- **Exceptional Report Generated** – Understating of exceptional report and its impact
- **Account Master** – Modification /Alteration other than by authorised personnel
- **Balance in General Ledger** – Tallied with the balance in subsidiary book



Balance Sheet Review

- **Macro Level Audit Checks some of the example**
 - Overdue Deposits & credit balance in CC / OD account should form part of Demand Deposit
 - Interest accrued but not due – should be classified under “other liabilities”
 - Manual test checks of interest accrued – Whether correctly calculated?
 - The unrealised income represent by FITL should have a corresponding credit in “Sundry Liabilities Account” (Interest Capitalisation)

- **Balance with Banks – BRS / Confirmation as well as long outstanding entries & necessary provision (including balance with RBI)**

- **Verification of Fixed Assets**
 - Opening balance difference – Reconciliation with separate software for fixed asset
 - Depreciation posted centralized - Calculation available at Branch

- **Sundry Assets**
 - No capital working progress is parked under sundry assets.
 - Old entries adjustments pending.

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Balance Sheet Review

- Bank Guarantee, Letter of Credit, SBLC, Letter of Undertaking & Other Off Balance sheet items
 - BG - Reversal – where claim period is expired (Through MOC only)
 - Classification – Performance & Financial Guarantee
(Incorrect classification has impact on income as well as capital adequacy)
 - Letter of credit devolved / Bank Guarantee invoked should be debited to current / cash credit account of borrower.
If parked in a separate account, IRAC norms applicable considering the same as part of CC/OD



Profit and loss account Review

- Verification of nature of each account and its classification /disclosure in Profit & Loss
- Comparison of each head of income & expenses – Identifying abnormal variance - rectification through MOCs if required
- Cost of deposit & Yield on Advances – Comparison with industry averages
- Validation of any changes in Base Rate / MCLR
 - Correct rate of interest is applied
 - Value date of change matches with date specified in HO Circular

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Profit and loss account Review

- Facility wise analysis
 - Cash Credit Account — If interest rate is sanctioned @ BR / MCLR Plus spread which is linked to the credit rating, then with the change in credit rating, interest rate has to change. Generally, interest changes which are linked to BR/MCLR, the same is being given effect in the centralised data server.
 - Housing Loan Account — Whenever there is a change in interest rate, how the EMIs are adjusted? What practice is followed by bank so that proper interest is charged
 - Agriculture Account - Advance for long duration crops, interest to be charged at annual rests



Profit and loss account Review

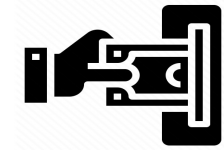
- Advance for short duration & allied activities – Due dates to be fixed considering fluidity with borrowers & harvesting / marketing season
- In case loan to project under construction -
 1. If advance is “Standard” – Accrual Basis
 2. If advance is “Sub-Standard” – Cash Basis
- Funded Interest Term Loan — Any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.
 - Interest recognised on accrual - **to ensure** that unrealised interest reversed at the year end.



Profit and loss account Review

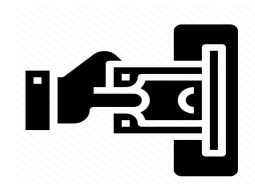
- Interest on NPA
 - Only on Realisation basis (Even in case of Govt. guaranteed accounts)
 - If interest recognised on accrual - To ensure that unrealised interest reversed at the year end
- Recovery in NPA
 - To be appropriated as per accounting policy of the bank. – Unrealised Interest → Principal outstanding → uncharged interest
- BG / LC Commission
 - Accrual basis – To amortise over the period of BG/LC
 - Some banks are still accounting the same on Cash Basis – Need to review accounting policy of the bank
 - For devolved LCs – to check system has charged interest correctly.
- Written off Accounts
 - To obtain list of written off accounts & to check that any recovery in the account is correctly accounted for at branch
 - In some of the banks, same is accounted for at Head Office

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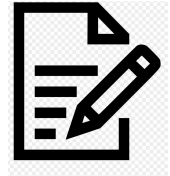
Advances Review

- Reversal of all income accrued once account slips to NPA (Including Govt. guaranteed a/c)
- Cash Credit / Overdraft – Credits during 90 days is not sufficient to cover int. charged during the same period
 - Para 2.1.3. Of Master Circular is not applicable for CC/OD (“In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.”)



Advances Review

- NPA Borrower wise & Not facility wise — Exception is when Bills discounted under LC favouring borrower
- Up gradation of NPA Accounts — Entire overdue is to be recovered & not critical amount
 - For restructured accounts – Both the conditions
 1. Satisfactory performance;
 2. Specified period is to be fulfilled before up gradation



Memorandum of changes (MOCs)

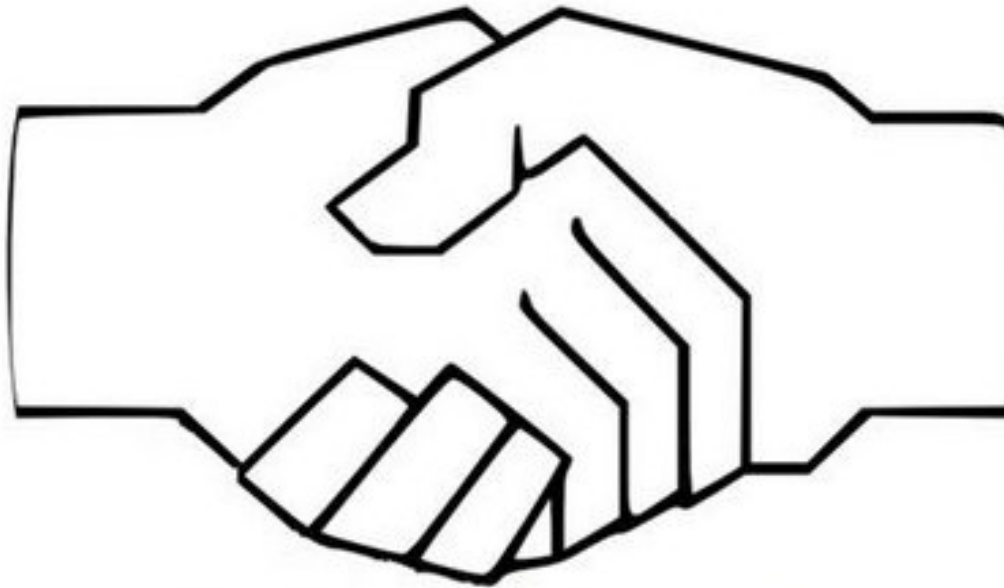
- MOC is very important document attached with Bank Audit Report whenever the Auditor observes significant issues effecting the Financial Statements of the Bank.
- Unlike other entities where the accounts are audited and then the financial statements are drawn up adhering to all the regulatory principles, in banks, the final accounts are drawn which are already sent for compilation at controlling office on closing date itself.
- Hence, during the audit, if the auditor observed any significant changes which has the impact on financials of the branch, he has to mention the same in the MOC & will have to attach the same with his audit report addressed to CSA of the bank.
- Changes suggested by branch auditor will be given effect at the controlling / zonal / circle office of the bank.
- MOC can for the following reasons:
 - changes in Balance Sheet
 - changes in Profit and Loss Account
 - Changes in advances – due to classification etc.
 - Outstanding balances of advances – due to interest reversal etc.
 - Yearly return of provisions
 - Summary of advance return
 - MOC for fixed assets

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Memorandum of changes (MOCs)

- Suggested MOC are also required to be given reference in the main audit report.
- The following points have to be noted about MOC:
 - Clear justification for every change suggested by auditor i.e. the nature of changes suggested
 - The format of MOC in most banks will have both sides like a trial balance. It should be ensured that total of changes suggested in balance sheet and profit and loss account is tallied on both accounts.
 - The total of reclassification of the advances suggested in secured, unsecured, guaranteed advance and sector wise advance should be correctly brought out in the MOC and total of both sides should tally.
 - In case of change suggested as per prudential norms on income recognition, the impact, if any on the provisioning of the assets is also to be looked into.
 - It is to be ensured that a NIL MOC is invariably forwarded, even if there are no change to report.
 - Branch manager are required to report on each item reported in MOC.
- The format of MOC is provided along with other supporting material sent by Banks to the respective auditors



THANK YOU

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