

# Audit of Banks

## (Revisionary Question Bank)

### -Relevant for CA Inter May'2018

**Note: The following is an illustrative list of questions for your practice. Kindly go through all the questions only after you have read the entire chapter thoroughly from the study material.**

#### Question 1

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. State your views on the following issues which were brought to your notice by your Audit Manager:

- (a) The bank has recognised on accrual basis income from dividends on securities and Units of Mutual Funds held by it as at the end of financial year. The dividends on securities and Units of Mutual Funds were declared after the end of financial year.
- (b) The bank is a consortium member of Cash Credit Facilities of ` 50 crores to X Ltd. Bank's own share is ` 10 crores only. During the last two quarters against a debit of ` 1.75 crores towards interest the credits in X Ltd's account are to the tune of ` 1.25 crores only. Based on the certificate of lead bank, the bank has classified the account of X Ltd as performing.

#### Answer

(a) It is not a prudent practice to treat dividend on shares of corporate bodies and units of mutual funds as income unless these are actually received. Accordingly, income from dividend on shares of corporate bodies and units of mutual funds should be booked on cash basis. In respect of income from government securities and bonds and debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly and as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the central government or a State government. Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting and the owner's right to receive payment is established. This is also in accordance with AS 9 as well. In the instant case, therefore, the recognition of income by the bank on accrual basis is not in order.

(b) The bank is a consortium member of cash credit facilities of ` 50 crores to X Ltd. Bank's own share is ` 10 crores only. During the last two quarters against a debit of ` 1.75 crores towards interest, the credits in X Ltd's account are to the tune of ` 1.25 crores only. Sometimes, several banks form a group (the 'consortium') under the leadership of a 'lead bank' to make advance to a large customer on same conditions and security with proportionate rights. In such cases, each bank may classify the advance

given by it according to its own experience of recovery and other factors. Since in the last two quarters, the amount remains outstanding and, thus, interest amount should be reversed. This is despite the certificate of lead bank to classify that the account as performing. Accordingly, the amount should be shown as non-performing asset.

**Question 2**

**What is the income recognised in the case of 'non-performing' assets of bank?**

**Answer**

**Income Recognition:** As per the master circular issued by RBI relating to Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, the banks may book income in the following manner:

- (i) Income from NPAs is not recognised on accrual basis but is booked as income only when it is actually received. However, interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
- (ii) Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.
- (iii) If Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realised.

**Question 3**

**As a branch auditor of a nationalised bank, how would you verify the following?**

**(a) Advances to DOT COM Companies.**

**(b) Balances in account of a bank situated in a foreign country.**

**Answer**

**(a) Advances to DOT COM Companies**

- (i) Evaluate the efficacy of internal control system in general to ascertain whether an advance is made only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank. The sanction for an advance must specify, among other things, the limit of borrowing, nature of security, margin to be kept, interest, terms of repayment, etc. Also see that all the necessary documents, e.g., agreements, demand promissory notes, letters of hypothecation, etc. have been executed by the parties before advances are made.
- (ii) Examine loan documents such as certificate of commencement of business, resolution of board of directors, and resolution of shareholders.
- (iii) Verify the business plan of the company especially where the revenue model is in place. Verify whether the company depends only on outside funding or can self generate funds.
- (iv) Examine in case the security is in the form of mortgage, apart from mortgage deed (in the case of English Mortgage) or letter of intent to create mortgage (in the case

of Equitable Mortgage), the evidence of registration of the charge with the Registrar of Companies.

(v) Review the operation of advance account to see that limit is not generally exceeded; that the account is not becoming stagnant; that the customer is not drawing against deposits which are not free from lien; that the account is not window-dressed by running down overdrafts at the year end and again drawing further advances in the new year, etc.

(vi) Examine whether there is a healthy turnover in the account. It should be seen that the frequency and the amounts of credits in the account are commensurate with the sanctioned limit and the nature and volume of business of the borrower. Any unusual items in the account should be carefully examined by the auditor. If the auditor's review indicates any unhealthy trends, the account should be further examined. The auditor's examination should also cover transactions in the post-balance sheet date period. Large transactions in major accounts particularly as at the year-end may be looked into to identify any irregularities in these accounts.

(vii) Review periodic statements, cash flow statements, latest financial statements, etc. to assess the recoverability of advances.

(viii) Verify whether the advance is secured and determine whether the security is legally enforceable, i.e., whether the necessary legal formalities regarding documentation, registration, etc., have been complied with; whether the security is in the effective control of the bank; and to what extent the value of the security, assessed realistically, covers the amount outstanding in the advance.

(ix) Ensure that proper provisioning norms have been applied in view of non-observance of terms, coupled with irregular payment of interest and default in repayment of instalments, if any.

**(b) Balances in Account of a Bank situated in a Foreign Country**

(i) Verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements as at the year-end.

(ii) Review the reconciliation statements and pay particular attention to the following.

(1) Examine that no debit for charges or credit for interest is outstanding and all the items which ought to have been taken to revenue for the year have been so taken. This should be particularly observed when the bills collected, etc., are credited with net amount and entries for commission, etc. are not made separately in the statement of account.

(2) Examine that no cheque sent or received in clearing is outstanding. As per the practice prevalent among banks, any cheques returned unpaid are accounted for on the same day on which they were sent in clearing or on the following day.

(3) Examine that all bills or outstanding cheques sent for collection and outstanding as on the closing date have been credited subsequently.

(iii) Examine the large transactions in inter-bank accounts, particularly towards the year-end, to ensure that no transactions have been put through for window-dressing.

(iv) Check original deposit receipts in respect of balances in deposit accounts in addition to confirmation certificates obtained from banks in respect of outstanding deposits.

(v) Check whether these balances are converted into the Indian currency at the exchange rates prevailing on the balance sheet date and ensure compliance with relevant Accounting Standard.

**Question 4**

**Write a short note on - Principal Enactments Governing Bank Audit.**

**Answer**

**Principal Enactments Governing Bank Audit:** There is an elaborate legal framework governing the functioning of banks in India. The principal enactments which govern the functioning of various types of banks are-

- (i) Banking Regulation Act, 1949.
- (ii) State Bank of India Act, 1955.
- (iii) Companies Act, 2013.
- (iv) State Bank of India (Subsidiary Banks) Act, 1959.
- (v) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.
- (vi) Regional Rural Banks Act, 1976.
- (vii) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.
- (viii) Information Technology Act, 2000.
- (ix) Prevention of Money Laundering Act, 2002.
- (x) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- (xi) Credit Information Companies (Regulation) Act, 2005.
- (xii) Payment and Settlement Systems Act, 2007.

Besides, the above enactments, the provisions of the Reserve Bank of India Act, 1934, also affect the functioning of banks. The Act gives wide powers to the RBI to give directions to banks which also have considerable effect on the functioning of banks.

**Question 5**

**What are the exceptions to the general rule of treating advances as Non-performing Assets (NPAs)?**

**Answer**

**Non-performing Assets:** RBI has laid down norms for classification of assets and provisioning norms for NPAs. However, certain exceptions to these norms are discussed below-

- (i) **Temporary deficiencies**, e.g., non availability of current drawing power due to non-receipt of latest stock statement, temporary delay in renewals of limits on due date, etc.
- (ii) **Natural Calamities:** Where, in the wake of natural calamities, short-term agricultural loans are converted into term loans or there is rescheduling of repayment period or fresh short-term loans are sanctioned, the term loan as well as fresh short term loan may be treated as current dues and need not be classified as NPA.
- (iii) **Facilities Backed by Central Government Guarantees:** Credit facilities backed by guarantee of the Central Government though overdue should be treated as NPA only when the government repudiates its guarantee when invoked (this exemption is only for the purpose of asset classification and provisioning and not for the purpose of recognition of income).
- (iv) **Advances to "On Lending" arrangements** are also exempted under this category.

**Question 6**

**(a) What do you understand by Long-form Audit Report?**

**(b) As the auditor of Nagpur Main Branch of XYZ Bank Ltd. state the issues which have to be considered in the audit of advances.**

**Answer**

**(a) Long Form Audit Report:** The long form Audit Report has to be furnished by the auditor of a bank in addition to the audit report as per the statutory requirement. The matters which the banks require their auditor to deal with in the form of Long Form Audit Report have been specified by Reserve Bank of India. The LFAR is to be submitted before 30th June every year. To ensure timely submission of LFAR, proper planning for completion of the LFAR is required. While the format of LFAR does not require an executive summary to be given, members may consider providing the same to bring out the key observations from the whole document.

**(b) Audit of Advances of a Bank:** The items to be covered in the audit of advances of a bank are as follows-

- (i) Amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet.
- (ii) Advances represent amount due to the bank.
- (iii) Amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances.
- (iv) There are no unrecorded advances.
- (v) The stated basis of valuation of advances is appropriate and properly applied,

and that the recoverability of advances is recognised in their valuation.

(vi) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.

(vii) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

#### Question 7

**How will you evaluate the Internal Control system in the area of Credit Card operations of a Bank?**

#### Answer

**Evaluation of Internal Control System in the area of Credit Card Operations in a bank:**

- (i) There should be effective screening of applications with reasonably good credit assessments.
- (ii) There should be strict control over storage and issue of cards.
- (iii) There should be a system whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- (iv) There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- (v) Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.
- (vi) All the reimbursement (gross of commission) should be immediately charged to the customer's account.
- (vii) There should be a system to ensure that statements are sent regularly and promptly to the customer.
- (viii) There should be a system to monitor and follow-up customers' payments.
- (ix) Items overdue beyond a reasonable period should be identified and attended to carefully. Credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- (x) There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

#### Question 8

**Write a short note on reversal of income under bank audit. Also explain the concept of a Memorandum Account in this regard. How would you deal with income recognition in case of partial recoveries in NPAs?**

#### Answer

**Reversal of Income:** If any advance, including bills purchased and discounted, becomes Non-Performing Assets as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).

**Memorandum Account:** On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books for control purposes. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

**Partial Recoveries in NPAs:** In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e., towards principal or interest due), banks are required to adopt an accounting policy and exercise the right of appropriation of recoveries in a uniform and consistent manner. The appropriate policy to be followed is to recognise income as per AS 9 when certainty attaches to realisation and accordingly amount reversed/derecognised or not recognised in the past should be accounted. Interest partly/fully realised in NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.

**Question 9**

"An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank." On the basis of this statement, answer the following:

- a. What is the criteria to be applied to determine the status of various credit facilities as non-performing assets?
- b. What are the various categories of Non-Performing Assets?
- c. How is provisioning done for these type of assets?

**Answer**

**a. Classification of Non-Performing Assets:** An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

The following criteria are to be applied for determining the status of various types of credit facilities:

**(a) Term Loans:** A term loan is treated as a non-performing asset (NPA) if interest and/or instalment of principal remain overdue for a period of more than 90 days.

**(b) Cash Credits and Overdrafts:** A cash credit or overdraft account is treated as NPA if it remains out of order as indicated above.

**(c) Bills Purchased and Discounted:** Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days.

**(d) Securitisation:** The asset is to be treated as NPA if the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

**(e) Agricultural Advances:** A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons and, a loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

**(f) Credit Card Accounts:** RBI vide its Circular on "Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Credit Card Accounts" advised that a credit card account will be treated as non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between two statements should not be more than a month.

For answer to part (b) and part (c), Refer Chart on Study Material Page 12.19

**Question 10**

As the concurrent auditor of Z Bank Ltd., you are requested by its management to draft an internal control policy in respect of loans and advances. What factors do you consider as important while drafting such a policy?

**Answer**

**Drafting of Internal Control Policy for Loans and Advances:** The following are the important factors to be considered while drafting internal control policy in respect of loans and advances of Z Bank Ltd. -

(i) The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from the proper authorities of the bank.

(ii) All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.

(iii) Sufficient margin should be kept against securities taken so as to cover any decline in the value thereof and also to comply with Reserve Bank directives. Such margins should be determined by the proper authorities of the bank as a general policy or for particular accounts.

(iv) All the securities should be received and returned by responsible officer. They should be kept in the Joint custody of two such officers.

(v) All securities requiring registration should be registered in the name of the bank or otherwise accompanied by the documents sufficient to give title of the bank.

(vi) In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipts. The godowns should be regularly and frequently inspected by a responsible officer of the branch concerned, in addition by the inspectors of the bank.

(vii) Surprise checks should be made in respect of hypothecated goods not in the possession of the bank.

(viii) Market value of goods should be checked by officers of the bank by personal enquiry in addition to the invoice value given by the borrowers.

- (ix) As soon as any increase or decrease takes place in the value of securities proper entries should be made in the Drawing Power Book and Daily Balance Book. These entries should be checked by an officer.
- (x) All accounts should be kept within both the drawing power and the sanctioned limit at all times.
- (xi) All the accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.
- (xii) The operation in each advance should be reviewed at least once every year.
- (xiii) Post disbursement supervision and follow-up should be proper, such as receipt of stock statements, instalments, renewal of limits, etc.
- (xiv) There should not be any mis-utilisation of the loans and instances indicative of diversion of funds should be checked.
- (xv) Letters of credit issued by the branch should be within the delegated power and should be for genuine trade transactions.
- (xvi) Bank guarantees issued, should be properly worded and recorded in the register of the bank. They should be promptly renewed on the due dates.
- (xvii) Proper follow-up should be made for overdue bills of exchange.
- (xviii) The classification of advances should be done as per RBI guidelines.
- (xix) The submission of claims to DICGC and ECGC should be on time.
- (xx) Instances of exceeding delegated powers should be promptly reported to controlling/Head Office by the branch and should be got confirmed or ratified at the required level.

#### Question 11

In course of audit of Good Samaritan Bank as at 31st March, 16 you observed the following:

- (a) In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government ?
- (b) The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.

#### Answer

**(a) Government Guaranteed Advance:** If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not to be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

**(b) The Audit Programme to Verify Advances against Life Insurance Policies is as under-**

- (i) The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer.
- (ii) The auditor should also examine whether premium has been paid on the policies and whether they are in force.
- (iii) Certificate regarding surrender value obtained from the insurer should be examined.
- (iv) The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

**Question 12**

**As a Statutory Auditor, how would you verify advances against Goods?**

**Answer****Verification of Advances against Goods (Banking Companies):**

- (i) **Sanction:** Examine the sanction letter, letter of hypothecation and note the important terms and conditions of the advances.
- (ii) **Stock statements:** Verify the quantity and value of goods hypothecated based on the stock statements received from the borrower. Test check the Godown Register and examine the valuation of goods to ascertain the reasonableness of the same.
- (iii) **Inspection:** Ascertain as to whether the premises of the borrowers are periodically visited by the bank officials to verify the quantity as per the periodic stock statements.
- (iv) **Stock Audit:** See whether the bank has got a system of obtaining stock and receivables audit report in respect of such advances. If so, review the stock audit report and identify adverse comments, if any.
- (v) **Hypothecation/Pledge:** Examine the letter of hypothecation and certificate of registration of charge, in respect of goods pledged with the bank.
- (vi) **Insurance:** Examine the insurance policies for their validity, adequacy etc. and see that policies are in favour of the bank.
- (vii) **Documents of title:** Inspect the documents of title to goods like bill of lading, dock warrant, railway receipts etc to ensure that they are endorsed registered in favour of the bank.
- (viii) **Third party certificate:** Where the hypothecated goods are in possession of third parties, such as clearing and forwarding agents, transporters, bankers, etc. undertaking has been obtained by the bank that they will handover the goods or sale proceeds thereof to the bank only. In such cases, certificate should be obtained by the bank from such third parties regarding quantities on hand, on balance sheet date. The valuation of such goods should be checked by the auditor.

**Question 14**

**Shy & Co. had been allotted the branch audit of a nationalized bank for the year ended 31st March, 2016. In the audit planning, the partner of Shy & Co. observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose. He needs your assistance in incorporating the criteria prescribed for determination of NPA norms in respect of agricultural advance, in audit plan.**

**Answer**

**NPA Norms in respect of Agricultural Advance:** A loan granted for short duration crops will be treated as Non Performing Asset, if the instalment of principal or interest thereon remains overdue for two crop seasons and, a loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

As per the guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State. Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him.

The above norms should be made applicable to all direct agricultural advances as listed in the Master Circular on Lending to Priority Sectors. In respect of all other agricultural loans, identification of NPAs would be done on the same basis as non-agricultural advances, which, at present, is the 90 days delinquency norm.

If natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-scheduling of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines issued by RBI.

**Question 15**

**What are the requirements of an effective risk management system in a bank?**

**Answer**

Requirements of a Risk Management Process/System in a Bank:

1. **Involvement of TCWG:** Risk Management policies should be approved by TCWG. While approving the policies, TCWG should ensure that the policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.
2. **Identification, measurement & monitoring of risks:** Risks that may significantly affect the

achievement of bank's goals and objectives should be identified, measured and monitored against pre-approved limits and criteria.

3. **Control activities:** Banks must have appropriate controls to manage its risks, including the following:

- effective segregation of duties,
- verification and approval of transactions,
- setting of limits,
- reporting and approval of exception.

4. **Monitoring activities:** Independent risk management unit should be set up which regularly assess the Risk management models, methodologies and assumptions used to measure and manage -- risk.

5. **Reliable information systems:** Banks must have a reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis to management and TCWG.

#### Question 16

**As the statutory auditor of a Nationalised Bank, state how you would verify the provisioning done against Non-Performing Assets.**

**Answer**

#### **Verification of Provision for Non-Performing Assets:**

1. Study the latest Master Circular of RBI to get familiarise with the norms prescribed by RBI in relation to provisioning requirements for NP A. The circulars issued by RBI after the date of issue of Master Circular and till the date of audit should also be considered.
2. Provisioning norms as laid down in the master circular should be construed as the minimum provisioning requirements and wherever a higher provision is warranted in the context of the threats to recovery, ensure that higher provision is made by the bank.
3. Examine whether the classification made by the branch into Standard, Sub-standard, doubtful and loss assets is appropriate.
4. Examine whether the secured and the unsecured portions of advances have been segregated correctly and provisions have been calculated properly.
5. As per the RBI guidelines, if an account has been regularised before the balance sheet date by payment of overdue amount through genuine sources, the account need not be treated as NP A. However if an account indicates inherent weakness, the account should be deemed as a NPA. In other genuine cases, auditor need to examine satisfactory evidence about the manner of regularisation of the account to eliminate doubts on their performing status.
6. Date of NPA is of significant importance to determine the classification and hence specific care be taken in this regard and ensure that the classification is made as per the position as on date and hence classification of all standard accounts be reviewed as on balance sheet date.

#### Question 17

**Discuss certain common questions/steps which have to be kept in mind while undertaking control activities in the audit of a banking company.**

**Answer**

Refer Page 12.5 of Study Material

#### Question 18

**You have to lead an engagement of statutory audit of ABC Bank Ltd. You will be leading a team of 7 individuals and you have also called a meeting of the entire engagement team. State the matters that you will discuss in the engagement team meeting.**

**Answer**

Refer Page 12.6 of Study Material

#### Question 19

**State the contents of an auditor's report in case of a nationalised bank. To whom is this report addressed?**

**Answer**

Refer Pg 12.8 of Study Material

**Question 20**

Mr Ram, a Chartered Accountant, during the course of his audit of XYZ Bank comes across certain instances which give him reason to believe that an offence involving fraud has been committed on the company. Discuss how Mr Ram should report the same to the appropriate authorities.

**Answer**

Refer Page 12.9 of Study Material.

**Question 21**

While drafting the balance sheet of a banking company, how would you disclose the following – ADVANCES?

**Answer**

Refer Page 12.15 of Study Material.

**Question 22**

Discuss the appropriate classification of Advances for banks as per RBI Prudential Norms.

**Answer**

Refer chart on Page 12.16 of Study Material

**Question 23**

What are the various modes of creation of security for procurement of bank finance?

**Answer**

Refer Page 12.17 of Study Material.

**Question 24**

What do you understand by drawing power in case of cash credit accounts? Discuss the procedure for computation of drawing power.

**Answer**

Refer Page 12.22 of Study Material

**Question 25**

As the statutory auditor of ABC Bank Ltd., you are requested by your engagement team to draft the procedure in respect of audit of revenue items. What factors do you consider as important while drafting such a document? What items are expected to be included under the head "Income" in case of ABC Bank Ltd

**Answer**

Refer Page 12.27 of Study Material for Audit Approach and Page 12.26 for Items to be Included.

**Question 26**

As the statutory auditor of XYZ Bank Ltd., you are requested by your engagement team to draft the procedure in respect of audit of expenses. What factors do you consider as important while drafting such a document? What items are expected to be included under the head "Expenses" in case of XYZ Bank Ltd.

**Answer**

Refer Page 12.32 of Study Material for Audit Approach and Page 12.31 for items to be included.

**Question 27**

Describe the audit procedures to be followed by a Statutory Auditor of a bank for audit of contingent liabilities.

**Answer**

**Verification of Contingent Liabilities:** In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. To this end, the auditor should, generally follow the audit procedures given below:

(i) the auditor should ensure that there exists a system whereby the non fund based facilities or additional/ad hoc credit facilities to parties are extended only to their regular constituents, etc.

(ii) Ascertain whether there are adequate internal controls to ensure that transactions giving rise to contingent liabilities are executed only by persons authorised to do so and in accordance with the laid down procedures.

(iii) The auditor should also ensure that in case of LCs for import of goods, as required by the abovementioned Master Circular on guarantees and co-acceptances, the payment to the overseas suppliers is made on the basis of shipping documents and after ensuring that the said documents are in strict conformity with the terms of LCs.

(iv) Ascertain whether the accounting system of the bank provides for maintenance of adequate records in respect of such obligations and whether the internal controls ensure that contingent liabilities are properly identified and recorded.

(v) Performs substantive audit tests to establish the completeness of the recorded obligations. Such tests include confirmation procedures as well as examination of relevant records in appropriate cases.

(vi) Review the reasonableness of the year-end amount of contingent liabilities in the light of previous experience and knowledge of the current year's activities.

(vii) Review whether comfort letters issued by the bank has been considered for disclosure of contingent liabilities.

(viii) Obtain representation from the management that-

(a) all contingent liabilities have been disclosed;

(b) the disclosed contingent liabilities do not include any contingencies which are likely to result in a loss/expense and which, therefore, require creation of a provision in the financial statements;

(c) the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including any possibility of any reimbursement;

(d) in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate and effective arrangements have been made so that the commitments would be met out of the party's own resources and that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) and that no violation of section 20 of the Banking Regulations Act, 1949 has arisen on account of such guarantee; and

(e) such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote, include the management's justification for reaching such a decision in respect of those contingent liabilities.

(ix) The auditor should also examine whether the bank has given any guarantees in respect of any trade credit (buyer's credit or seller's credit). The period of guarantees is co-terminus with the period of credit reckoned from the date of shipment.

(x) Verify whether bank has extended any non-fund facility or additional/ad hoc credit facilities to other than its regular customers. In such cases, auditor should ensure concurrence of existing bankers of such borrowers and enquire regarding financial position of those customers.