Guidance Note on Audit of State Co-operative Banks (StCBs) & District Central Co-operative Banks (DCCBs)

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi
India’s banking industry is moving from strength to strength to support one of the most vibrant economies of the world i.e. India. Notable changes have been made in policy and regulation to strengthen the said sector. These changes include not only prudential norms, revitalization of payment mechanism but also integrate regulations between commercial and co-operative banks and introduction of structural changes in the co-operative banks. The co-operative banks are present in every nook & corner of the country, in both urban & rural centers. They are involved in financing not only agriculture based activities like farming, cattle, poultry, personal finance but also home finance, consumer finance, various small scale industries and self-employment driven activities.

As State Co-operative Banks & District Central Co-operative Banks have now been brought under the regulatory regime of NABARD and their audit is now being entrusted to Chartered Accountants, a need was felt to guide the members so that they are aware of the peculiarities of the business of Central Co-operative Banks and accordingly conduct the audit. Audit serves as review mechanism to ensure that the transactions/decisions are within the policy parameters laid down and are in compliance with the applicable circulars of NABARD and RBI.

Professional Development Committee has brought out Guidance Note on Audit of State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) with due co-ordination and involvement of the senior officials of the NABARD in preparation and finalization of the Guidance Note.

I am sure, members would find the guidance contained in this publication useful in conducting the audit of State Co-operative Banks and District Central Co-operative Banks.
I would like to thank CA. Charanjot Singh Nanda, Chairman, PDC and his dynamic team for bringing out publication on such an important topic of national relevance.

Date: June 22, 2012
Place: New Delhi

CA. Jaydeep Narendra Shah
President, ICAI
Preface

The co-operative banks have a history of almost 100 years. Co-operatives in India came into being as a result of the Government taking cognizance of the agricultural conditions that prevailed during the latter part of the nineteenth century and the absence of institutional arrangements for finance to agriculturists, which had resulted in mounting distress and discontent. Small, local, locally worked institutions, co-operative in form, which would satisfy the postulates of proximity, security and facility for providing credit, were seen as the answer to this situation. Subsequent events during both pre and post Independence period have led to a vast growth of co-operatives covering various sectors of the Indian economy. The potential of the co-operative sector for bringing about development, right up to the nineties, resulted in an increase in the number of co-operatives and their contribution, making the Indian co-operative movement one of the largest movements of its kind in the world.

With development in the co-operative movement, internal structures, procedures in areas of audit need to be strengthened. Moreover, the year 2012 has been recognised as the “International Year of Co-operatives (IYC)” with the theme of “Co-operative Enterprises Build a Better World”, the year seeks to encourage the growth and establishment of co-operatives all over the world. It aims to encourage all the nations and all relevant stakeholders to take advantage of the IYC to promote co-operatives and raise awareness of their contribution to social and economic development and promote the formation and growth of co-operatives.

The Institute at its end has been extending a helping hand in the form of guidance note/advisory and training programmes/seminars in the relevant area to its members to help them effectively discharge the onerous responsibilities placed on them. This Guidance Note on State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) being brought out by Professional Development Committee of the Institute is I personally feel, a landmark in this direction. Written by a panel of auditing experts drawn from the banking sector, the Guidance Note is a comprehensive document in itself, touching upon almost all critical aspects in audit of State Co-operative Banks (SCBs) and District Central Co-operative Banks (DCCBs) and deals with the audit principles and practices. For easy understanding and practical implementation, the Guidance Note is written in a very lucid and logically flowing manner. Reference to different circulars of
NABARD and RBI as applicable to State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs), etc. are also included in it. It has been designed to equip the auditors with as much knowledge on all the topics as is desirable from the point of view of economic position of the State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs).

At this juncture, I wish to express my sincere gratitude to CA. Ramesh S. Prabhu and other members of the group CA. Niranjan Joshi, CA. K. M. Rege, CA. Ramesh Shetty, CA. Prakash Kulkarni, CA. Satish Nade for their sincere efforts in drafting the entire Guidance Note. I am also obliged to CA. Ravi Patwa for his help, co-operation and suggestions in reviewing the entire Guidance Note and my sincere thanks to the officials of NABARD, Shri G. C. Panigrahi, CGM, Shri Prabhu Deva, DGM, Shri R. M. Kumnur, CGM, Shri K. Venkateswara Rao, CGM and their entire team for their inclusive comments on the important aspects of the Guidance Note. I am also thankful to CA. Pankaj Jain for formation of the said group, CA. Amarjit Chopra for putting his untiring efforts and sparing time out of the professional and personal preoccupations. I am obliged by the efforts put in by Shri Vijay Kapur, Director, ICAI, CA. Namrata Khandelwal, Secretary, Professional Development Committee & CA. Akshika Dhingra and other officials of PDC Secretariat for their invaluable guidance and support in giving final shape to this Guidance Note. I am also obliged to CA. Jaydeep Narendra Shah, President, ICAI and CA. Subodh Kumar Agrawal, Vice President, ICAI for their unstinted support and encouragement to the activities of the PDC.

I firmly believe that this publication would serve a very useful purpose in increasing the efficiency in conduct of audit of co-operatives and would serve as a basic guide for the members and other stakeholders interested in the subject.

Date : June 22, 2012
Place : New Delhi

CA. Charanjot Singh Nanda
Chairman
Professional Development Committee
1. Audit of State Co-operative Banks (StCBs) and Central Co-operative Banks (CCBs) is relatively a new area for Chartered Accountants. On the recommendations of Revival Package for Short Term Co-operative Credit Structure (Chairman: Prof. Vaidyanathan) NABARD has issued instructions in the year 2008 for audit of StCBs and CCBs by Chartered Accountants to bring in professionalism in the audit process. With a view to equipping the Chartered Accountants, several guidelines, format of LFAR, etc., were issued by NABARD in the past 5 years. Besides, sensitization meets / National Seminars etc., were also conducted to discuss operational problems and find suitable solutions. During the seminars, a strong need for a Manual / Guidance Note for audit of co-operative banks was expressed by the participants.

2. The ‘Guidance Note on Audit of StCBs/CCBs’ is the end result of the long consultation, exchange of ideas between ICAI and NABARD, involvement of expert CAs etc., in preparation and vetting of the contents and coverage of aspects required for effective audit of StCBs and CCBs.

3. I wish to place on record my appreciation for all those actively involved in preparation, vetting and publication of this guidance note and hope that the same would be of immense use to the CAs and those connected with audit functions.

Mumbai
11 April 2012

K. Venkateswara Rao
Chief General Manager
National Bank for Agriculture and Rural Development
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Chapter 1

Scope and Objectives of the Guidance Note

1.1 Introduction

The Guidance Note has been designed to guide the auditors of State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) to conduct statutory audit as envisaged by the respective State Co-operative Societies Act (“the Act”), Banking Regulation Act (as applicable to Co-operative Banks), 1949, Reserve Bank of India (RBI) and National Bank for Agriculture and Rural Development (NABARD), Notifications & Circulars issued by Central Government and RBI and Accounting and Auditing & Assurance Standards, Guidance Notes issued by ICAI as amended from time to time in accordance with uniform auditing scope, programs and techniques as detailed in this Guidance Note. The principles, practices and programs set out in this Guidance Note need to be applied for the audits of StCBs and DCCBs irrespective of their geographical distribution.

The standards and practices set out in this Guidance Note should be incorporated as the minimum benchmark for all audits of StCBs and DCCBs. However, the audit approach and the extent of the test procedures may be “tailored” by the auditors to suit the specific needs of the small or very large StCBs and DCCBs.

1.2 Implementation of the Guidance Note

The Guidance Note has been prepared as per the mandate and guidance given by NABARD and ICAI to facilitate the Statutory Auditors of StCBs and DCCBs and their branches to have uniform practices and techniques in the audit of StCBs and DCCBs under the aegis of the NABARD. There may be a few sections that each State might want to customize in order to bring in certain specific statutory or regulatory compliances or techniques to suit the specific business needs of the StCBs and DCCBs in those states. However, it is strongly recommended that such customization should be limited and specific to a particular section of an audit program.
1.3 Objectives of the Guidance Note

The objectives of this Guidance Note are, therefore, as under: -

(i) To serve as a ready handbook of practical guidance to auditors of StCBs and DCCBs.

(ii) To serve as a codified handbook of RBI, NABARD & departmental instructions relating to StCBs and DCCBs accounts and audit.

(iii) To serve as a ready reference book to auditors and those who are responsible for maintenance of accounts.

(iv) Above all, to help to improve the quality of audit work and maintain a high standard of audit.
2.1 An Overview of Banking Institutions in India

Banks are one of the foremost agents of financial intermediation in a developing economy like India and therefore, development of a strong and resilient banking system is of an utmost importance. The impact of reforms initiated in the decade of nineties is showing greater efficiency, productivity and diversity in the Indian banking system. The banking institutions in the country are performing in a competitive environment and their regulatory framework is now aligned with the international best practices. Thus, financial deepening has taken place in India and continues to be in progress with a focus on orderly conditions in financial markets while sustaining the growth momentum.

The RBI acts as the monetary authority and the central bank of the country.

At present, there are following four types of banking institutions in India which are regulated by RBI directly or indirectly through its subsidiary NABARD:

- Commercial Banks
- Regional Rural Banks
- Co-operative Banks
- Development Banks (more commonly known as 'term-lending institutions')

At March-end 2010, there were 79 Commercial Banks (excluding Regional Rural Banks (RRBs)), 91 RRBs, 1770 Urban Co-operative Banks (UCBs) and 4 Development Financial Institutions (DFIs).

Commercial banks are regulated by RBI directly and RRBs are regulated by NABARD.

Co-operative banks are further classified into two major sections:

(a) Urban Co-operative Banks being regulated by RBI directly.

(b) Rural Co-operative Banking and Credit Institutions being regulated by RBI through its subsidiary NABARD.
Thus, StCBs, DCCBs and RRBs function under the overall supervision and control of the RBI. However, various regulatory functions of the RBI in relation to StCBs, DCCBs and RRBs have been delegated to the NABARD.

2.2 Structure of Co-operative Credit Institutions

2.2.1 Origin and Growth

The origin of Indian Co-operative Credit Movement can be traced far back in the year 1844 as per the report of Woodhead Famine Commission of Bengal Province. The said Commission recommended that credit should be given at a lower rate of interest to the needy people. Based on the above corollary, the Rayat Commission in the year 1872 recommended for the starting up of Co-operative Organization as an agency to give credit to agriculturists. Thereafter, the first Co-operative Land Mortgage Bank was started in the year 1882.

The first Co-operative Credit Societies Act was passed in the year 1904, which led to the formation of Co-operative Credit Societies in India. Being an agricultural economy predominantly, the agricultural credit through cooperatives had constantly attracted attention of the Government.

2.2.2 Co-operative Credit Structure

The Co-operative Credit Structure has three broad categories i.e. Short-term Credit Structure, Long-term Credit Structure and Primary Urban Co-operative Bank Structure. Generally, the short term credit structure is meant for taking care of production activity, whereas long term structure is meant for extending investment credit to farmers. The medium term structure is largely meant for providing consumption credit.

2.2.3 Short-term Credit Structure

The short-term credit structure consists of Primary Agricultural Credit Societies (PACS) at the grass root level, DCCBs at the intermediate level and StCBs at the State level.

2.2.4 Long Term Co-operative Credit Structure

The long term co-operative credit structure or investment credit structure consist of Primary Co-operative Agricultural and Rural Development Bank (PCARDB) at the grass root level and State Co-operative Agricultural and Rural Development Bank (SCARDB) at the State level.
2.2.5 Urban Co-operative Credit Structure

The urban co-operative banks being primary co-operative credit institutions function individually as there is no separate secondary or higher tier institutions functioning for them at district and state level. The urban co-operative banks even though treated as a primary co-operative institution, their area of operation in many cases extend to more than one State. Such institutions are registered under Multi State Co-operative Societies Act, 2002. In addition to this structure, there are salary earners/wage earners/employees credit co-operative societies.

2.2.6 Short Term Structure

Primary Agriculture Credit Societies (PACS)

Primary Agricultural Credit Societies, (PACS), are the very foundation stone of the grass root level co-operative credit structure in India. The co-operative movement in India has developed through PACS only. PACS are formed by a group of farmers residing in the same village or group of villages. The PACS came into existence as a substitute for traditional credit functionaries i.e. money lenders etc. to arrest the evils created by them.

Now to have proper control over PACS and to keep their accounting methods transparent and uniform at all PACS, they are proposed to be brought under computerization and will have direct connectivity with DCCBs where they maintain their account. It is proposed that this should be achieved by the end of year 2011.

District Central Co-operative Banks & State Co-operative Banks

The features have been discussed in subsequent paragraphs in this chapter.

2.2.7 Long-Term Structure

Co-operative Agricultural and Rural Development Banks

The agriculture sector, like any other sector, requires all types of financial support and assistance i.e. short-term, medium-term and long-term credit arrangements. As the banking credit and banking institutions were at the primitive stage in the early part of the 20th century, the farmers were finding it very difficult to get large financial assistance for undertaking activities such as digging of well, land reclamation and developmental work which were not oriented towards bringing immediate benefits. The money lenders were therefore, reluctant to extend such financial assistance having long repayment periods. Even the commercial banks in existence at that time
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were reluctant to meet the long term credit needs of farmers keeping in view the risk involved in blocking the funds for a longer period. In order to overcome the said difficulty, the land development banks came into existence as an alternate system to overcome the said crisis.
Chapter 3

Overview of State Co-operative Banks and District Central Co-operative Banks in India

3.1 District Central Co-operative Banks

3.1.1 Introduction

The initial co-operative legal framework enacted in the year 1904 did not contemplate the establishment of federal or central co-operatives to function as financing agencies for the primary co-operatives. However, the need for the institution of such second-tier co-operatives, with co-operatives as its members was felt. Accordingly, the enactment of the Co-operative Societies Act, 1912 was made which permitted the establishment of higher federal or central co-operatives.

Thereafter, the primary co-operative credit societies functioning in specified areas federated themselves into collective banking activities, giving birth to central co-operative banks with the prime objective to mobilize funds from urban outlets and divert the same to the rural societies. Gradually, over a period of time, every district in a state started having one or more co-operative bank. This reorganized them at district level to form District Central Co-operative Banks (DCCBs).

3.1.2 Functions, Objects and Features of DCCBs

i. To act as a balancing centre of finance for the primary societies in the district by providing them funds when they have a shortage.

ii. To attract local deposits.

iii. To provide a safe place for investing the reserves of primary societies.

iv. To develop and extend banking facilities in rural areas.

v. To develop the co-operative movement in the district.

vi. To supervise, guide and control the working of member societies.

vii. To make PACS viable units for extending rural credit.
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3.1.3 Area of Operation
The area of operation plays a significant role for the success of any organization. Initially the area of operation of many central co-operative banks was very small with the result they could not function as a viable economic unit. The Standing Advisory Committee on Agriculture Credit of the Reserve Bank of India in the year 1952 recommended for only one central co-operative bank for each district.

3.1.4 Business of DCCBs
The DCCBs generally extend their financial support to member primary co-operative credit societies for short and medium term on the basis of the security of land, houses, fixed deposits, gold and jewellery, Government securities, bonds, etc. The loans are generally granted up to a fixed limit to each society depending upon its repayment capacity. The rate of interest levied on loans by DCCBs is 3 to 4 per cent above the rate at which it borrows funds, which constitute the income of banks for the purpose of meeting its administrative and operational expenses. DCCBs are expected to pay dividend on the share capital and to build up the reserve fund.

3.1.5 Sources of Working Capital
The sources of working capital of DCCBs consist of,

i. Share capital
ii. Reserve and other funds
iii. Deposits, from members as well as non-members including Government deposits and
iv. Borrowings

3.1.6 Management of DCCBs
The management of DCCBs vests in the hands of Board of Directors consisting of elected and nominated members. Like any other Co-operative Society, the general body, consisting of the members, is supreme in all respects. The formation/constitution of the Board is done through the election. The elected and nominated members of the Board further elect the office bearers such as Chairman, Vice-Chairman etc. The executive and administrative functions are carried out by the full time Chief Executive Officer/Managing Director.
3.2 State Co-operative Banks

3.2.1 Introduction
The federal character in co-operative financial system was initially recommended by the Maclagan Committee in the year 1914. The same committee had also underlined the need for establishing an apex co-operative bank in each of the major province. Accordingly, at the request of Mehta Bhansali Committee in the year 1939, the Apex Co-operative Banks were established at the provincial level with the prime objective of co-ordinating the work of DCCBs and linking up the co-operative credit organization with general money market and the RBI.

3.2.2 Reason and Causes for the Emergence of Apex Bank
There were many DCCBs in India before Independence having large quantum of surplus funds but they were not in a position to find out adequate credit outlet. On the other hand, there were many other DCCBs starving for funds to meet their potential needs. There was no institution in existence to act as a balancing centre between the two, hence, the need for establishing Apex Co-operative Bank at each State level was felt with the prime purpose and objective of coordinating the activities and functions of central banks. The jurisdiction of these apex banks was restricted for the State as a whole.

3.2.3 Object and Functions of StCBs

i. To function as a balancing centre for the resources of the co-operatives in the State by borrowing funds from surplus DCCBs and channelising the same to the DCCBs in need.

ii. To act as an intermediary between the DCCBs, RBI and Money Market i.e. to borrow money from market and lend it to DCCBs.

iii. To play a pivotal role in the formulation and extension of credit policies for the entire co-operative movement of the state as a whole.

iv. To act as an investment agency for the DCCBs.

v. To supervise, regulate and inspect the functioning of DCCBs and extend timely guidance.

vi. To act as a nodal agency for channelization of funds from RBI/NABARD to DCCBs and farmers through PACS.

vii. To carry out banking business.
4.1 Audit in StCBs and DCCBs

Audit is a systematic examination of books of accounts with relevant supporting documents such as vouchers, bills, receipts and other documents to ascertain and/or to verify the financial operations and to report whether the balance sheet of StCBs and DCCBs has been properly drawn up so as to give a true and fair view of the state of affairs of the bank and whether the profit and loss account for the period under audit gives a true & fair view of the profit or loss of the bank.

Audit in StCBs and DCCBs is a more comprehensive inquiry into the general affairs and management of the bank, its governance in accordance with applicable statutory obligations and its Bye-laws and Rules; its financial record keeping, propriety of transactions and adherence to basic internal controls and procedures. It is therefore, a financial and an administrative audit.

According to the Maclagan Committee, co-operative audit extends beyond the bare requirements of the Societies Act and should embrace an enquiry into all the circumstances which determine the general position of the bank/society. It would, for instance be the duty of the auditor to notice any instances in which the Act, Rules or Bye-laws have been infringed upon, to verify the cash balance and certify the correctness of the accounts to ascertain that loans are made fairly for proper periods and objectives and on adequate security, to examine repayments in order to check book adjustments and improper extension and generally see that the bank is working on sound lines and that the Board of Directors, the officers and the ordinary members understand their duties and responsibilities.

Objectives of Audit

1. To ensure that the business is conducted in an orderly and prudent manner in accordance with established policies and practices.

2. To ensure observance of rules, regulations, guidelines, etc. issued by NABARD, RBI, State Government and the Government of India and
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also to ensure the compliances and adherence to Registered Bye-laws, applicable Acts, applicable Rules and all the Government Notifications.

3. To assess that the bank's performance in various banking activities are being conducted in conformity with the provisions of the relevant Acts, Rules, Regulations etc.

4. To examine financial and managerial soundness of a bank and evolve an action plan for developmental role of the affiliates.

5. To ensure that the assets are safeguarded and liabilities are properly controlled.

6. To ensure that the documents are complete and enforceable.

7. Timely submission of various returns to Registrar Co-operative Societies, NABARD, RBI etc.

8. Compliance with provisions of Co-operative Societies' Act (CSA) and Rules.

9. Management is able to identify and assess the risks to the business and ensure efficacy of the risk management system of the bank.

10. To ensure that the refinance availed of by District Central Co-operative Banks (DCCBs) from time to time have been deployed in accordance with the terms and conditions of sanction.

In the present context, the audit strategy should aim at including the effectiveness of supervision over banks and also to ensure that the audit reports serve as an useful management tool for banks. The focus of audit should be on the core areas of the bank's function mainly Capital Adequacy, Management, Earnings, Liquidity, Systems and Controls (CAMELS).

The important roles of the audit team are to ensure improvement in the systems, operational efficiency and financial soundness and report to the stakeholders as a tool for taking the important decisions.

4.2 Appointment and Remuneration of Auditors

Consequent upon the signing up of MoU between the Government of India, NABARD and by most of the State Governments for implementing the covenants of Co-operative Reforms Package, State Co-operative Societies Acts have been amended in majority of States so as to facilitate undertaking of statutory audit of co-operative banks (including StCBs & DCCBs) by the
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Chartered Accountants. The respective co-operative banks were given the freedom of selecting the Chartered Accountants out of the panel circulated by NABARD.

In view of this, appointment of statutory auditors can be made by StCBs & DCCBs, from the panel of Chartered Accountants circulated by NABARD. The appointment is normally made by the Board of Directors of the bank.

Remuneration of the auditors is also fixed by the respective bank.

4.3. Special Features of StCBs and DCCBs Audit

The auditors of StCBs and DCCBs, besides being well versed with core techniques of audit, are expected to have a fairly reasonable knowledge of subject of the co-operation and the accounting system and controls followed in StCBs and DCCBs. The implementation of internal control systems and procedures to take care of several vulnerable business risks and frauds. Some of the special features relevant to the audit of StCBs and DCCBs are:

- The auditor of StCBs and DCCBs should be familiar with the relevant provisions of the Co-operative Societies Act, 1912 (the Central Act) as well as the respective State Acts which are modeled on the basis of the Central Act;
- Every StCBs and DCCBs should have framed its byelaws and registered the same with the RCS; further no amendment to the byelaws will be valid until the same has been registered by the Registrar;
- StCBs and DCCBs can accept deposits, lend and carry out all the banking business as per the notifications and the guidelines issued by the NABARD and RBI from time to time.;
- In respect of any debt due from a member, StCBs and DCCBs shall have a charge on his/her share or interest in the capital of the StCBs and DCCBs, his/her share of deposits and on dividends, bonus or profits due to him from the StCBs and DCCBs;
- StCBs and DCCBs are permitted to invest only in the securities as may be notified by RBI and NABARD from time to time which may include the following securities:
  - post office savings banks;
  - any securities specified in Section 20 of the Indian Trust Act, 1882;
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- in the shares or the securities of any other registered society;
- with banks as approved for this purpose by the Registrar;
- in any other mode as may be prescribed by the Act or Rules made thereunder.

- StCBs and DCCBs are required to create statutory reserves as prescribed by the RBI and NABARD and Societies Act including transferring a prescribed percentage of profits to a reserve fund;

- Under the provisions of the Act, the Registrar shall audit or cause to be audited by an authorized person the accounts of StCBs and DCCBs once at least in every year. As per the guidelines issued by NABARD, now the audit of StCBs and DCCBs will be done by Chartered Accountants empanelled with RBI.;

- The audit of StCBs and DCCBs shall include the following:
  - examination of overdue debts, if any;
  - verification of cash balance;
  - verification of securities;
  - valuation of assets and liabilities;
  - prudent management of the affairs of the StCBs and DCCBs;
  - examination of audit schedules and returns furnished to auditor along with books of accounts;
  - physical verification of stocks, investments, furniture, fixtures and all other fixed assets;
  - issue of an audit certificate and the report as prescribed by NABARD and StCBs.

- The statements that need to be furnished to the auditors along with books of accounts are:
  - membership and share capital of StCBs and DCCBs; cash balances; investments and other securities;
  - schedule of individual ledger balances with opening and closing balances duly reconciled;
  - details of loans and advances along with demand, collection and balances statements of borrowings of the StCBs and DCCBs;
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- statement of interest accrued and overdue on loans and borrowings;
- statement of investments with confirmations furnished by entities with whom those investments are made;
- estimated bad and doubtful debts including the provisions for non performing assets including loans and advances.

- The annual statements of account to be prepared by StCBs and DCCBs as per Schedule III of the Banking Regulations Act, 1949 which include (i) profit & loss account and (ii) balance sheet (iii) schedules (iv) notes on accounts in such format as prescribed from time to time by RBI and NABARD as per their relevant circulars.

- The form of audit report to be submitted by the auditor such as Long Form Audit Report (LFAR) as applicable to StCBs and DCCBs prescribed by RBI and NABARD. Several of these requirements are covered by the following minimum reporting requirements:
  - affirmations on proper maintenance of books of accounts; agreements of financial statements with the books of accounts; availability of necessary information and explanations; and true and fair nature of the financial statements;
  - particulars of transactions that may appear to be contrary to the provisions of the Act, Rules, Notifications, Circulars of RBI and NABARD;
  - all sums that should have been brought in to the accounts but have not been brought in;
  - any impropriety or irregularity in the expenditure or in the realization of moneys due to the StCBs and DCCBs;
  - any money or asset which appears to be bad or doubtful of recovery;
  - any other matter that is specified.
Chapter 5
Auditors’ Roles and Responsibilities

5.1 Powers of Auditors
Auditors should have free access to books and records of the StCBs and DCCBs at all reasonable times to ensure that they can discharge their duties without any hindrance. In the presence of responsible officials of StCBs and DCCBs, auditors shall also be given access to cash, securities and documents of StCBs and DCCBs to facilitate the audit procedures;

Auditors are also entitled to requisition any data or information relating to any transaction, working and affairs of the StCBs and DCCBs from current and/or past officers, employees and members of the bank;

As may be required under the provisions of the Act, auditors can probe even beyond the books of accounts and other information and evaluate the services rendered by the StCBs and DCCBs to ensure that the objectives of StCBs and DCCBs are met with and that its transactions with the members and other stakeholders are reasonable and were carried out in accordance with the principles of co-operation, the provisions of the Act, Rules, Registered Bye-laws of StCBs and DCCBs, Notification, Guidelines, Circulars issued by RBI & NABARD from time to time and other administrative and executive circulars and instructions issued by the regulators and other authorities;

In connection with the audit of StCBs and DCCBs, auditors shall have adequate powers to call upon for explanations and responses on any matter/deficiency/defect as observed by the auditors during the course of their audit;

Auditors shall have powers to visit any facility of the StCBs and DCCBs or facilities/crops of its borrowers to physically verify the existence of the assets financed by StCBs and DCCBs.

5.2 Duties and Responsibilities of Auditors
As part of the audit of StCBs and DCCBs, auditors shall examine and verify all books of accounts, records, assets and liabilities to satisfy themselves that they relate to StCBs and DCCBs and to enable expressing an opinion on the same;
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An audit report in such format and content as may be prescribed shall be submitted by the auditors immediately upon completion of the audit;

In addition to the above, based on the recommendations made by a study team, NABARD advised StCBs & DCCBs to include following areas in the Engagement Letters to be issued to the statutory auditors of the bank:

i. Verification of cash bank balances and securities.

ii. Verification of balances at the credit of depositors, creditors and of the amount due from the debtors of the bank.

iii. Examination of overdue debts.

iv. Valuation of assets and liabilities of the bank.

v. Evaluation of the accounting system and internal controls in operation and reporting on the weaknesses observed.

vi. Examination of accounts and related records and verification of financial statements and expression of auditor's opinion on the same.

vii. Review of the adequacy of compliance with risk management framework of the bank.

viii. Review of the adequacy of compliance with the internal audit function of the bank.

ix. Review of classification of loans and advances and comment on the adequacy of provision for losses and classification of assets.

x. Review of compliance with applicable laws, regulations, guidelines/instructions and report on violations.

xi. LFAR as already prescribed by NABARD.

5.3 Audit of Accounts

Statutory Audit of a StCBs or DCCBs involves:

- Audit of Head Office
- Audit of Zonal/Regional/Other Administrative Offices
- Audit of Branches

As per the guidelines issued by NABARD, branches covering at least 70% of total advances outstanding of a bank must be covered by audit. A branch having advances in excess of Rs. 2 crores, as on the balance sheet date, is compulsorily required to be subjected to statutory audit. Other branches are
subject to statutory audit, at least once in a cycle of 3 years. In addition, some other branches may be compulsorily required to be audited as per requirement of guidelines laid down by NABARD. Bank management has discretion to increase the number of branches in addition to the minimum branches required as per NABARD guidelines.

5.4. Auditors’ Report
Auditors of StCBs and DCCBs are required to prepare a report on the financial statements audited by them and submit the same to the members of the bank.

A specimen of Auditors’ Report is given in Annexures to the Guidance Note.

5.5 Long Form Audit Report
Apart from the Auditors’ Report submitted to the members, auditors are required to prepare Long Form Audit Report, as per the guidelines issued by NABARD for StCBs & DCCBs. The requirements as to LFAR are discussed in detail in Chapter 20 of the Guidance Note.

5.6 Special Reports/ Notes, if required to be given along with the Audit Report

Indicative Notes
1) Special note on serious violations of statutory provisions, violation of important provisions of Co-operative Societies Act/Rules/Bye laws etc., if any.

2) Special note on irregularities, if any, noticed in utilization of various types of credit limits sanctioned by the StCBs which warrant immediate action.

3) Special note on serious frauds/complaints against the bank.
6.1 Acts, Rules & Regulations applicable to StCBs & DCCBs

There is an elaborate legal framework governing the functioning of Co-operative banks in India. The principal enactments which govern the functioning of various types of Co-operative banks are:

- Co-operative Societies Act, 1912 or the relevant State Co-operative Societies Act, applicable Rules under which the bank is registered and its Registered Bye-laws.
- Rules, Bye-Laws and Guidelines prescribed by the Reserve Bank of India.
- Banking Regulation Act, 1949 (As applicable to Co-operative Societies).
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.
- Deposit Insurance and Credit Guarantee Corporation Act, 1961.
- National Bank for Agriculture and Rural Development Act, 1981.
- Negotiable Instruments Act, 1881.
- Regional Rural Banks Act, 1976.
- Companies Act, 1956.
- Credit Information Companies Regulation Act, 2005.
Beside the above enactments, various circulars/guidelines issued by RBI, NABARD and respective State Governments as well as the Bye Laws of the respective banks are also applicable to StCBs and DCCBs.

6.2 Constitution

The StCBs and District Central Co-operative Banks (DCCBs) are constituted as “co-operative societies” under the Co-operative Societies Acts of the respective States, in which the registered office of the bank is situated.

6.3 Applicability of Banking Regulation Act to StCBs and DCCBs

The Banking Regulation Act, 1949 was amended and provisions “As Applicable to Co-operative Societies” (AACS) came into force w.e.f. 01st March, 1966.

The Act has vested the Reserve Bank of India with various statutory powers for control & supervision over the Co-operative banks. However, the powers in respect of incorporation, management etc. of these banks are vested with the Registrar of the Co-operative Societies of the respective states.

The provisions of Banking Regulation Act, 1949 (AACS) in addition to the other laws applicable to them. In respect of matters specifically provided in the said Act, the provisions of the said Act and rules will prevail over the provisions of the respective Co-operative Societies Act and Rules made there under.

6.4 Various Returns to be filed by StCBs and DCCBs

The Banking Regulation Act, 1949 requires the following returns to be furnished to the Reserve Bank of India:

(a) Monthly return of assets maintained in India in accordance with Section 24 and demand and time liabilities in India at the close of business on each alternate Friday during the month. [Section 24]

(b) Quarterly return of assets and liabilities in India at the close of business on the last Friday of every quarter. [Section 25]

(c) Annual return of unclaimed accounts which have not been operated for 10 years. [Section 26]
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(d) Monthly return of assets and liabilities in India at the close of business on the last Friday of every month. [Section 27]

In addition to the above, in exercise of its powers under Section 27 of the Banking Regulation Act, 1949 the RBI requires a large number of returns to be furnished to it. Some of the important returns required to be furnished to the RBI are enumerated below, with their periodicity indicated in parentheses.

(a) Report on non-performing advances (annual).
(b) Statement showing the position of reconciliation of investment account (annual).
(c) Statement on compromises and settlements involving write off (half-yearly).
(d) Statement on bad debts written off (annual).
(e) Details of doubtful or loss assets and also suit filed accounts with outstanding aggregating Rs. 1 crore and above (half-yearly).
(f) Details of remittance of profits/surplus retained in India (annual).
(g) Particulars of provisions held on problem credits of overseas branches (half-yearly).
(h) Inter-branch reconciliation (quarterly).
(i) Reconciliation of outstanding inter-branch accounts (annual).
(j) Reconciliation of clearing differences (annual).
(k) Position of balancing of books (quarterly).
(l) Returns relating to frauds, robbery, etc. including fraud involving Rs. 1 crore and above (quarterly).
(m) Return of capital adequacy (quarterly).
(n) Return on asset quality (quarterly).
(o) Asset-liability management (monthly).

6.5 Some Important Sections of Banking Regulation Act, 1949 which are relevant for StCBs and DCCBs

6.5.1 Section 9: Disposal of Non-banking Assets

This section prohibits banks from holding any immovable property other than
the properties required for its own use, from a period exceeding seven years from the acquisition.

6.5.2 Section 11: Paid-up Capital
This section prescribes the minimum paid-up capital & reserves for a bank. Accordingly a co-operative bank can commence or carry on its banking business if and only if the aggregate value of its paid-up capital and reserves exceeds Rs. 1 Lakh. As per section 11(1) the value means Real or Exchangeable Value (REV) and not the nominal value.

6.5.3 Section 18: Cash Reserve
This section stipulates that every bank shall maintain in India by way of cash reserve with itself or with current account with RBI or other prescribed banks, amount equivalent to prescribed percentage of its total demand and time liabilities in India as on the last Friday of the second preceding fortnight. Also on monthly basis every bank shall submit to RBI returns showing the amounts of cash reserves held.

6.5.4 Section 19: Restriction on Holding of Shares in Other Co-operative Societies
This section stipulates that no co-operative bank can acquire & hold shares in other co-operative society except to such extent and subject to the conditions specified by RBI. However provisions of this section are not applicable to the DCCBs for holding the shares of the SICBs to which it is affiliated.

6.5.5 Section 21: Power to Regulate Advances by Banks
This section empowers the RBI to determine policy, regulate, issue guidelines relating to the purpose for which advances may or may not be made, margins to be maintained in respect of secured advances, maximum amount of advances or other financial accommodation may be made by a bank to any one company, firm, association of persons or individual, rate of interest and other terms and conditions for advances.

6.5.6 Section 22: Licensing
This section states that no co-operative society can carry out the banking business unless it holds a license issued by RBI in this behalf.
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6.5.7 Section 24: SLR requirements
This section stipulates the provisions relating to maintenance of the Statutory Liquidity Ratio in the prescribed manner & reporting requirements thereof.

6.5.8 Section 26: Unclaimed Deposits
This section contains provisions regarding submission of returns with RBI regarding non-operative and unclaimed deposit accounts.

6.5.9 Section 29: Accounts & Balance Sheet
Provisions/guidelines relating to the annual accounts and balance sheet are given in this section. The StCBs & DCCBs are now required to prepare their Profit and Loss Account and Balance Sheet as at 31st March every year in the form set out in the Third Schedule to the Act as near thereto as circumstances admit.

6.5.10 Section 31: Submission of Returns
Every co-operative bank has to submit to RBI three copies of Profit and Loss Account and Balance Sheet together with the Statutory Auditors’ Report signed by the principal officer of the bank and at least three directors before 30th September each year. Also the annual financial statements are required to be published under Rule 10 in one of the local news papers.

6.5.11 Section 35: Inspection
This section contains provisions regarding the inspection of books and records of banks by the officers of RBI. Such inspection shall also be conducted, upon the direction given by the Central Government.

As per sub-section (2), the RBI may also cause, at any time, a scrutiny of the affairs of any bank and its books and accounts.

If the Central Government is of opinion that the affairs of any bank are being conducted to the detriment of the interests of its depositors, then the Central Government under the powers conferred under sub-section (4) :

(a) prohibit the bank from receiving fresh deposits.
(b) direct the Reserve Bank to apply under Section 38 for winding up of the bank.

6.6 State Co-operative Societies Act & Rules
The auditor should verify the following provisions relating to accounts and
Legal Framework

audit provided in the respective State Co-operative Societies Act at the time of finalization of accounts and the audit:

1. Ascertainment & appropriation of profits, preparation of annual accounts.
2. Holding of annual general meetings & business to be transacted thereat.
3. Adoption of annual accounts & financial statements.
4. Audit of accounts.
5. Rectification of defects in accounts.
6. Restrictions on borrowings.
7. Form of balance sheet and profit & loss accounts.
8. Accounts and books to be kept.
9. Returns to be furnished to Registrar.
Chapter 7
Regulatory Authorities for StCBs and DCCBs

7.1 Reserve Bank of India

Reserve Bank of India (RBI) is the central bank of our country. The basic function of the Reserve Bank of India is to regulate the issue of bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage. As such, RBI is responsible for development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions) as well as for determining, in conjunction with the Central Government, the monetary and credit policies keeping in view the need of the hour. Among its important functions is issuance of currency, regulation of currency issue; acting as banker to the central and state governments; and acting as banker to commercial and other types of banks including term-lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks. No bank can commence the business of banking or open new branches without obtaining license from RBI. The RBI also has the powers to inspect any bank.

RBI is empowered under Section 21 of the Banking Regulation Act, 1949, to control advances by banks in general or by any bank in particular. Among the measures that the RBI can adopt for this purpose are to prescribe purposes and extent of advances, margin requirements, maximum exposure to a single borrower, rate of interest and other terms and conditions, etc. Besides these measures (which are usually called 'selective credit control' measures), RBI also controls the total volume of bank credit by varying bank rate through open market operations or by varying cash reserve and similar requirements.

Bank rate refers to the rate of interest at which the RBI re-discounts the first class bills of exchange or other eligible instruments from banks. Variations in bank rate affect the interest rates charged by banks – generally, interest rates of banks move up or down in tandem with movements in bank rate.

Open market operations involve sale or purchase of government securities in the open market. When RBI buys government securities from banks in the
open market, the funds in the hands of selling banks increase, enabling them to expand credit, and vice versa.

Banks are required to maintain at least a prescribed minimum percentage of their demand and time liabilities in India in the form of cash and/or current account balances with the RBI (called cash reserve). Additionally, they are required to maintain a further percentage in the form of cash and/or other liquid assets (called statutory liquidity ratio). Varying the cash reserve ratio and/or statutory liquidity ratio enables the RBI to increase or decrease (as the case may be) the funds available to banks for lending and other similar purposes.

Apart from directions relating to operational matters, RBI also issues, from time to time, guidelines on accounting matters to be followed by banks. These guidelines have a profound effect on annual accounts of banks. The text of the notifications/circulars/guidelines, etc., issued by RBI are also available on website www.rbi.org.in.

7.2 NABARD

7.2.1 Establishment

National Bank for Agricultural & Rural Development (NABARD) was constituted under NABARD Act, 1982 and started functioning in July 1982. NABARD is the apex bank for agricultural and rural credit. It provides credit to agricultural, small and cottage industries and other allied industrial activities in rural areas. NABARD thus has responsibility of integrated rural development. NABARD has taken over rural credit functions of RBI and refinance functions of Agricultural Refinance Development Corporation (ARDC). NABARD acts as apex bank in rural credit system and regulates activities of other credit institutions. It provides short term & long term credit to StCBs, RRBs and Land Development Banks and also provides refinance to these institutions.

NABARD has been sharing with the Reserve Bank of India certain supervisory functions in respect of Co-operative Banks and Regional Rural Banks (RRBs).
7.2.2 Core Functions of NABARD

NABARD has been entrusted with the statutory responsibility of conducting inspections of State Co-operative Banks (StCBs), District Central Co-operative Banks (DCCBs) and Regional Rural Banks (RRBs) under the provision of the Banking Regulation Act, 1949. In addition, NABARD has also been conducting periodic inspections of state level co-operative institutions such as State Co-operative Agriculture and Rural Development Banks (SCARDBs), Apex Weavers Societies, Marketing Federations, etc. on a voluntary basis.

As a part of supervisory functions, NABARD conducts:

- Periodic on-site inspection of StCBs, DCCBs, SCARDBs and RRBs and other Apex level Co-operative institutions
- Supplementary Appraisal
- Off-site Surveillance System (OSS)
- Portfolio Inspection/System Study
- CMA Returns

7.2.3 Supervisory Strategy

In the wake of the banking sector reforms, new set of international norms/practices were made applicable to Commercial Banks (CBs) to make them more competitive and sustainable in the changing scenario. The co-operative banks and RRBs were also to function in the general banking environment, emerging out of the financial sector reforms, introduced by the GoI/RBI. Accordingly, the prudential norms were extended to them in phases. While the capital adequacy norm has not yet been made applicable to these banks, the other prudential norms viz. income recognition, asset classification and provisioning, which were made applicable by RBI to the commercial banking sector had been extended to cover RRBs in the year 1995-96, StCBs and DCCBs in the year 1996-97 and to SCARDBs in the year 1997-98. NABARD, through a concrete and time-bound supervision strategy, facilitates these banks to adjust to the new financial discipline so as to internalize prudential norms stipulated.

7.2.4 Current Focus

Under the revised strategy, a sharp focus of the NABARD’s inspection was given on the core areas of the functioning of banks pertaining to Capital Adequacy, Asset Quality Management, Earnings, Liquidity, Systems and
Compliance (CAMELS). Thus, NABARD’s focus in its statutory ‘on-site’ inspections is on core assessments leaving the collateral appraisals to supplementary inspections. The micro level aspects are to be taken care of by the banks themselves by way of internal inspections or by other agencies such as auditors. In this direction, through a series of workshops and meetings held with the Chief Executives and auditors of co-operative banks, NABARD attempted to ensure that the other areas, particularly relating to the internal checks and controls, revenue and income realization by way of interest on loans and deposits and other routine features of carrying out general banking transactions were suitably taken care of by the respective banks and their concurrent/statutory audit systems.

7.3 Registrar of Co-operative Societies

In order to implement the provisions of Co-operative Societies Act such as registration of the societies, supervision, administration and liquidation of the societies are vested with the Registrar of Co-operative Societies. The powers and duties of the Registrar are prescribed under the respective Co-operative Acts and the Rules there under.
8.1 Accounting Systems

The auditor of the bank needs to obtain a thorough understanding of the accounting system of the bank to assess the relevance and reliability of the accounting records and other source data underlying the financial statements. He should gain an understanding of the books of account and other related records maintained by the bank. He should also understand the flow of various kinds of transactions. The auditor could gain such understanding through enquiries from appropriate personnel, by making reference to documents such as accounting manual, procedures manual and flow charts, and by observing the actual conduct of operations.

8.2 Salient Features of Accounting Systems of Banks

Banks, like most other large-sized institutions, follow the mercantile system of accounting. Thus, the system of recording, classifying and summarizing the transactions in a bank is in substance no different from that followed in other entities having similar volume of operations. However, in the case of banks, the need for the ledger accounts, especially those of customers, being accurate and up-to-date is much stronger than in most other types of enterprises. A bank cannot afford to ignore its ledgers particularly those containing the accounts of its customers and has to enter into the ledgers every transaction as soon as it takes place.

Banks follow the accounting procedure of ‘voucher posting’ under which the vouchers are straightaway posted to the individual accounts in the subsidiary ledgers. At the end of each day, the debit and credit vouchers relating to a particular type of transactions (e.g. savings bank accounts, current accounts, demand loans, cash credit accounts, etc.) are entered on separate voucher summary sheets and the total thereof is posted to the respective control account in the General Ledger. The general ledger trial balance is prepared every day.
Both debit and credit operations on all accounts - either by customers or by the bank itself are made by means of vouchers. There are two kinds of vouchers - one, which evidence only debit or credit to an account, and the other, which contain both debit and credit to different accounts, the latter kinds of vouchers may be called 'composite vouchers'.

An illustrative list of debit vouchers is given below:

- Cheques issued by the customers.
- Cheques/pay orders issued by the bank.
- Withdrawal forms received from the savings bank account holders.
- Drafts issued by other branches of the bank payable at the branch.
- Drafts issued by other banks on the branch, in terms of an approved arrangement between the two banks.
- Dividend/interest warrants issued by the bank's customers and payable by the branch in terms of an approved arrangement.
- Letters of authority signed by the customers, containing 'standing instructions'.
- Traveller's cheques issued by any branch of the bank which are presented to the branch for payment.
- Drafts/pay orders issued by the branch itself which are cancelled at the request of the customer and amount is refunded to him.
- Instruments like traveller's cheques/gift cheques, etc. of other banks which are paid by the branch in terms of an approved arrangement.
- Debit vouchers prepared by the branch on its printed stationery which are authorised by a designated official of the bank and may also carry authority from the customers in some cases, if the debit is to his account at the branch.
- In respect of realisation of collection instruments sent to other branches of the bank, a debit advice (which may be known by different names in different banks) prepared by the other branch may itself be treated as a debit voucher.
- In case of remittance of funds by one branch to the other by means of telegraphic transfer or a mail transfer, the bank may treat the advice of transfer itself as debit voucher or may prepare a separate debit voucher.
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An illustrative list of credit vouchers is as follows:

- Pay-in-slips filled in by the customers (depositors as well as borrowers) for deposit of amounts in their accounts. Generally, the pay-in-slips are in a standard format adopted by the bank but there may be cases of a special kind of pay-in-slips in respect of some customers pursuant to a formal agreement between the bank and the customer.

- Applications for issue of demand drafts, mail transfers, telegraphic transfers, banker's cheques, pay orders, gift cheques, traveller's cheques and other similar instruments. Some of these applications may be made on behalf of the branch itself for the payments it has to make.

- Challans for deposits into the accounts of Central/State Government, e.g., on account of direct/indirect taxes or under schemes like public provident fund, etc.

- Credit vouchers prepared by the branch on its printed stationery which are authorised by an official of the bank. Normally, these vouchers are signed on behalf of the branch only but there may be some instances where the customer concerned also signs on the voucher as evidence that the transaction actually pertains to him. Examples are, deposit of locker charges (credited to an income account of the bank); deposit of money with the bank for purchase of non-judicial stamps required for execution of documents in favour of the bank, etc.

On payment of collection instruments received from other branches of the bank, a credit advice (which may be known by different names in different banks) or a copy of the collection schedule received from the other branch may itself be treated as a credit voucher.

It may be stated here that in case of debits or credits of similar nature to a large number of accounts in the same ledger or group of ledgers (e.g. debit on account of periodic interest, inspection charges etc. or credit on account of periodic payment of interest to depositors), it is a common practice among banks to prepare a consolidated voucher on their stationery and enclose thereto a list containing details of accounts debited/credited and the amount of debit/credit.

As stated earlier, apart from debit vouchers and credit vouchers, there is also a category of ‘composite vouchers’. These vouchers record the particulars of both debit and credit accounts. Most of the transactions covered by composite vouchers pertain to the internal accounts of the bank, i.e., non-customer accounts. Examples are, bills received for collection; letters of credit issued by
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the branch; guarantees issued by the branch, etc. Such vouchers may also be prepared to rectify an error while debiting/crediting an account. For example, in case the current account is debited in general ledger instead of cash credit account by mistake, the composite voucher will show debit to cash credit account with a corresponding credit to current account.

All entries in the personal ledgers and the summary sheets are checked by persons other than those who have made the entries. Most clerical errors are thus detected immediately.

8.3 Principal Books of Account

The principal books of account, subsidiary books and statistical records generally maintained by banks are described in the following paragraphs. It may, however, be emphasized that the exact nature of such books may differ from one bank to another, depending upon the individual requirements of each bank.

List of books maintained by the banks are as under:

(a) **General Ledger**: The general ledger contains control accounts of all personal ledgers, the profit and loss account and different asset and liability accounts. There are certain additional accounts also (known as contra accounts) which are kept with a view to keeping control over transaction which have no direct effect on the assets and liabilities of the bank and represent the agency business handled by the bank on which it earns service charges; e.g., letters of credit opened, bills received or sent for collection, guarantees given, etc.

(b) **Profit and Loss Ledger**: Banks generally maintain a profit and loss account in the general ledger and maintain separate books for each revenue or expense head/sub-head. For example, there are separate accounts for basic salary, dearness allowance and various other allowances, which are grouped together in the published accounts. Similarly, various accounts comprising general charges, interest paid, interest received, etc., are maintained separately in the profit and loss ledgers.

The detail description of various books and records maintained by the banks are given in the Guidance Note on Audit of Banks published by the ICAI.

8.4 Subsidiary Books

(a) **Personal Ledgers/Subsidiary ledgers**: Each control account in the general ledger is supported by a subsidiary ledger (or more than one
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subsidiary ledger if the number of accounts is large). Thus, in respect of control accounts relating to accounts of customers, subsidiary ledgers are maintained for:

(i) various types of deposit accounts (savings account, current account, recurring deposits, etc.) which contain accounts of individual customers. Each account holder is allotted a separate folio in the ledger;

(ii) various types of loan and related accounts (cash credit, term loans, demand loans, bills purchased and discounted, letters of credit opened, bank guarantees issued) wherein the liability of each customer is reflected.

(iii) separate registers are maintained to record the particulars of term deposits (including derivatives like call deposits, certificates of deposits, etc.).

(b) Bills Registers: Details of different types of bills are kept in separate registers which have suitable columns. For example, bills purchased, inward bills for collection, outward bills for collection etc., are entered serially on a daily basis in separate registers. In the case of bills purchased or discounted, party-wise details are kept in normal form to ensure that the sanctioned limits of parties are not exceeded.

(c) Head Office Account, Inter-office Account: All such transfers of funds are channelised through a nodal account (this account has different names in different banks, e.g. Head Office Account, Inter-office Account, and so on).

(d) Suspense Register: Banks maintain a Suspense Ledger to record various suspense accounts. Sometimes due to clerical errors, e.g.; in preparing the voucher summary sheets, the trial balance may not tally. In such a situation, the difference is temporarily transferred to a Suspense Account (in case of short debit). Similarly, transactions of transitory nature, e.g., travel advances to employees, are also recorded in a suspense account pending their adjustment in the related expenses/income account.

(e) Departmental Journals: Each department of the bank maintains a journal to note the transfer entries passed by it. These journals are memoranda books only, as all the entries made there are also made in the day book through voucher summary sheets. The purpose of such a journal is to maintain a record of all the transfer entries originated by the department. As has been mentioned earlier, ‘a composite voucher’ (or two separate vouchers for debit and credit) is generally prepared for each transfer entry.
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The composite voucher is generally prepared by and entered into the Journal of the department which is accordingly credited to the other department. For example, if any amount is to be transferred from account of customer to his saving bank account, the voucher will be prepared by the current account department and entered in the journal of that department. Some of the important departmental books are described below:

1. **Cash Department:** The following books are usually maintained by the cash department:
   (a) Receiving cashiers' cash book
   (b) Paying cashiers’ cash book
   (c) Head cashier’s book
   (d) Cash balance book

2. **Outward Clearing Department:** The following books are usually maintained by the outward clearing department:
   (a) Clearing cheques received book for entering cheques received from customers for clearing;
   (b) Bank-wise list of the above cheques, one copy of which is sent to the clearing house along with the cheques.

3. **Inward Clearing Department:** The inward clearing department maintains a memorandum book to record the number of cheques given to each department.

4. **Loans and Overdrafts Department:** The Loans and Overdrafts Department usually maintains the following books:
   (a) Registers to record details of documents executed by the borrowers and guarantors in respect of credit facilities.
   (b) Securities registers for recording details of securities in respect of credit facilities.
   (c) Pending documents and document deficiency register.
   (d) Godown registers maintained by the godown-keepers of the bank.
   (e) Price register giving the wholesale prices of commodities pledged with the bank.
   (f) Overdraft sanction register.
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(g) Drawing power book
(h) Delivery order books
(i) Storage books
(j) Stock statements registers for loan accounts
(k) Suit filed register
(l) Inspection register for loan accounts

5. **Deposits Department** : The deposits department usually maintains the following books:
   (a) Account opening and closing register
   (b) Fixed deposits, rate register giving analysis of fixed deposits rates
   (c) Due date diary
   (d) Specimen signature book, containing specimen signatures of deposit account holders.

6. **Establishment Department**: The establishment department usually maintains the following:
   (a) Salary and allied registers, such as attendance register, leave register, overtime register, etc.
   (b) Register of fixed assets, e.g., furniture and fixtures, vehicles, etc.
   (c) Registers to record receipt, issue and balance of stationery including security papers, e.g., draft forms, cheque books, etc.
   (d) Old records register.

7. **General**: Besides the above, banks also maintain the following:
   (a) Specimen signature book (of the bank’s officers).
   (b) Private telegraphic code and cyphers.
   (c) Back up registers for various types of returns/statements.
   (d) Safe deposit lockers/safe custody registers.
   (e) Registers to record particulars of lost instruments (drafts, cheques, etc.) based on details received from the head office.
   (f) Transit books through which instruments are sent to the cash
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department for payment by the official authorising such payment.

(g) Registers to record particulars of outstanding inter-office entries received from the reconciliation department of the bank which are to be responded to by the branch.

(h) Cheque books issued register.

(i) Token register.

(j) Stop payment registers.

(f) Suitable registers with back-up registers to record classification under numerous sub-heads are maintained for:

1. Establishment expenses
2. Interest and discount income
3. Incomes by way of commission
4. Interest expenditure
5. Provision for interest accrued but not due on deposits
6. Fixed assets
7. Stationery consumed/in hand
8. Interest payable to, and receivable from head office, in respect of advances and deposits respectively.
9. Instruments received from customers for payment/collection by the branch. Separate registers are maintained to record and summarise the transactions relating to a particular head of account like Current Account, Savings Bank, Cash Credit, Term Loans. Such books may be called Log Books, Day Books, etc. The totals in this book are carried over to the cash book.

(g) In addition, there are different registers/records to record detailed particulars of various types of transactions. These registers/records do not form part of books of account but support the entries/balances in the various accounts. Some of the important registers/records relate to the following:

1. Drafts issued (separate registers may be maintained for drafts issued by the branch on other branches of the same bank and those on the branches of its correspondents in India or abroad). Depending upon the volume of business, some branches may have separate registers on some other basis also, like whether the drafts issued advice is
Guidance Note on Audit of StCBs & DCCBs

prepared or not/registers exclusive for some high volume customers of the bank/the range within which the amount of draft falls, e.g. below Rs. 1 lakh, Rs. 1-10 lakh, Rs. 10-100 lakh, etc.

2. Drafts paid (separate registers may be maintained on the same pattern as in the case of drafts issued).

3. Issue and payment of-
   (i) telegraphic transfers
   (ii) mail transfers
   (iii) bankers’ cheques/pay orders/Traveller’s cheques/gift cheques

4. Letters of credit.

5. Letters of guarantee.

8.5 List of Books of Accounts/Registers to be maintained by StCBs and DCCBs

An illustrative list of books of /registers accounts that are generally required to be maintained by StCBs and DCCBs are as follows:

- share capital ledger;
- daily deposit register;
- savings account ledger;
- fixed deposit ledger;
- recurring deposit ledger;
- borrowings ledger;
- cash book;
- investment ledger;
- short term loan ledger;
- MT/LT disbursement cum loan ledger;
- furniture, fittings, office equipment and other movable asset register;
- depreciation chart;
- sundry debtors ledger;
- sundry creditors ledger;
- safe deposit locker operation register;
Accounting Systems, Books and Registers of StCBs and DCCBs

- insurance policy register;
- minute book (meetings of board and/or management committee);
- purchase register;
- sale register;
- costing register;
- stock register;
- day book;
- bank book;
- general ledger;
- monthly interest payment register;
- accounts opened & closed register;
- gold stock register;
- maturity register for term, recurring and reinvestment deposits quarterly;
- register for acknowledgement of debt;
- NPA register (Statement of loan outstanding).
- demand, collection and balance register
- advance monitoring registers like, stock statement register, book debt statement register, limitation/due date register, review/renew register, insurance register, inspection register, mortgage register, drawing power register, suit file/ decree register, etc.
- other registers, books, accounts, ledgers depending on the requirement of the banks, banking business and the guidance issued by the regulator from time to time.

8.6 Incomplete Records

In some situations, the auditor may find that certain accounting and other records are not up-to-date. In such a situation, the auditor should first ascertain the extent of arrears in house-keeping, and the areas in which accounting and other records are not up-to-date. In case it is found that the general ledger, the main cash book, or the trial balances are in arrears or that they do not tally, the auditor should consider expressing a qualified opinion, adverse opinion or disclaimer of opinion, as may be appropriate in
Guidance Note on Audit of StCBs & DCCBs

the circumstances. In case any subsidiary ledgers are in arrears, the auditor should consider the impact of such arrears on the financial statements of the bank. It may be pointed out that in the absence of balanced and up-to-date subsidiary ledgers, verification of transactions or of year-end balances may become difficult. In such cases also, the auditor should consider expressing a qualified opinion, adverse opinion or disclaimer of opinion, as may be appropriate in the circumstances. It should also be noted that in long form audit report (LFAR), the auditor has to make detailed observations on such arrears of house-keeping. Therefore, from this point of view also, it is important for the auditor to satisfy himself about the completeness of all records before submitting his audit report.
Chapter 9
Financial Statements - Forms and Contents

9.1 Introduction
The financial statements reflect the financial position of the banks as on a particular date. These financial statements have to be prepared as per the provisions of the Act under which the banks are registered as on the last working of each financial year in respect of all business transacted during the year.

9.2 Legal Provisions regarding the Forms and Content of Financial Statements
Section 29 (1) and 29 (2) of the Banking Regulation Act, 1949 (AACS) deal with financial statements (Balance Sheet and Profit & Loss Account) of a co-operative bank.

(i) As per section 29 (1), every co-operative bank, in respect of all business transacted by it, shall prepare a balance sheet and profit and loss account as on the last working day of the year, in the forms set out in the Third Schedule of the Act.

(ii) As per sub-section 2, the balance-sheet and profit and loss account shall be signed by the Manager or the Principal Officer of the bank and where there are more than three directors of the bank, by at least three of those directors, or where there are not more than three directors, by all the directors.

1. The formats and contents of the Financial Statements are set out in the Third Schedule of the Banking Regulation Act. Form A contains the form at Balance Sheet and Form B contains the format of Profit & Loss Account in vertical as well as T-shape format for both the financial statements. For the purpose of this Guidance Note, the vertical format has been considered. The broad heads for the Balance Sheet and Profit & Loss Account are given in the Annexures to the Guidance Note alongwith the Assets Classification and Provisioning Statement as on the date of audit.
Guidance Note on Audit of StCBs & DCCBs

9.3 Additional Disclosures prescribed by RBI

In order to bring transparency in the annual financial statements of StCBs & DCCBs, RBI has introduced certain disclosure standards in the form of “Notes on Accounts” to the financial statements. In this regard, RBI has issued circular No. RBI/2005-06/178 RPCD. CO. RF. BC. No. 44/07.38.03/2005-06 dated 10th October, 2005 (The circular is given in the CD along with the Guidance Note). The StCBs & DCCBs are accordingly required to furnish the additional information from the year ending March 31, 2006 onwards and also disclose CRAR as per RBI circular dated 4th December, 2007. Various disclosures to be given in the “Notes to Accounts” are as under:

a. Investments

SLR & non-SLR investments made by the StCBs & DCCBs are categorised as permanent investments & current investments. Banks are required to make below mentioned disclosures by way of notes to accounts.

In respect of SLR investments, the break-up of the investments under permanent and current category is required to be disclosed. Moreover, the information regarding the book value, face value & the market value on the date of the balance sheet in respect of the investments under the current category is required to be disclosed.

As regards to non-SLR investments, the instructions regarding disclosure of the same given in the RBI circular No. RPCD. CO. RF. BC. No. 65/07.02.03/2003-04 dated 23rd February 2004 (The circular is given in the CD along with the Guidance Note) is required to be followed. As directed in the said circular, the disclosure is required to be given on the details issuer composition & non-performing non-SLR investments.

The total non-SLR investments of bank are to be bifurcated between the instruments/securities issued by Public Sector Undertakings, All India Financial Institutions, Banks, Private Corporates & others like Central and State Government Sponsored Institutions. Further, the information regarding the extent of private placement, extent of below investment securities already invested, extent of unrated securities already invested, and extent of unlisted securities of the so bifurcated securities is also required to be disclosed. The amount of provision held towards depreciation of non-SLR investments is required to be given.
The statistical data regarding Opening balance of non-performing non-SLR investments, additions and reductions in the same, during the year under reference, closing balance of the non-performing non-SLR investments as at the balance sheet date, total amount of provision held towards non-performing non-SLR investments is required to be disclosed.

b. **Advances to the Directors or their Relatives**

Advances made by the bank to its directors or their relatives and to the firms or companies in which the directors or their relatives are interested are required to be disclosed separately. While giving the said disclosure, the fund based advances and non-fund based advances in the nature of bank guarantees, letters of credits are to be disclosed separately.

A person shall be deemed to be relative of the director of the bank if:

- They are members of a Hindu Undivided Family.
- They are husband & wife.
- They are related to each other in the manner indicated below:
  - Father
  - Mother (including step mother)
  - Son (including step son)
  - Son’s wife
  - Daughter (including step daughter)
  - Daughter’s husband
  - Brother (including step brother)
  - Brother’s wife
  - Sister (including step sister)
  - Sister’s husband

Concerns in which a director or his relative is interested shall mean:

- Proprietary concerns or partnership firms or Hindu Undivided Family (HUF) concerns or association of persons in which the director or his above referred relative is interested as proprietor/ partner/ co-parcener.
- Private/public limited companies where a director is a guarantor for repayment of loans granted to the company.
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c. Average Cost of the Deposits

The information regarding the average cost of the deposits for the year under reference is required to be disclosed.

d. Non-performing Assets (NPA)

In case of non-performing advances of the bank, the following details are required to be disclosed:

- Gross amount of NPA as on the balance sheet date.
- Net amount of NPA after deducting the provisions made for the NPAs (Bad and doubtful debt reserve-BDDR).
- The percentage of gross NPA to total advances of the bank
  - The percentage of the gross NPA is worked as
  - Total amount of gross NPA/total outstanding advances X 100
- The percentage of the net NPA to the net advances of the bank.

The percentage of net NPA is worked as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross NPA as at the balance sheet date</td>
<td>xxx</td>
</tr>
<tr>
<td>Less: Amount of BDDR (NPA) provision</td>
<td>xxx</td>
</tr>
<tr>
<td>Net NPA (A)</td>
<td>xxx</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross total advances as at the balance sheet date</td>
<td>xxx</td>
</tr>
<tr>
<td>Less: Amount of BDDR (NPA) provision</td>
<td>xxx</td>
</tr>
<tr>
<td>Net Advances (B)</td>
<td>xxx</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Percentage of Net NPA (A/B X 100)</td>
<td>xx %</td>
</tr>
</tbody>
</table>

e. Movement of NPAs

The information regarding movement in the NPAs as compared to the immediately preceding previous year is required to be disclosed. Any increase in the amount of NPA may be shown in the positive figures whereas the decrease in the amount of NPA may be disclosed by way of negative figure.
9.4 Profitability

a. Following items are required to be disclosed under this head:
   - Interest income as a percentage of working funds
   - Non-interest bearing income as a percentage of working funds
   - Operating profit as a percentage of working funds
   - Return on assets
   - Business (Deposits + Advances) per employee
   - Profit per employee

The following factors should be taken into consideration while calculating these ratios:

b. Interest income as a percentage of working funds

   Interest Income (as per P&L A/c)/Average Working Funds x 100.

   Working funds shall be calculated as under:

   Aggregate of balance sheet items excluding:
   - Contra items
   - Intangible assets like accumulated losses, overdue interest reserve, if shown as contra i.e. not routed through the P & L Account, etc.
   - Fixed assets like land, buildings, fixtures, fittings, furniture, plant and machinery, etc.
   - Branch adjustment (if the account happens to be shown on both sides of the balance sheet, taking into account only the net balance)
   - Stock of stationery, computers and vehicles and
   - Security deposits with service providers (like telephones, electricity connection, etc.)

   For calculation of working funds, average monthly figures of balance sheet items should be taken.

c. Non-interest income as a percentage to working funds

   Rest of income (other than interest on advances & investments) as per P&L Account/Average Working Funds (as above) x 100

d. Operating Profit as a percentage of working funds

   Operating profit/Working funds x 100
Guidance Note on Audit of StCBs & DCCBs

Operating Profit = (Interest Income on Loans and Advances and Investments + Other Operating Income) less (Interest Expenses on Deposits and Borrowings + Staff Cost + Other Operating Costs like rent, postage and stationary etc).

e. Return on Assets
Net Profit/Average Total Assets × 100

f. Provisions
Bank is required to disclose the amount of various provisions required to be made, as per the regulations, under certain heads vis-a-vis the amount of actual provisions made for arriving at the net profit/loss disclosure of following provisions is required:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount of provisions required to be made</th>
<th>Amount of provisions actually made</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overdue interest taken to income account, provisions for gratuity fund, provident fund and arrears in reconciliation of inter-branch accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation on investments</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The required provisions for NPA shall be made by the bank as per the guidelines, circulars issued by RBI/NABARD from time to time.

g. Movement in Provisions
The information regarding movement in the various provisions required to be made as well as actually made for the year under reference as compared to the immediately preceding previous year is required to be disclosed. Increase in the amount of provisions is to be shown in the positive figures whereas the decrease to be disclosed by way of negative figure. The movement in provisions is required to be disclosed in respect of following:
Particulars | Amount of Increase/(Decrease)
---|---
Movement in provisions towards:-
NPAs
Depreciation on Investments
Standard assets
Overdue interest income taken to income
Towards gratuity & provident fund
Arrears in reconciliation in inter-branch accounts etc.

h. Deposit Insurance & Credit Guarantee Corporation (DICGC) Premium

Disclosure should be made of amount of insurance premium paid to DICGC during the year along with bifurcation of the amount towards premium of the year under reference and towards arrears of the said premium for any earlier years, if any.

i. Penalty imposed by RBI

If penalty for violation of any of the provisions of the Banking Regulation Act, 1949 rules or guidelines issued by RBI/NABARD has been imposed by RBI/NABARD during the year under reference, the same has to be disclosed and brought to the attention of the readers of the financial statements.

j. Position of arrears in reconciliation of inter-bank and inter-branch accounts

Necessary statistics shall be disclosed in respect of such as number of entries pending in the inter-branch & inter-bank reconciliation, along with the total amount thereof, age-wise analysis thereof, amount of provision made, if any, against such net debit pending entries. If Net Debit balance is outstanding for more than six months, the bank has to make 100% provision as per RBI circular No. RPCD. RF. BC. No. 59/07.02.03/2003-04 dated 5th January 2004 (The circular is given in the CD along with the Guidance Note).

k. Accounting Policies & Other Disclosures under Accounting Standards

As per Accounting Standard (AS-1) issued by ICAI, relating to Disclosure of
Guidance Note on Audit of StCBs & DCCBs

Accounting Policies, the significant accounting policies followed in preparation of the financial statements needs to be disclosed at one place along with the financial statements. In addition, if any accounting policy is changed during the financial year, such change and financial impact thereof needs to be disclosed.

If the fundamental assumptions such as “Going Concern, Consistency and Accrual” are not followed, this fact needs to be disclosed. Accounting policies adopted by the enterprise should facilitate presentation of true and fair view of the state of affairs of the financial statements. Hence, every StCB & DCCB has to disclose the significant accounting policies followed for the preparation of the financial statements.

Accounting policies normally disclosed by banks consist of:

- Basis for preparation of Financial Statements/Accounting Conventions
- Use of estimates
- Revenue recognition
- Investments
- Advances
- Fixed Assets (including depreciation)
- Employee benefits
- Taxation

The format of Significant Accounting Policies to be disclosed is enclosed in Annexures to the Guidance Note. The format has been prepared as illustration only and does not purport to be model policies. The policies to be adopted by a bank may vary from this model.

9.5 Compliance with Accounting Standards

The Co-operative Societies Act (Central as well State Acts) or NABARD/RBI has not so far prescribed/recommended applicability of Accounting Standards to StCBs and DCCBs. However, as required by ICAI, while conducting audit of StCBs and DCCBs, Chartered Accountant firms must verify whether the accounts to be attested by them are in conformity with the Accounting Standards except in cases where the Parent Act or the Regulatory has prescribed a different treatment for the same.
9.6 Preparation, Adoption and Filing of Accounts

StCBs & DCCBs are required to prepare their Profit and Loss Account and Balance Sheet as at 31st March every year in the form set out in the Third Schedule to the Act as near thereto as circumstances admit. Accounting heads, grouping etc. has to be done as per the Schedule III of the Banking Regulations Act, 1949.

The financial statements are generally approved by the Board of Directors of the bank and then placed before the Annual General Meeting of the members of the bank for adoption.

Time limit for convening Annual General Meeting of the members has been specified under the respective State Co-operative Societies Act.

The banks have to submit to RBI three copies of Profit and Loss Account and Balance Sheet together with the Statutory Auditors’ Report, before 30th September each year.

StCBs & DCCBs are also required to send the copies of the Balance Sheet and Profit & Loss Account along with the Statutory Auditors’ Report to the concerned Regional Office of NABARD.

The annual financial statements of StCBs and DCCBs are required to be published, under Rule 10 in one of the local newspapers within a period of 9 months from the end of the period to which they relate i.e. before 31st December every year.
10.1 Introduction

Banks have the following characteristics which distinguish them from most other commercial enterprises:

- They have custody of large volumes of monetary items, including cash and negotiable instruments, whose physical security has to be ensured. This applies to both the storage and the transfer of monetary items and makes banks vulnerable to misappropriation and fraud. They, therefore, need to establish formal operating procedures, well-defined limits for individual discretion and rigorous systems of internal control.

- They engage in a large volume and variety of transactions in terms of both number and value. This necessarily requires complex accounting and internal control systems and widespread use of Information Technology (IT).

- They normally operate through a wide network of branches and departments which are geographically dispersed. This necessarily involves a greater decentralization of authority and dispersal of accounting and control functions, with consequent difficulties in maintaining uniform operating practices and accounting systems.

- They often assume significant commitments without any transfer of funds. These items, commonly called 'off-balance-sheet' items, may not involve accounting entries and consequently, the failure to record such items may be difficult to detect.

- They often engage in transactions that are initiated in one location, recorded in a different location and managed in yet another location.

- Transactions can often be directly initiated and completed by the customer without any intervention by the bank's employees, for example over the Internet or through Automated Teller Machines (ATMs).

- They are regulated by Government authorities and the resultant regulatory requirements often influence accounting and auditing practices in the banking sector.
10.2 Special Audit Considerations arise in the Audit of Banks because of

- the particular nature of risks associated with the transactions undertaken by banks;
- the scale of banking operations and the resultant significant exposures which can arise within short periods of time;
- the extensive dependence on IT to process transactions.
- the effect of the statutory and regulatory requirements; and
- the continuing development of new services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices.

The auditor should consider the effect of the above factors in designing his audit approach.

10.3 Audit Plan and Audit Program

(A) Planning the Overall Audit Strategy

Normally an overall audit strategy that sets the scope, timing and direction of the audit precedes the development of a detailed audit plan. The overall audit strategy should be well documented so that the detailed audit plans and programs can be properly developed. The key components of an audit strategy, interalia, include:

1. discussion with the StICBs’ and DCCBs’ management to review and update background information on StICBs and DCCBs, its location, the financial reporting framework applicable for StICBs and DCCBs, accounting systems, specific reporting requirements as may be imposed by RBI, the RCS, NABARD and other authorities;
2. audit commencement and reporting deadlines;
3. method of communicating with management and the RCS, RBI, NABARD and other authorities in resolving the audit defects/observations; special reporting requirements, if any;
4. review of control environment and setting out audit materiality;
5. plans to obtain evidence regarding the effectiveness of internal controls;
Guidance Note on Audit of StCBs & DCCBs

6. instructions on analytical procedures and other substantive procedures for audit;
7. review of recent entity-specific, industry, financial reporting or other developments;
8. assessment of the internal resource requirements and use of experts on complex matters;
9. resource allocation to specific audit areas;
10. review of last year’s Statutory Audit Report and audit observations and audit compliances.
11. review of last year’s inspection and current year inspection reports of regulators like registrar, NABARD, RBI and other authorities and inspection observations and inspection compliances.
12. review all the returns sent to regulators like Registrar, NABARD, RBI and other authorities and verify the authenticity of the data submitted along with returns, regulators’ observations and the compliances thereof.
13. review of Concurrent Audit Reports of large branches along with observations therein and compliance therein.

(B) Audit Plan

Audit plan are critical to ensure that the audit is performed in an effective manner. Planning is about establishing and documenting the overall audit strategy. Audit plan include significant audit procedures to be carried out by the field auditors to obtain appropriate and sufficient audit evidence to reduce audit risk and express necessary audit opinions.

(a) Audit plan facilitate
1. devoting appropriate attention to key audit areas and significant risks;
2. identification of potential problems and their resolution;
3. assignment of audit work to audit staff;
4. directing and coordinating the work done by experts and other auditors.

(b) Audit plan should cover amongst other things the following:
1. business understanding of the StCBs and DCCBs, its accounting systems, policies and internal control procedures;
2. degree of reliance to be placed on internal controls;
Audit Plan and Audit Program

3. nature, timing and extent of the audit procedures to be performed;
4. audit allocation to the staff and seniors as per the audit plan and their review by the Chartered Accountant of the firm;
5. coordinating the work to be performed.

(c) Audit planning normally involves the following elements:
1. developing an overall plan for the expected scope and conduct of audit;
2. developing an audit programme showing the nature, timing and extent of audit procedures; and
3. further development and revision of plan (as necessary during the course of audit).

(C) Risk Assessments and Internal Control System

Standard on Auditing (SA) 315, “Identifying and assessing the Risks of Material Misstatement Through Understanding the entity and its Environment” requires the auditor to identify and assess the risks of material misstatement at the Financial statement level and the assertion level for classes of transactions, account balances and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor shall:

a) Identify risk throughout the process of obtaining and understanding of the entity and its environment, including relevant control that relate to the risks and by considering the classes of the transaction, account balances and the disclosure in the financial statements;

b) Assess the identified risk and evaluate whether they relate more pervasively, to the financial statement as a whole and potentially affect many assertions;

c) Relate the identified risks to what can go wrong at the assertions level, taking account of relevant controls that the auditor intends to test;

d) Consider the likelihood of misstatement, including the possibility of multiple misstatements and whether the potential misstatement is of a magnitude that would result in a material misstatement.

SA 315, requires the auditor to put specific emphasis on the risks arising out of the fraud, changes in the regulatory environment, complex transactions, related party transaction and abnormal business transactions.
Guidance Note on Audit of StCBs & DCCBs

The details of the Risk Assessment and Internal Control are given in the Guidance Note on Audit of Banks published by ICAI.

(D) Audit Program

Audit program outline the whole procedure of audit and are specific to each StCBs and DCCBs, although a general template can be prepared and made applicable with necessary customization to each StCBs and DCCBs. Audit program are valuable records for the auditor for checking the progress of work done and enable the auditor to effectively control the whole scope and conduct of audit in an efficient manner. Besides, these are part of audit work paper documentation as required under the established standards of audit.

Audit programme should normally cover the following:
1. review of the system of internal controls and procedures;
2. checking of routine audit items like postings, casting and arithmetical accuracies;
3. checking the audit evidences through vouching internal and external evidences, confirmation, and reconciliation;
4. ledger scrutiny;
5. review of cut off procedures for transactions and closure of accounts;
6. ascertaining and confirming consistency of accounting principles;
7. examining the accuracy of financial statements and their presentation;
8. application of analytical procedures and ratio analysis;
9. audit closure and reporting.

(E) Audit Evidence and Audit Procedures

The auditors of StCBs and DCCBs have to express an opinion on the financial statements audited and such opinion has to be based on audit evidence obtained by performing test of controls and substantive procedures.

- test of controls are designed to test transactions to obtain reasonable assurance that the internal controls are effective;
- substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by accounting system. Substantive procedures could be (i) test of details of transactions and balances and (ii) analysis of ratios and trends.
Audit Plan and Audit Program

Audit evidence is intended to assure the auditor in the following manner:

- audit evidence from tests of controls assures that internal controls are functioning and are effective;
- audit evidence from substantive procedures assures:
  - that a transaction pertaining to the entity took place and the same is recorded in the proper amount and relates to the correct period;
  - that an asset is rightfully owned by StCBs and DCCBs on a given date;
  - that a liability exists as an obligation of StCBs and DCCBs at a given date;
  - that the value of an asset or a liability is carried at its appropriate value;
  - that the asset/liability or income/expenditure is disclosed, classified and recognized in accordance with Generally Accepted Accounting Principles (GAAP);

The source and nature of audit evidence is important in considering its reliability for the purpose of assurance on financial statements. While the assessment of audit evidence should be left to the best judgment of the auditors, the following generalization may be useful in understanding the source and its reliability.

- external evidence, like confirmations from third parties, is more reliable than internal evidence;
- internal evidence is more reliable when related controls are effective and satisfactory;
- documents and written representations are more reliable than oral representations;
- evidence obtained by auditors directly is more reliable than obtained through StCBs and DCCBs.

Some of the methods that may be employed in obtaining audit evidence are:

- examination of records, documents, inspection of assets- in this connection it is relevant to note that the documentary evidence originating from different sources like (i) from third parties, (ii) from the StCBs and DCCBs itself but held by third parties. (iii) originating from and held by StCBs and DCCBs is an acceptable evidence;
Guidance Note on Audit of StCBs & DCCBs

- observing a process or procedure being performed by the StCBs and DCCBs staff;
- formal written enquiries to third parties; oral enquiries to StCBs and DCCBs staff and MC members; confirmations to corroborate the information in the accounting records of StCBs and DCCBs;
- checking the arithmetical accuracy of source documents and/or performing independent calculations by auditors;
- computing and studying significant ratios and trends and investigating unusual/unexplained fluctuations.

(F) Audit Materiality

Audit materiality is a concept relating to the importance/significance of an amount, transaction, or discrepancy when either seen/judged individually or in aggregate. Auditors express opinion on the financial statements as to whether they are prepared, in all material respects, in accordance with the Generally Accepted Accounting Principles. The assessment of what is material is a matter of professional judgment.

As defined in SA 320 (corresponding to AAS 13)

"Information is material if its misstatement (i.e. omission or erroneous statement) could influence the economic decision of users taken on the basis of the financial information. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."

(G) Analytical Procedures

“Analytical procedures” are the analysis of significant ratios and study of resulting information or fluctuations which appear inconsistent or which deviate from prescribed or predicted ratios. Auditors normally employ analytical procedures at the audit planning stage or at the overall review stage. It may also be necessary to employ these procedures during the course of audit if the available audit evidence requires such procedures.

The purpose of analytical procedures is to:

- help the auditors in planning their other audit procedures and their timing;
Audit Plan and Audit Program

- substitute the test of details (substantive procedures) when they can be more effective in reaching an audit opinion/conclusion;
- facilitate an overall review of the financial statements at the time of closing the audit and arriving at an overall conclusion as to the reasonableness of the financial statements and expression of an opinion.

The choice and extent of analytical procedures is a matter of professional judgement and the size and complexity of the StCBs and DCCBs. However, these may include any or all of the following:

- **simple comparison** (either absolute or simple averages) of current financial information with the previous year/periods and with the budgets for the year;
- performing a **ratio analysis**, generally done either during the course of audit or at the overall review stage. An illustrative list of performance ratios that need to be studied are given in Table 1;
- **complex analysis** of standard deviations, variance, co-efficient, portfolio at risk etc;
- **consideration of relationships** between the data – for example, payroll costs to number of employees; acreage financed to growth in agricultural loan portfolio, number of total members to number of borrowing members etc.

Table 1: Performance ratios auditor may apply in the audit of StCBs & DCCBs

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Financial ratio</th>
<th>Formula for computation</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Average yield on assets</td>
<td>(Total Interest Received/Average Working Fund) * 100</td>
<td>Refer 9.4(b) for Working Fund Definition.</td>
</tr>
<tr>
<td>2</td>
<td>Average yield on advances</td>
<td>(Interest Income from Loans &amp; Advances /Average Loans and Advances) *100</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Average cost of deposits</td>
<td>(Total Interest on Deposits/ Average Deposits) * 100</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Average cost of borrowings</td>
<td>(Total Interest on Borrowings/Average borrowings) * 100</td>
<td></td>
</tr>
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</table>
**Guidance Note on Audit of StCBs & DCCBs**

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Formula</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Average cost of funds</td>
<td>(Total Interest Expense/Average Working Fund) * 100</td>
<td>Refer 9.4(b) for Working Fund Definition.</td>
</tr>
<tr>
<td>6</td>
<td>Gross financial margin</td>
<td>Average Yield on Assets – Average Cost of Funds</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Ratio of non fund Income</td>
<td>(Total Non-fund Income/Average Working Fund) * 100</td>
<td>All income other than interest income is “non fund income”</td>
</tr>
<tr>
<td>8</td>
<td>Risk cost</td>
<td>(Provision for NPA and Standard Assets/Average Working Fund) * 100</td>
<td>Refer 9.4(b) for Working Fund Definition</td>
</tr>
<tr>
<td>9</td>
<td>Net financial margin</td>
<td>{(Gross Financial Margin+ Ratio of Non Fund Income)-Risk cost}</td>
<td>Compare these ratios over 2 or 3 different years. Unusual increase/decrease to be tested in detail.</td>
</tr>
<tr>
<td>10</td>
<td>Transaction cost</td>
<td>(Total Cost of Management/Average Working Fund) * 100</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Net margin</td>
<td>Net Financial Margin-Transaction cost</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Return on assets</td>
<td>Net Profit per P&amp;L/Total Assets</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Return on equity</td>
<td>Net Profit per P&amp;L/Total Equity</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Return on net worth</td>
<td>Net Profit per P&amp;L/Shareholders Funds</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Ratio of interest earned to interest paid</td>
<td>Interest Received/Interest Paid</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>NPA ratio</td>
<td>(Total NPA/Total Loans &amp; Advances) * 100</td>
<td>Compare these ratios over 2 or 3 different years. Unusual increase/decrease to be tested in detail.</td>
</tr>
<tr>
<td>17</td>
<td>Credit deposit ratio</td>
<td>(Total Loans Outstanding/Total Deposits Outstanding) * 100</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Capital adequacy ratio</td>
<td>(Own Funds/Risk Weighted Assets) * 100</td>
<td></td>
</tr>
</tbody>
</table>
10.4 Preparation and Submission of Audit Report

The audit report is the end-product of the audit. It is through the medium of the audit report that the auditor conveys his observations/comments on the financial statements. The form and content of the audit report should be determined by the auditor taking into account his terms of engagement and applicable statutory, regulatory and professional requirements.

10.5 Long Form Audit Report

- The terms of engagement of auditors of STCBs and DCCBs require them to furnish a long form audit report in addition to their report in pursuance of statutory provisions. The matters to be dealt with in long form audit reports by the auditors have been specified by NABARD.

- The auditor should ensure that the LFAR is submitted within the time limit stipulated in this behalf by the bank. In case no time limit has been so laid down, the LFAR should be submitted either along with the main report or within a short period thereafter.

- The duties and responsibilities of auditors of banks and their branches are governed by the relevant statutes. In all cases, matters covering the central responsibilities of the auditors should be dealt within the main report and in this regard, the LFAR cannot in any way be a substitute for the main report. However, the matters included in the main report may be elaborated in the LFAR. Similarly, while framing his main report, the auditor should consider, wherever practicable, the significance of various comments in his LFAR. It may, however, be emphasised that the main report should be a self-contained document and should not make any reference to the LFAR.

- The auditor needs to see whether modifications reported in the previous years have been resolved and if not, evaluate the impact of the same on the current year’s audit report. In the preparation of LFAR, the auditor should call for and look into the previous reports to ascertain whether in respect of the accounts for the year under audit, there are any matters which deserve the attention of the management particularly as regards adverse comments of a material nature on which remedial action was warranted.

- Some of the matters dealt within the LFARs require compilation of detailed information/statements. It should be recognised that the responsibility for such compilation is that of the branch/bank concerned.
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- The auditor should invariably seek corroborative evidences against the representations made by management.
- For long form audit reports to be more meaningful, it is desirable that a reply to the comments made therein is submitted by the concerned branch/bank management to appropriate higher authorities.

10.6. Approach to Audit in a CIS Environment

The auditor's specific audit objectives do not change whether accounting data is processed manually or by computer. However, the methods of applying audit procedures to gather evidence may be influenced by the methods of processing. The auditor can use manual audit procedures, or computer-assisted audit techniques, or a combination of both to obtain sufficient evidence. However, in some accounting systems that use a computer for processing significant applications, it may be difficult or impossible for the auditor to obtain certain data for inspection, inquiry, or confirmation without computer assistance. The detail audit plans and procedure in a CIS environment is given in “Guidance Note on Audit of Banks” published by ICAI, which the auditor is advised to refer and understand before commencing the audit in a CIS environment.
Chapter 11
Balance Sheet and Profit & Loss Account

11.1 Introduction

Provisions/guidelines relating to the annual accounts and balance sheet are given in section 29 of Banking Regulation Act (AACS). The StCBs & DCCBs are now required to prepare their Profit and Loss Account and balance sheet as at 31st March every year in the Form set out in the third schedule to the Act as near thereto as circumstances admit. The format of Balance sheet in Form A and Profit and Loss Account as per Form B as given in the third schedule of the Banking Regulation Act are given in Annexures to the Guidance Note.

11.2 The disclosure requirements and the audit procedure/compliance on the liabilities side of the balance sheet are given as under:

11.2.1 Capital

Authorised Capital indicating the total number of shares, face value of each share, the total amount of the authorised capital as mentioned in the bye-laws of the bank are required to be disclosed. Similarly, the information regarding the total number of shares issued, subscribed, called up & paid up, face value of each share, total amount of issued, subscribed, called up and paid up capital needs to be mentioned. The amount of calls in arrears should be deducted and the amount of calls in advance is to be added to arrive at the amount of paid up capital.

Further in addition to the above, information about capital subscribed by co-operative societies, Government, individuals & other institutions are required to be shown separately.

The provisions regarding the membership, various types of members such as ordinary member, nominal member etc., rights and liabilities of a member, procedures for admission, resignation and removal etc. of a member are given in the Co-operative Acts of the respective State and Rules made there under and based on such information the provisions are incorporated in the Bye-laws of the StCB/DCCB.
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Audit procedure/ compliance regarding share capital:

1. The auditor should study the provisions of the Act and also peruse the Bye-laws and perform the audit of the share capital & report his observations based on the provisions contained in the Act, Rules and Bye-laws.

2. Comment on increase/decrease in share capital - reasons for reduction of share capital over the previous year's position.

3. Check whether share certificates have been issued to all the shareholders.

4. Check whether paid up share capital is within the ceilings prescribed in the Bye-laws of the bank.

5. Check the composition of the share capital, i.e. State Government, Societies and Individual share to the total share capital.

6. Check whether any share capital is in arrears from co-operatives. Adequacy or otherwise of share-linking is required to be commented.

7. Check the amount of share capital contribution received from the State Government during the year and repayments, if any, made during the year by the bank.

8. Check whether any Bye-law amendment has been made/proposed to be made for increasing the share capital contribution by nominal members and 'A' class members.

11.2.2 Reserves and Surplus

Various reserves are grouped for the purpose of presentation as per the nature of the reserve. Information regarding opening balance, addition during the year, deduction/utilisation during the year and the final closing balance is required to be given. The reserves & surplus include:-

i) Statutory Reserve Fund

ii) Capital Reserve

iii) Revenue & other Reserves

iv) Balance of Profit & Loss Account

For illustration some of the item appearing under the reserves & surplus are given below:

- Statutory Reserve Fund
- Building Fund
Balance Sheet and Profit & Loss Account

- Dividend Equalisation Fund
- Charity Fund
- Member Welfare Fund
- Employee Welfare Fund
- Reserves for Bad & Doubtful Debts (NPA Reserve)
- Investment Fluctuation Reserve
- Investment Depreciation Reserve
- Balance of Profit & Loss A/c
- Agricultural Credit Stabilisation Fund
- Contingent Provision for Standard Assets

The Co-operative Societies Act of every State and Rules there under contain the provision regarding the statutory reserves to be earmarked, amount to be transferred to the said reserve before declaration of dividends, appropriation from the statutory reserve, mode of investment of statutory reserve outside the business etc.

Audit procedure/compliance regarding reserves and surplus:

1. The auditor should go through the said provisions and should also refer the Bye-laws of the bank for carrying out his audit exercise.
2. The auditor should verify the opening balances of various reserves with reference to the audited balance sheet of the previous year.
3. Additions to/deductions from the reserves should also be verified in the usual manner, for e.g. with reference to AGM/board resolution. Comment on increase/decrease over the previous year and reasons thereof.
4. The auditor should also examine the nature of various accounts included under this head to ensure that only accounts in the nature of reserves are included.
5. The auditor should refer to the provisions of the Act, Rules and also those provisions given in the bye-laws for the audit of Charity Fund and other funds.
6. Adherence to the guidelines regarding the reserve for bad and doubtful debts, reserve for standard assets are contained in the various circulars/guidelines issued by RBI/NABARD on the subject of Income Recognition and Asset Classification (IRAC) should also be checked.
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7. The auditor should refer to the various guidelines/circulars issued by RBI/NABARD as regards to the investments by StCBs & DCCBs for the purpose of understanding the provisions relating to Investment Fluctuation Reserve & Investment Depreciation Reserve.

8. Check whether the bank has adhered to the appropriation of profits for contribution to various reserves/funds as stipulated in the bank’s bye-laws.

9. Check the creation of any special reserve as per provisions of any Act (e.g., Income Tax Act, Co-operative Societies’ Act etc.).

11.2.3 Deposits

Deposits are required to be classified in the balance sheet under Demand Deposits, Savings Deposits and Term Deposits. Further deposits from banks and others are required to be shown separately.

Audit procedure/compliance regarding deposits:

1. The auditor should go through the provisions and should also refer the Bye-laws of the bank, RBI and NABARD Circulars for carrying out his audit exercise.

2. Check the composition of Deposit Portfolio.

3. Check the cost of deposits.

4. Examine the trends (share of the bank in total deposits mobilised by the banks in the District).

5. Check the share of low cost/zero cost deposits.

6. Examine individual v/s. institutional deposits (from co-operative institutions/lower tiers).

7. Check the details of deposit mobilisation campaigns conducted.

8. Examine the changes in interest rate on deposits and how interest rates on deposits are fixed by the bank.

9. Comment on the interest rate-wise position of bank’s deposits and suggest measures for smooth switchover so as to reduce the cost of funds.

10. Adherence to Know Your Customer (KYC)/Anti-Money Laundering (AML) guidelines issued by RBI/NABARD, filing of Cash Transaction Reports (CTRs)/ Suspicious Transaction Reports (STRs)/Counterfeit Currency Reports (CCRs).
11. Check the computation of assessable deposits for DICGC cover.
12. Check and ensure the payment of premium to DICGC, submission of DICGC returns, etc.
13. Check the practices followed for accounting interest accrued on cumulative deposits/other re-investment deposits, etc.
14. Check the maturity profile of deposits.
15. The auditor should verify the various types of deposits, categorization of the deposits and the various terms and conditions of its acceptance, applicable rate of interest and whether they are as per the directions of RBI and NABARD.

11.2.4 Borrowings

Borrowings of the bank are required to be classified and presented in the balance sheet as under:-

(i) Borrowings from Reserve Bank of India.
(ii) Borrowings from NABARD.
(iii) Borrowings from Other Banks.
(iv) Borrowings from Other Institutions & Agencies.

Out of the total amount of borrowings, the total amount of secured borrowings is to be given separately.

Acts and Rules under the Co-operative Acts of various States prescribe the format in which the financial statements are to be presented. These formats may contain some additional disclosures as regards to the borrowings, which have to be complied with.

Audit procedure/compliance regarding borrowings:

1. The auditor should refer to the provisions of the respective State Act & Rules thereunder in order to confirm that the borrowing is within the power of the Board of Directors and the total borrowings are within the limit prescribed in the said Act/Rules.

2. Borrowings from RBI/NABARD, other banks/financial institutions, etc. should be verified by the auditor with reference to confirmation certificates and other supporting documents such as agreements, correspondence etc. Audit evidence in the form of external confirmations received directly may help the auditor in this regard.

3. The auditor should confirm that clear distinction has been made between ‘rediscout’ and ‘refinance’ for disclosure of the amount.
**Guidance Note on Audit of StCBs & DCCBs**

4. Check whether the bank’s total borrowings were within the overall ceiling (Reserve Borrowing Power) stipulated in the bank’s bye-law. Indicate violations, if any.

5. Check interest rate-wise borrowings of the bank.

6. Check the maintenance of borrowing register.

7. Check violation of terms and conditions of borrowings and verify the loan documents.

8. Check cost of borrowings and year wise variation therein.

9. Check instances of defaults in repayment of borrowings (if any).

### 11.2.5 Other Liabilities and Provisions

As per the prescribed format under third schedule, the bank has to disclose the following liabilities.

(i) Bills payable.

(ii) Inter-office adjustments (Net credits).

(iii) Interest accrued.

(iv) Other liabilities including provisions.

#### 11.2.5.1 Bills Payable

Bills payable represents the instruments such as pay-orders, demand drafts, traveller’s cheques etc. issued for consideration received from customers but not presented for payment till the date of balance sheet.

Audit procedure/compliance regarding bills payable (other liabilities):

1. The auditor should confirm whether there is effective internal control over the bills payable.

2. The auditor should also ascertain whether there is adequate follow-up for the pay-slips outstanding for long time, DD’s paid without advice.

3. The auditor should also confirm whether the signatures on instruments like DD are checked by the bank officials from the book containing specimen signatures.

#### 11.2.5.2 Inter-Office Adjustments (Net credits)

Each branch of the bank has a number of transactions with other branches and Head Office of the bank. In many transactions undertaken, one leg of the transaction involved is Inter-Office Account. The major types of inter-branch transactions are given under:
Balance Sheet and Profit & Loss Account

(i) Remittances in the form of issue of Demand Drafts/Telegraphic Transfers/Mail Transfers on other branches and payment of the same.

(ii) Payment made under LCs of other branches.

(iii) Transactions as regards to cash lodgement and replenishment.

(iv) Transactions with regard to Government receipts.

(v) Profit/loss transferred by branch to Head Office.

(vi) Head Office interest receivable/payable by the branches.

(vii) Payment to/receipts from other branches of the proceeds of instruments received/sent for collection/clearing.

(viii) Transactions through National Electronic Fund Transfer (NEFT)/Real Time Gross Settlement (RTGS).

(ix) Payment of expenses on behalf of the HO/branch (POB).

The work as regards reconciliation of inter-branch transactions is generally done by separate department. The department generates at regular intervals report on outstanding/un-reconciled entries on a particular date. Report on such un-reconciled entries is sent to the branches. Branches are expected to submit their replies for the outstanding entries within a given time. In some cases particularly those involving high value transactions, branches are required to send documentary evidence in support of the entries. The transactions which remain unmatched appear as Inter-Office adjustment balance in the balance sheet of the bank under the head “Other Assets”, if in debit and under the head “Other Liabilities & Provisions”, if in credit. The entries remain un-reconciled due to wrong identification of the type of transaction, error in writing the amount, incorrect branch code numbers etc.

Audit procedure/compliance regarding Inter-Office Adjustments (Net Credits) (Other Liabilities)

1. The auditor should ascertain the procedure followed by the bank for recording inter-branch transactions.

2. The auditor should check inter-branch reconciliation as it is a fraud-prone area, and has to pay special attention to the pending entries in the report on inter-branch reconciliation.

3. The auditor is also expected to ascertain whether there are any adverse comments on IBR (Inter Branch Reconciliation) in internal audit, concurrent audit reports or reports of internal inspection.
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4. The auditor should see whether there are any pending entries in respect of cash transactions and whether there are any reversal entries. The auditor should ask for explanation from the bank officials and ascertain the reasons for such entries.

5. The auditor should also see whether follow up is made with the concerned branch/branches for such pending entries. As per RBI circular No., RBI/2004-05/482 R.P.C.D. CO. RF. BC. No. 103/07.37.02/2004-05 dated 30th May 2005, all StCBs/DCCBs are required to segregate all the debit and credit entries in inter-branch account and arrive at net position.

6. The net debit position attracts 100% provisioning in respect of those entries that remain outstanding for over six months. Auditor should also check whether such provision has been properly made.

11.2.5.3 Interest Accrued/Payable

Interest due and payable and interest accrued but not due on deposits as well as borrowings will be shown under this head. Such interest is not to be clubbed with the figures of deposits and borrowings shown under the head "deposits and borrowings".

Audit procedure/compliance regarding Interest Accrued/Payable (Other Liabilities):

1. The auditor should carry out test check of the interest provision particularly on high value deposits.

2. The auditor should confirm that provision is made on eligible deposit schemes.

11.2.5.4 Other Provisions

Following items will be generally included under this head:

(i) Provision for income tax & other taxes.

(ii) Dividend payable/unclaimed dividend.

(iii) Creditors for expenses & other creditors.

(iv) Contingent provisions for standard assets.

(v) Provision for gratuity etc.

(vi) Share suspense.

(vii) Other contingencies payable.

(viii) Deposits/margins received for loans, staff security deposits, subsidy received but not appropriated to loans etc.
Audit procedure/compliance regarding Other Provisions (Other Liabilities):
The auditor should ascertain that adequate provisions are made for outstanding expenses. He may resort to the comparative analysis of the amount of provisions for the earlier years.

11.3 The disclosure requirements on the asset side of the balance sheet are given as under:

11.3.1 Cash and Balances with RBI

The third schedule to the Banking Regulation Act, 1949, requires the following disclosures to be made in the balance sheet regarding cash, balances with RBI, balances with other banks and money at call and short notice.

A. Cash and balances with Reserve Bank of India
   (i) Cash in hand (including foreign currency notes)
   (ii) Balances with Reserve Bank of India
        1. in current account
        2. in other accounts

B. Balances with Banks and Money at Call and Short Notice
   I. In India
      (i) Balances with banks
          (a) in current account
          (b) in other deposit accounts
      (i) Money at call and short notice
          (a) with banks
          (b) with other institution
   II. Outside India
      (i) in current account
      (ii) in other deposit accounts
      (iii) money at call and short notice

Audit procedure/compliance regarding Cash and Bank Balance with RBI:
1. One of the important determinants of cash balances to be maintained by a StCB/DCCB is the requirement for maintenance of a certain minimum
Guidance Note on Audit of StCBs & DCCBs

cash reserve specified under section 18 of the Banking Regulation Act (AACS). In case of Scheduled State Co-operative Banks, section 42(1) of RBI Act, 1934 applies. Section 24 of the Banking Regulation Act, 1949 (AACS) contains the provisions relating to maintenance of the Statutory Liquidity Ratio (SLR) in the prescribed manner & reporting requirements thereof. RBI issues circulars/guidelines from time to time as regards maintenance of Cash Reserve Ratio (CRR) and SLR and procedures of computation of demand and time liabilities for SLR.

As regards to balances with various banks, the auditor should verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements as at year end. The auditor should review the reconciliation statements. He should pay special attention to the following items appearing in the reconciliation statements.

(i) cash transactions remaining unresponded
(ii) revenue items requiring adjustments/ write-offs and
(iii) old outstanding balances remaining unexplained/ unadjusted for over one year.

2. The auditor should also examine the large transactions in inter-bank accounts, particularly towards the year-end, to ensure that no transaction has been put through for window dressing.

3. The auditor should obtain a written explanation from the management as to the reasons for old outstanding transactions in bank reconciliation statements remaining unexplained/ unadjusted for more than six months.

4. As per the guidelines, the statutory auditors are also required to verify and certify that all items of outside liabilities, as per the bank’s books had been duly compiled by the bank and correctly reflected under DTL/ NDTL in the fortnightly/ monthly statutory returns submitted to RBI for the financial year. The auditor should refer to circulars issued by RBI, NABARD and the regulators from time to time.

5. StCBs/DCCBs maintain accounts with RBI/SBI & its subsidiaries and other banks. DCCBs maintain their account with the StCB of the concerned State. The branches also maintain account with other banks. The auditor should obtain balance confirmation and verify them with the bank balances and reconciliation statement.

6. Money at call and short notice represents short term investment of surplus funds in the money market. Money lent for one day is money at `call' while money lent for a period of more than one day and up to fourteen days
is money at `short notice'. The auditor should check the accounting treatment and obtain balance confirmation and verify them with the banks' balances and reconciliation statement.

7. Further, the auditor should examine whether there is proper authorization, general or specific, for lending of the money at call or short notice. Compliance with the instructions or guidelines laid down in this behalf including the limits on lending in inter bank call money market should also be examined.

8. Call loans should be verified with the certificates of the borrowers and the call loan receipts held by the bank. The auditor should examine whether the aggregate balances comprising this item as shown in the relevant register tally with the control accounts as per the general ledger. He should also examine subsequent repayments received from borrowing banks to verify the amounts shown under this head as at the year end. It may be noted that call loans made by a bank cannot be netted-off against call loans received.

9. The auditor should examine whether interest accrued has been properly accounted for on year-end outstanding balances of money at call and short notice and deposits with various banks.

10. The auditor should evaluate the effectiveness of the system of internal controls regarding daily verification of cash, maintenance of cash related registers and vault register, custody of cash, custody of keys, daily cash holding and retention limit of the branches etc.

11. The auditor should ensure that insurance policy for the bank as a whole (Banker’s Indemnity Policy) has been taken for safety of cash from theft or burglary and such policy is effective.

12. The auditor should verify the cash balance in hand and should obtain a copy of the cash docket/daily cash balance book indicating denomination-wise cash balance. As far as possible, the auditor should visit the head office/selected branches at the close of business on the last working day of the year or before the commencement of business on the next day for carrying out the physical verification of cash. If, for any reason, the auditor is unable to do so, he should carry out the physical verification of cash as close to the balance sheet date as possible. The extent of verification would depend upon the auditor’s assessment of the efficacy of internal control system including adherence to cash retention limits fixed by the head office, mode of custody of cash (whether single or joint) and frequency of cash verification by branch officials and/or by internal or concurrent auditors.
13. The auditor should verify that the banks have not stapled the notes and the bank observes the guidelines as regards to clean note policy issued by RBI.

**11.3.2 Investments**

The guidelines/directives issued by Reserve Bank of India in respect of the classification of the investments, quantum of investments should be followed. Investments of the bank are to be disclosed under:

(i) Investments in Government Securities.
(ii) Investments in other Approved Securities.
(iii) Investments in Shares subject to the restrictions under Section 19 of Banking Regulations Act, 1949 (AACS).
(iv) Investments in Debentures and Bonds.
(v) Other Investments.

Audit procedure/compliance regarding investments:

1. Banks are not permitted to make investments in immovable properties as a part of their investment portfolio and the same should be checked by the auditor.
2. As per RBI guidelines, bank should have investment policy and should form an Investment Committee - proceedings of the meetings, issues discussed, delegation of powers to various officials, adherence thereto, violations, if any, noticed, etc. should be checked by the auditor.
3. Check whether investments have been made in permissible avenues or not.
4. The auditor should check the Composition of SLR and Non-SLR investments and adherence to the RBI/NABARD guidelines in respect of various limits fixed for Non-SLR investments.
5. The auditor should check whether interest/dividend on investments was received/collected in time.
6. The auditor should check Funds Management, Fixation of Cash Retention Limits to Branches, periodical review thereof, adherence to such retention limits by the branches.
7. The auditor should check Half-Yearly Review of Investments by the Board and submission of reports to NABARD.
8. Review of Non-performing Investments (NPI) should be checked by the auditor.

9. Check whether Amortization Account is being maintained.

10. The auditor should examine the procedure followed for shifting of securities from Permanent to Current categories and vice-versa.

11. The auditor should check Accounting for investments, valuation of investments, creation of Investment Fluctuation Reserve (IFR) and Capital Reserve.

12. The auditor should check system of investment dealings and auditing of investment transactions.

11.3.3 Advances

As per third schedule to the Banking Regulation Act, 1949, banks are required to show the advances as under.

(i) Category-wise

(ii) Security-wise

(iii) Advances in India/outside India.

Category-wise information will cover the following information:

- Bill Purchased and Discounted.
- Cash Credits, Overdrafts & Loans Repayable on Demand.
- Term Loans.

Security-wise bifurcation of the loans and advances portfolio is to be disclosed as under:

- Loans secured by Tangible Assets.
- Loans covered by Bank/Government Guarantees.
- Unsecured Loans.

Advances in India are to be bifurcated as below:

- Advances to priority sector.
- Advances to public sector.
- Advances to banks.
- Advances to others.
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Audit procedure/compliance regarding Advances:

- **Auditors Report on Loans and Advances should cover**
  
  (a) Observations on different scheme.
  
  (b) Appraisal.
  
  (c) Sanction.
  
  (d) Documentation.
  
  (e) Disbursement.
  
  (f) Monitoring and Follow up.
  
  (g) Asset Classification.
  
  (h) NPA management, including following of IRAC norms, movement of NPAs, etc.
  
  (i) General observations (compliance with exposure norms, quarterly review of large advances, submission of reports to NABARD, credit risk/concentration, Government priority, RBI/NABARD guidelines etc.)
  
  (j) Loan MIS.
  
  (k) Recovery of loans & performance vis-à-vis targets, legal action etc.

- **Auditor should verify and report on the Imbalance:**
  
  (a) Examine whether the borrowings made by the affiliated societies are fully covered by the loans and advances outstanding from the members at society's level.
  
  (b) In case the borrowings outstanding are more than the loans outstanding, what are the reasons for the imbalance.
  
  (c) Examine whether the DCCB had been monitoring recoveries at the societies’ level and whether it had ensured that all the recoveries had been passed on to it.
  
  (d) Suggest suitable remedial measures in case of imbalance.

11.3.4 Fixed and Other Assets

As per the third schedule to the Banking Regulation Act, 1949, fixed assets are required to be classified into two categories in the balance sheet viz., premises and other fixed assets. The assets taken on lease and intangible
Balance Sheet and Profit & Loss Account

assets are generally shown separately for classification and disclosure with a view to comply with the Accounting Standards.

The original cost of the fixed assets as on 31st March of the preceding year, additions thereto and deductions therefrom during the year and total depreciation written off till date are to be disclosed in the financial statements.

No rates of depreciation on fixed assets have been prescribed by the Banking Regulation Act, 1949. The auditor should examine whether the rates of depreciation are appropriate in the context of the expected useful lives of the respective fixed asset. However, as per RBI circular No. RBI/2006-06//276/R.P.C.D.CO.RF.BC.No. 62/07.40.06/2005-06 dated 19th January, 2006 all StCBs & DCCBs are required to charge depreciation on computers on straight line method @ 33.33% per annum. If there is any changes in the depreciation rate, the same should be disclosed along with the effect thereof.

Audit procedure/compliance regarding fixed assets:

1. An immovable property acquired by the bank in satisfaction of its dues should be normally included under the head Non Banking Assets (Refer to section 9 of B.R. Act, 1949 (AACS). In case it is decided to hold the same for its own use, then it will be classified under Fixed Assets.

2. If an asset is recovered in satisfaction of dues, the auditor should review the system of internal controls relating to fixed assets, particularly the following:
   (i) Control over expenditure incurred on fixed assets acquired.
   (ii) Accountability and utilisation controls.
   (iii) Information controls for ensuring availability of reliable information about fixed assets.

3. Moreover, the auditor should ascertain the location of the documents of title or other documents evidencing ownership of various items of fixed assets.

4. The auditor should examine whether the balances as per fixed assets register reconciled with those as per the ledger and the final statements. In the case of leasehold premises, capitalisation and amortisation of lease premium, if any should be examined.
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5. Any improvements to leasehold premises should be amortised over their balance residual life. In case the title deeds of property are held at head office or some other location, the branch auditor should obtain written representation to this effect from the branch management.

6. If the premises or any other fixed assets are revalued, the auditor should examine the appropriateness of the basis of revaluation. The auditor should also examine whether the treatment of resultant revaluation, surplus or deficit, is in accordance with Accounting Standard 10 – Accounting for Fixed Assets. The auditor should also check the impairment, if any, by applying the principals laid down in Accounting Standard 28 – Impairment of assets.

7. In respect of movable fixed assets, the auditor should pay particular attention to the system of recording the movements as well as other controls over the same. For e.g. physical verification of the assets at periodic intervals by the branch officials/auditors.

8. Examine whether adequate provision has been made in respect of any damaged asset. In case of transfer of assets from one branch to another, the auditor should confirm that accumulated depreciation in respect of such asset is also transferred.

9. Examine that the fixed assets have been properly classified.

10. Examine whether any expenditure incurred on fixed assets after it has been brought to its working condition for its intended use has been dealt with properly.

11.3.5 Other Assets
The other assets of the bank are to be disclosed under the following heads:

(i) Inter-office adjustments (Net debits).
(ii) Interest accrued.
(iii) Tax paid in advance and tax deducted at source.
(iv) Stationery & Stamps.
(v) Non banking assets acquired in satisfaction of claims.
(vi) Other assets.

Inter-office adjustments (net debit balance): This topic of inter-branch account has already been discussed under the liabilities side.
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**Interest accrued:** This item will include interest accrued but not due on the investments as well as advances and interest due but not collected on the investments.

The auditor should check the terms of payment of interest, rate of interest; period elapsed till the date of balance sheet etc. The auditor should confirm that only such interest as can be realised in the ordinary course of business is shown under this head as per AS - 9 Revenue Recognition.

**Tax paid in advance & tax deducted at source:** While conducting the audit, the auditor should check that all the TDS certificate for the amount of tax deducted by various deductors have been received for claiming the refund of the same in the Income Tax Returns (ITR) of the bank. He should also refer to the copies of the ITR filed to ensure that correct amount of TDS has been claimed in the return. As regards to the tax paid in advance, he should check the amount with the copies of tax challans and also cross tally the same with the amount shown as prepaid in the ITR.

**Stationery & Stamps:** This head represents the stock of printed stationery and the stamps in hand at the head office as well as branches as at the balance sheet date. This also includes the stock of security items such as deposit receipts, cheque books, pay-order and draft books etc.

The auditor should ascertain whether there are adequate internal controls as regards to receipt, issue & balance (stock) of the items of the stationery as bank is likely to incur losses in case of misuse of any of these items. Auditor should also ensure that the physical verification of the stock of sensitive stationery at the head office/branches is carried out at regular intervals by the branch officials as well as Concurrent/Internal Auditors/Branch Statutory Auditor and confirmation about verification of such stocks is held on record.

**Non banking assets acquired in satisfaction of claims:** Those immovable properties/tangible assets which are acquired by the bank in satisfaction of the debts due to it or its other claims and which are being held with the intention of being disposed off are shown under this head. As per provisions under section 9 of Banking Regulation Act, 1949, a bank cannot hold any immovable property however acquired (i.e. whether by way of satisfaction of claims or otherwise) except such as is required for its own use for any period exceeding seven years from the date of acquisition thereof. The Reserve Bank of India has the powers to extend the aforesaid period in the particular case in the interest of the depositors. The auditor should verify such assets with reference to the relevant documentary evidence for e.g. terms of settlement with the party, order of the Court, award of administration etc. The
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auditor should satisfy himself that the ownership of the property is legally vested with the bank. In case of any dispute or other claim about the property, the auditor has to examine whether the recording of the asset is appropriate or not. In case any dispute arises after the acquisition of the asset, the auditor should ascertain whether provision for liability or disclosure of contingent liability as appropriate is made as per AS – 29 “Provisions, Contingent Liabilities and Contingent Assets.

Others: This head will include all the items which are not specifically covered under the other subheads for e.g.

- Prepaid expenses.
- Receivables on account of Government business.
- Claims lodged with various authorities not yet settled such as subsidy claim, interest subvention claims.
- Advances to various parties/vendors
- Security deposits with Government/Telephone Authorities/Electricity Board/Landlord, etc.
- Non Interest bearing advances to staff such as festival advances.
- Amounts debited to suspense account such as DD paid without advice, clearing differences receivable, amount of dividend warrants paid, amounts involved in frauds etc.

The auditor should specifically focus on the unusual items under suspense account. He should obtain from the management details of the old outstanding entries along with the reasons for delay in adjusting such entries. He should examine whether any amount requires provision to be made and whether the same has been made.

11.3.6 Contingent Liabilities

The third schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet:

- Claims against the bank not acknowledged as debts.
- Liability for partly paid investments.
- Liability on account of outstanding forward exchange contracts.
- Guarantees given on behalf of constituents
  - In India
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- Outside India
- Acceptances, endorsements and other obligations.

The term ‘contingent liabilities’ can be of two forms. Firstly, a contingent liability refers to possible obligations arising from past transactions or other events or conditions, the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

Secondly, a contingent liability may also take form of present obligation that arises from past events or transactions but is not recognized due to the fact that either it is not probable that an outflow or resources embodying economic benefits will be required to settle the obligation, or a reliable estimate of the amount of obligation cannot be made. Thus contingent liabilities may or may not crystallize into actual liabilities. If they do become actual liabilities, they give rise to a loss or an expense. The uncertainty as to whether there will be any obligation differentiates a contingent liability from a liability that has crystallized.

Letters of credit and bank guarantees constitute two of the principal items of contingent liabilities of a bank. Besides, banks also sometimes issue what are commonly known as “letters of comfort”.

a. Letters of Credit

Letters of credit are an important payment mechanism especially in international trade. The customers open letters of credit to facilitate import or purchase of goods. By means of such letters, the customers take advantage of the credibility of the bank in as much as the exporter or the seller relies upon the promise of reputed bank instead of the customer. A letter of credit (LC) is an undertaking by a bank to the payee (the supplier of goods and/or services) to pay to him on behalf of the applicant (the buyer) any amount up to the limit specified in the LC, provided the terms and conditions mentioned in the LC are complied with and the documents specified in the LC are submitted by the payee to the LC opening bank through the medium of a bank. There are various types of LCs such as revocable LC, irrevocable LC, revolving LC, back to back LC, documentary LC and clean LC etc.

In the real sense, the LCs are non-fund based facilities granted by the banks. The bills under the LCs are assumed to be honoured by the drawees on due dates. In case, the drawee fails to pay the same, the banks have to per force grant financial accommodation to the LC applicant for the purpose of payment of bills. To that extent, the LC arrangement has the latent potential
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of becoming a fund-based exposure for the bank. To safeguard against such eventualities, banks normally obtain cash margin at the time of opening the LC, which reduces their exposure in the event of devolvement of LC liability on them. The margin may be held in a current account or in term deposit.

b. Bank Guarantees

Issuance of guarantees is another non-fund based activity for banks. Bank guarantees are issued by the banks on behalf of their customers for various purposes such as submission of bank guarantees with various authorities such as Excise & Customs, Electricity Boards, Local Bodies in lieu of security deposits for various purposes. Guarantees are also issued to guarantee the performance of contractual obligations undertaken or satisfactory performance of goods supplied by the customers of the bank.

A bank guarantee is a contract between the bank and the beneficiary of the guarantee which is independent of the contract between the bank and its customer on whose behalf the guarantee is issued by the bank. This implies that in case the beneficiary makes a demand on the bank for payment of any money under the guarantees, the bank is obliged to unconditionally pay the sum so demanded, within the amount guaranteed, provided the guarantee has been invoked by the beneficiary strictly in accordance with the terms outlined in the guarantee deed. The guarantees are for a specified amount and a specified period. Banks are expected to get back the original guarantee deeds from the beneficiary within a reasonable period after their expiry of the period of guarantee or on completion of the obligations thereunder, whichever occurs earlier, and to mark off the liability in their books. In practice, however, banks remove this item from their books of account shortly after the expiry of the period of validity of the guarantee and sending a letter to the beneficiary to that effect. The guarantees executed by banks comprise both performance guarantees and financial guarantees. A guarantee may be either a specific guarantee or a continuing guarantee extending to a series of transactions. In both the cases, banks generally specify a time limit up to which they will be liable unless, of course, the guarantee is renewed for a further period. It is also generally provided that any claim under the guarantee should be made within a specified time after the expiry thereof. All guarantees outstanding as at the date of the balance sheet have to be shown as contingent liabilities of the bank, showing separately the guarantees given on behalf of constituents in India and those outside India. While issuing guarantees, banks generally take (except in the case of established customers) sufficient margin either in cash on in some other form of security. This margin may be equal to the amount of the
guarantee or a proportion thereof. If it is cash margin, it may be held in a current account or in term deposit.

c. Letters of Comfort

Banks issue a letter normally to their correspondents to confirm that they have created charges on securities of the correspondent’s borrowers, on the strength of which the said correspondent releases financial assistance to the borrower. Such letters are called 'letters of comfort'.

(i) Claims against the Bank not acknowledged as Debts

Claims against the bank should be included under this head where it is considered possible but not probable that they may crystallize into actual liabilities. Such claims would include suits filed against the bank arising out of its business, claims on account of alleged payment of forged cheques or misappropriation of customer’s security, workmen’s demand for compensation, etc. There could also be claims for expenditure items, such as rent, local taxes or from service providers/ suppliers. The auditor needs to inquire whether such claims exist and the status thereof. To the extent it is an admitted claim, a liability is to be recognized. The balance needs to be disclosed as a contingent liability in accordance with the requirements of the Accounting Standard (AS) 29, “Provisions, Contingent Liabilities and Contingent Assets”.

(ii) Liability of Partly Paid Investments

If the bank holds any partly paid shares, debentures etc. the auditor should examine whether the uncalled amounts thereof are shown as contingent liability in the balance sheet.

(iii) Liability on Account of Outstanding Forward Exchange Contracts

This is applicable only in cases of branches which undertake foreign exchange business. The amount of forward exchange contracts, which are outstanding on the balance sheet date, is to be shown under this head.

(iv) Guarantees given on behalf of Constituents

The amount of all guarantees discussed in above paragraph outstanding on the balance sheet is to be shown under the above head after deducting therefrom any cash margin.

This head includes the following:

- Various types of Letters of Credit (discussed in above paragraphs) opened by the bank on behalf of its customers and
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- Bills drawn by the bank’s customers and accepted or endorsed by the bank (to provide security to the payees)

The total of all outstanding letters of credit as reduced by the cash margin and after deducting the payments made for the bills negotiated under them should be included in the balance sheet. In case of revolving credit, the maximum permissible limit of letters of credit that may remain outstanding at any point of time as reduced by the cash margin should be shown.

Sometimes, a customer of the bank may issue a usance bill payable to his creditor and drawn on the bank. The bank on accepting such a bill becomes liable to pay it on maturity. In turn, it has to recover this amount from its customer. The total of all outstanding acceptances and endorsements at the end of the year, as reduced by the cash margin, should be disclosed as contingent liability.

(vi) Other Items for which the Bank is Contingently Liable

This head includes the items such as bills rediscounted, estimated amounts of contracts remaining to be executed on capital account, disputed tax liabilities etc. Rediscounting is generally done with the RBI, Industrial Development Bank of India (IDBI) or other financial institutions or, in the case of foreign bills, with foreign banks. If the drawer dishonours the bills, the rediscounting bank has a right to proceed against the bank as an endorser of the bill. Tax demands, which have been disputed are in the nature of contingent liability and should be disclosed. Where an application for rectification of mistake has been made by the entity, the amount should be regarded as disputed. Where the demand notice/ intimation for the payment of tax is for a certain amount and the dispute relates to only a part and not the whole of the amount, only such amount should be treated as disputed. A disputed tax liability may require a provision or suitable disclosure as per provisions of Accounting Standard (AS) 29, “Provisions, Contingent Liabilities and Contingent Assets”,

Audit Procedure/ Compliance

In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should, generally follow the audit procedures given below:

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

The auditor should also ensure that in case of LCs for import of goods 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.

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.

Perform 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.

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.

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

Obtain representation from the management that:

(i) All contingent liabilities have been disclosed.

(ii) 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.

(iii) 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.

(iv) For 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.

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

(j) In case of claims against the bank not acknowledged as debts, the auditor should examine the relevant evidence, e.g. correspondence with lawyers/ others, claimants, workers/ officers and workmen’s/ officers’ unions. The auditor should also review the minutes of meetings of board of directors/ committees of board of directors, contracts, agreements and arrangements, list of pending legal cases and correspondence relating to taxes, and duties etc. to identify claims against the bank. The auditor should ascertain from the management the status of claims outstanding as at the end of the year. A review of subsequent events would also provide evidence about completeness and valuation of claims.

(k) In case of guarantees given on behalf of constituents, the auditor should ascertain whether there are adequate internal controls over issuance of guarantees e.g. whether guarantees are issued with proper sanctions, whether adherence to limits sanctioned for guarantees is ensured, whether margins are taken from customers before issuance of guarantees as per the prescribed procedures etc.

The auditor should also ascertain whether there are adequate controls over unused guarantee forms, e.g. whether these are kept under the custody of a responsible official, whether a proper record is kept of forms issued, whether stock of forms are periodically verified and reconciled with the book records etc. The auditor should examine the guarantee register to seek evidence whether the prescribed procedure of marking off the expired guarantees is being followed or not. The auditor should check the relevant guarantee registers with the list of outstanding guarantees to obtain assurance that all outstanding guarantees are included in the amount disclosed in this regard. The auditor should also examine that expired guarantees are not included under this head. He should verify guarantees with the copies of the letters of guarantee issued by the bank and with the counter guarantees received from the customers. He should also verify the securities held as margin. The auditor should obtain a written confirmation from the management that all obligations in respect of guarantees have been duly recorded and that there are no guarantees issued up to the year-end which are yet to be recorded and there are no guarantees as at the year-end which are invoked but not paid by the bank.
(l) In case of the letter of credit (LCs), the auditor should evaluate the adequacy of internal controls over their issuance and over custody of unused LC forms in the same manner as in the case of guarantees. The auditor should verify the balance of letters of credit from the register maintained by the bank. The register indicates the amount of the letters of credits and payments made under them. The auditor may examine the guarantees of the customers and copies of the letters of credit issued. The security obtained for issuing letters of credit should also be verified.

(m) In respect of disputed tax demands, the auditor should examine whether there is a positive evidence or action on the part of the bank to show that it has not accepted the demand for payment of tax or duty. In determining whether a provision is required, the auditor should among other procedures, make appropriate inquiries of management, review minutes of the meetings of the board of directors and correspondence with the entity’s lawyers/tax consultants and obtain appropriate management representations.

Bills for Collection

Bills held by a bank for collection on behalf of its customers are to be shown as a footnote to the balance sheet. These bills are generally hundies or bills of exchange accompanied by documents of title to goods. The bank is asked to present invoices and documents of title with instructions to collect the amount thereof from the party in whose name the invoice has been made.

A bank may get bills for collection from:

- Its customers, drawn on outstation parties or
- Its other branches or other outstation banks or parties, drawn on local parties.

On receipt of the bills drawn on outstation parties, the bank forwards them to its branch or other correspondent at the place where they are to be collected. Such bills are called Outward Bills for Collection. Bills received by the bank from its outstation branches and agents etc. for collection are called Inward Bills for Collection. It may be noted that if a bill is received by one branch of the bank from a customer and sent by it to another branch of the bank for collection, the same bill will be shown as an Outward Bill at the first branch and as an Inward Bill at the other branch. In the consolidated balance sheet of the bank, however, all such bills should be shown only one. Therefore, Inward Bills for collection are excluded from the balance sheet of each branch.
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Audit Procedure/ Compliance

The auditor should ensure that the bills drawn on other branches of the bank are not included in bills for collection.

Inward bills are generally available with the bank on the closing day and the auditor may inspect them at that time. Since the outward bills for collection are not likely to be in hand at the date of the balance sheet, the auditor may verify them with reference to the register maintained for outward bills for collection.

The auditor should also examine collections made subsequent to the date of the balance sheet to obtain further evidence about the existence and completeness of bills for collection. In regard to bills for collection, the auditor should also examine the procedure for crediting the party on whose behalf the bill has been collected. The procedure is usually such that the customer’s account is credited only after the bill has actually been collected from the drawee either by the bank itself or through its agents etc.

The commission of the branch becomes due only when the bill has been collected. The auditor should, accordingly, examine that there exists adequate internal control system that debits the customer’s account with the amount of bank’s commission as soon as a bill collected is credited to the customer’s account. The auditor should also examine that no income has been accrued in the accounts in respect of bills outstanding on the balance sheet date.

11.4 Profit and Loss Account

The third schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as Profit and Loss Account:-

(A) Income

(a) Interest earned

1. Interest/Discount on Advances/Bills: This includes interest and discount on all types of loans and advances like cash credit, demand loan, overdraft, export loans, term loans, domestic and foreign bills purchased and discounted (including those rediscounted), overdue interest and interest subsidy, if any, relating to such advances/bills. The amount to be included under this head is net of the share of participating banks under inter-bank participation schemes on risk-sharing basis.

2. Income on Investment: This includes all income derived from the investment portfolio by way of interest and dividend, except income earned
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by way of dividend, etc., from subsidiaries and joint ventures abroad in India. Interest and dividend on Investments is usually accounted for at the Head Office.

3. **Interest on Balances with RBI and Other Inter-Bank Funds**: This includes interest on balances with Reserve Bank of India and other banks, call loans, money market placements, etc.

4. **Others**: This includes any other interest/discount income not included under the above heads. Interest on advances given by the bank to staff member in its capacity as employer rather than as banker should be included under this head.

**(B) Other Income**

1. **Commission, Exchange and Brokerage**: This item comprises of the following:
   - Commission on bills for collection.
   - Commission/exchange on remittances and transfers, e.g. demand drafts, telegraphic transfers, etc.
   - Rent from letting out lockers.
   - Commission on Government business.
   - Commission on other permitted agency business including consultancy and other services.
   - Brokerage on Securities.
   - Fee on insurance referral.
   - Commission on referral of mutual fund clients.

2. **Profit on sale of Investments**

3. **Profit on revaluation of Investment**

4. **Profit on sale of Land, Building and Other Assets**

5. **Profit on Exchange Transaction**

6. **Income earned by way of Dividends, etc., from Subsidiaries and Joint Ventures Abroad/in India**

7. **Miscellaneous Income**: This head generally includes following items of income:
   - recoveries from the constituents for godown rents;

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- income from bank’s properties;
- security charges;
- insurance charges recoverable from customers, etc.;
- rent

Audit procedure/compliance in carrying out an audit of income: The auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertain to the bank, that there is no unrecorded income, and that income is recorded in proper amounts and is allocated to the proper period. In view of the mandatory requirement of recognition of income, the recognition of revenue will have to be subjected to examination vis-à-vis the guidelines.

1. **Interest Earned:**
   - The auditor should check whether, in terms of income recognition guidelines issued by the RBI has been followed by the bank properly and also to ensure that the bank has either reversed or made provision in respect of interest accrued and credited to income account, in respect of an advance (including bills purchased and discounted) that becomes NPA as at the close of any year.
   - The auditor may assess the overall reasonableness of the figure of interest earned by working out the ratio of interest earned on different types of assets to the average quantum of the respective assets during the year.
   - The auditor should, on sample basis, check the rates of interest, etc. (with sanctions and agreements) as well as the calculation of interest to satisfy himself that:-
     - (a) Interest has been charged on all the performing accounts upto the date of the balance sheet;
     - (b) Interest rates charged are in accordance with the bank’s internal regulations, directives of the RBI and agreements with the respective borrowers. The security of interest rates charged is particularly important in the case of advances made on floating interest rate basis;
     - (c) Discount on bills outstanding on the date of the balance sheet has been properly apportioned between the current year and the following years;
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(d) Interest on inter-branch balances has been provided at the rates prescribed by the head office; and

(e) Any interest subsidy received (or receivable) from RBI in respect of advances made at concessional rates of interest is correctly computed.

- The auditor should check the Accounting procedure followed by the bank in regard to accrued overdue interest in respect of (a) loans and advances and (b) investments, and satisfy himself that it is as per Law. Auditor should check that the overdue interest was taken to profit and loss account, and to ensure that the bank has made corresponding provision for an equivalent amount.

- The auditor should also satisfy himself that interest on non-performing assets has not been recognised unless realized.

- In case of accounts under Corporate Debt Restructuring (CDR) scheme, the auditor should see whether the income on project under implementation which has been classified as standard has been accounted for on accrual basis pursuant to the RBI's income recognition norms. Banks are not permitted to recognise income on accrual basis from projects under implementation which have been classified as 'sub-standard' asset. Banks may recognise income in such accounts only on realisation i.e. on cash basis.

- The auditor should check that bank books 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, provided interest is serviced regularly and as such is not in arrears.

- The auditor should check that bank has booked interest income from all other performing investments on accrual basis provided interest rates on these instruments are pre-determined.

- Discount earned on discounted instruments like commercial papers, zero coupon bonds should be booked on accrual basis. The discount may either be accrued equally over the remaining period to maturity or by following the constant yield method. Auditor needs to check that discount income is properly accounted for.

- The auditor needs to check that interest income from non-performing investments has been booked on realization only.
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- Checking should be done to ensure that Income from units of mutual funds should be booked on cash basis only.

- Dividend received should be checked with reference to counterfoils of dividend warrants. As per AS 9, “Revenue Recognition”, dividends should be recognised when the right to receive payment is established, i.e. dividend has been declared by the corporate body at its Annual General Meeting and owner’s right to receive payment thereof is established.

2. Other Income

- The auditor may check the items of commission, exchange and brokerage on a test basis. The auditor should examine whether the commission on non-funded business (e.g. letter of credit, guarantees and bills for collection) has been properly apportioned between the current year and the following year.

- The auditor should also check whether any fees or commission earned by the bank as a result of renegotiation or rescheduling of outstanding debts has, in terms of the income recognition guidelines issued by the RBI, has been recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.

The auditor can check authority for disposal of:
  - Fixed assets, if any, sold during the year under audit; and
  - Ensure that proper accounting entries have been made in connection with profit or loss on sale of fixed assets.

- The auditor should check all income earned by way of foreign exchange. Commission and charges on foreign exchange transactions except interest are to be included under the head “Profit on Exchange Transaction”. In addition, the auditor should apply the following checks:
  - The auditor should check that the year-end outstanding entries are translated at appropriate rates of exchange as communicated by the Controlling authority, for recording profit/loss on exchange transactions.
  - The auditor should check large transactions on test check basis to ensure that these are recorded in compliance with the directions of the controlling authority.
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- The auditor should check the transactions recorded in the post-Balance sheet period to ensure that no material items have been ignored up to the year end.
- The auditor should enquire into unusually large entries involving huge gain/losses for the year.

- The notes and instructions for compliance of profit and loss account, issued by the Reserve Bank, requires that in case any item under the head “Miscellaneous Income” exceeds one percent of the total income, particulars thereof may be given in the notes.
- The auditor can ascertain whether any premises or part thereof is let out, and, if, so, whether rent recoveries are recorded upto the year-end at the rates as applicable.
- Fees on insurance referral are fast emerging as a major source of income for bank. In terms of the RBI circular on para banking activities, banks are permitted to undertake insurance business as agents of insurance companies on fee basis without any risk participation. The auditor should carefully examine the agreement entered into by the bank and the concerned insurance company to see the basis for calculation of the said fee, time when the referral fees becomes due to the bank, etc.

(B) Expenditure

(a) Interest Expended
1. Interest on Deposits: This includes interest paid/payable on all types of deposits including deposits from banks and other institutions and also brokerage paid by the bank on deposits.
2. Interest on RBI/Inter Bank borrowings: This includes interest/discount on all borrowings and refinance from the RBI and other banks.
3. Others: This includes discount/interest on all borrowings/re-finance from financial institutions. All other payments like interest on participation certificates, penal interest paid, etc. may also be included here.

(b) Operating Expenses
1. Payment to and provision for employees
2. Rent and Taxes
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3. Printing and stationary
4. Advertisement and publicity
5. Depreciation on bank's property
6. Directors’ fees, allowances and expenses
7. Auditors’ fees and expenses
8. Law charges
9. Postage, telegram, telephone, etc
10. Repairs and maintenance
11. Insurance
12. Other expenditure

(c) Provisions and Contingencies: This item represents the aggregate of the provisions made in respect of the following:
1. Non-performing assets
2. Taxation
3. Diminution in the value of investments
4. Provision for contingencies.

Audit procedure/ compliance in carrying out an audit of expenditure:
The auditor is primarily concerned with obtaining reasonable assurance that the recorded expenditure arose from transactions, which took place during the relevant period and pertain to the bank, that there is no unrecorded expenditure, and that expenditure is recorded in proper amounts and is relating to the relevant period.

(a) Interest Expended
The auditor should, on a sample basis, check the calculation of interest. The auditor should satisfy himself that:

- interest has been provided on all deposits and borrowings up to the date of the balance sheet; verify whether there is any excess or short credit of material amount.
- interest rates are in accordance with the bank’s internal regulations, of the RBI directives and agreements with the respective depositors;
- in case of fixed deposits it should be ensured that the interest rate in the accounting system are in accordance with the interest rate mentioned in the fixed deposits receipt/certificate.
Balance Sheet and Profit & Loss Account

• interest on Saving Bank Account should be checked on a sample basis.

• interest has been provided on all deposits and borrowings up to the date of the balance sheet; verify whether there is any excess or short credit of material amount.

• discount on bills outstanding on the date of the balance sheet has been properly apportioned between the current year and the following year;

• payment of brokerage and deposits collected is properly authorised.

(b) Operating Expenses:

- The auditor should check the calculation of salaries and allowances, etc. on a sample basis with reference to relevant agreements/awards. He may also assess the reasonableness of expenditure on salaries, allowances, etc. by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.

- Regarding Rent, Taxes and Lighting the auditor should check the following on a sample basis:
  - Verify rent paid and check whether adjustments have been made for the full year on account of rent at the rates as applicable and as per agreement in force.
  - Examine that rent does not include House Rent Allowance to employees.
  - Check whether municipal rates/ taxes are duly paid/ adjusted for the year under audit.
  - Enquire whether any disputed liability exists on this account upon the year-end.

- Expenditure incurred by the bank for advertisement and publicity, including printing charges of publicity material should be verified by the auditors with the documents.

- Regarding depreciation on bank’s property, the auditor should;
  - Ascertain the exact procedure followed by the bank for calculation of depreciation.
  - Check Head Office instructions as regards adjustments of depreciation on the fixed assets of the branch.
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- Check whether depreciation on fixed assets has been adjusted at the rates and in the manner required by H.O.
- Report unadjusted depreciation on assets acquired but not capitalized.
- Ascertain the exact procedure followed.

- The auditor should verify that the legal charges payable by the bank in respect of all legal disputes/cases currently being pursued at various courts of law, etc. are accounted for in the accounts. For this purpose, the auditor may go through the list of contingent liability prepared by the bank as at the year end to verify the disputes/cases which the bank is contesting.

- The auditor should check that the payment made to Directors/Key management personnel on account of Directors Fees, Allowance and Expenses are in accordance with the terms of contract, and it should be ensured that the payment has been duly approved as well authenticated by the authority concern.

- The auditor should verify the expenditure made on account of Printing & Stationary, Law Charges, Repairs & Maintenance, Postage, Telegrams, Telephones, Insurance, Auditors' Fees & Expenses and other Miscellaneous expenses with reference to documents evidencing/vouchers, purchase/debit note received along with proper authentication of payment made.

- The auditor should check that all expenses other than those included in any of the other heads, like, license fees, donation, subscriptions to papers, periodicals, entertainment expenses, traveling expenses, etc. have been properly accounted for. The notes and Instructions for compilation of profit and loss account, issued by the Reserve Bank, require that in case any particular item under this head exceeds one percent of the total income, particulars thereof may be given in the notes.

(c) Provision and Contingencies:

- The auditor should verify that the provisions in respect of NPA (Non Performing Assets) and NPI (Non Performing Investment) should be verified with the regulatory requirements to ensure full provisioning.
- The auditor should check that interest is not charged in NPA accounts.
- The auditor should ensure that all interest charged in NPA accounts
Balance Sheet and Profit & Loss Account

from the date it became NPA is reversed when it is actually classified as NPA.

- The auditor should check that an account is not upgraded as performing assets from NPA until all unrealized interest including interest not charged and installment/principal due has been cleared.
- The auditor should thoroughly check those cases where deposit has been adjusted to create a credit entry to ensure that account does not become NPA.
- The auditor should check whether there is any diminution in the value of Investment during the financial year and also ensure that the same has been accounted for in the book of accounts properly.
- The auditor should check the provision made for income tax payable with reference to the computation of taxable Income and should also get satisfied with the accounting treatment made in this regard.
- The other provisions for expenditure, taxes, etc. are to be examined by the auditors with the circumstances warranting the provisioning and the adequacy of the same.
- The auditor should ensure whether any claims have been made by any Government department or any demand has been raised by any office or department against the bank which has not been provided for in the books as a liability e.g., Municipal Taxes, Stamp duty on lease deed etc.
- The auditor should check whether there are any suits filed against the bank at Consumer Court or any other court which might require provisioning.

(C) Profit/ Loss

This head includes the following:

- Net profit or Loss (-) for the year, i.e. net of income over expenditure/Expenditure over Income.
- Profit & Loss (-) of previous year brought forward.

(D) Appropriations

Net Profit/ Loss for the year as well as profit/loss brought forward have to be shown under this head. The appropriations of the aggregate thereof are to be shown under the following heads:
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- Transfer to Statutory Reserve
- Transfer to Other Reserves
- Transfer to Government/ Proposed Dividend

Audit procedure/ compliance in carrying out an audit of Appropriation:
The appropriation of profits is decided at the Head Office level. The Central Statutory Auditor should therefore verify compliance with the statutory requirements regarding transfers to reserve accounts and the other appropriations as applicable will have to be taken into consideration while verifying these. The auditor should check whether the appropriations are done according to the Bye-laws of the bank and also ensure that no amount has been directly credited to reserves without routing it through Profit and Loss Account.

In addition to above, the auditor should carry out detailed analysis of Profit and Loss Account and its constituents to find significant deviations and reasons thereof. The auditor should also check whether the bank has derived any substantial income or suffered any loan from non-banking business such as purchase/sales/revaluation of investments, premises, other assets, etc.
Chapter 12
Verification and Audit of Advances

12.1 Legal Aspects of Advances and Documentation

1. Identification of the borrower by the branch beyond any doubt by proper introduction, photograph etc.

2. To ensure that the borrower is competent to enter into a legal contract.

3. In respect of a partnership firm, a copy of the partnership deed is to be obtained and ensure that the amount borrowed by the firm is for the purpose of carrying on the firm's business as stated in the deed.

4. In respect of credit facilities to companies, the following points have to be examined:

   a. Whether the company is a Private Limited Company or a Public Limited Company.

   b. Whether the company has submitted the following:-

      (i) Certificate of Incorporation, in respect of Private Limited Company.

      (ii) Memorandum and Articles of Association.

      (iii) List of Directors and Managers.

      (iv) Names of the persons authorised to operate the bank account.

      (v) Names of the persons authorised to execute the documents.

      (vi) Names of the persons in whose presence the common seal of the company will have to be affixed on the documents.

      (vii) Names of the persons authorised to deposit the title deeds.

      (viii) Certified copy of the resolution seeking credit facilities from the bank.
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(ix) Whether the credit facilities sought are within the borrowing powers of the company as restricted by its Memorandum of Association or Section 293 (1) (d) of the Companies Act, 1956.

(x) Whether the borrowing is for the purpose of achieving the objectives of the company as stated in the Memorandum of Association otherwise the contract will be unenforceable at law and ultra vires.

(xi) Whether the branch holds on record a resolution passed by the Board of Directors certifying that the borrowings including the proposed borrowings by the company are within the limits specified by the Memorandum/Companies Act or the limit sanctioned by the shareholders at the general meeting.

(xii) In case, a company has offered its guarantee, whether the company is expressly authorised by its Memorandum to stand a guarantor and the guarantee has been offered only after a resolution was passed by the shareholders and also a specific resolution was passed by the Board of Directors.

(xiii) Whether in respect of advances to societies, the Bye-laws have been studied, borrowing powers have been ascertained, requisite resolutions have been passed by the Managing Committee.

5. Whether a no-objection letter ceding second charge has been obtained from the first charge holder.

6. Whether a letter ceding Pari Passu charge has been obtained from other financial institutions.

7. Whether the borrower(s)/guarantors have duly acknowledged the sanction letter and copy thereof is held by the branch along with the document.

8. Whether, in respect of advances to companies, the terms of sanction conveyed by the bank have been accepted by the company by means of a resolution passed by the Board of Directors.

9. Whether all the documents have been adequately stamped and properly cancelled prior to execution of the document.
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10. Whether search at the office of the Registrar of Companies was carried out to rule out any prior charges over the assets/properties charged/mortgaged to the bank.

11. Whether search of the Register of Charges maintained by the Company in terms of Section 143 of the Companies Act, 1956 was carried out to cross-check the particulars of the prior charges registered with the Registrar of the Companies under section 125 of the Companies Act and also to ascertain the particulars of other charges like pledge etc.

12. When immovable property was offered as security, whether search was carried out at the Registrar of Assurances to rule out any prior mortgages/charges.

13. Whether Encumbrance Certificate was obtained.

14. Whether clearance from the legal advisor was obtained before creating the mortgage and the property was physically inspected by the branch functionaries.

15. Whether mortgage has been properly created? Whether in respect of simple mortgage obtention of mortgage deed duly attested by two witnesses has been ensured.

16. Whether in respect of equitable mortgage, deposit of only original title deeds by the owner of the property or by his authorised agent, creation of mortgage at a notified centre, entry of particulars in the title deeds register and confirmation letter from the mortgagor dated subsequent to the date of deposit having deposited the title deeds by means of a registered post have been ensured.

17. The following points are to be adhered to by the bank while obtaining the documents that:

   (a) no amount was released until all the requisite documents were properly executed by all the parties concerned including the guarantor.

   (b) the documents were executed in the presence of the branch manager or any other officer of the bank so as to be able to identify the borrower(s)/ guarantor(s) personally.

   (c) all the blanks filled up were authenticated by the borrower under his initials.

   (d) each document and schedule attached thereto was completed in one sitting and in the same handwriting.
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(e) all types of cuttings, deletions, additions, alternations, modifications etc., were authenticated by the borrower under his full signature.

(f) the documents were executed in the branch premises and that the date and place of execution was mentioned by the borrower under his full signature.

(g) in case of an illiterate borrower, the contents of the documents were explained to him in a language that he could understand.

(h) the borrower has signed in full and in the same style throughout all the documents.

(i) if a borrower had signed in left hand, a small note was annexed to the document recording that the borrower had signed in left hand.

(j) the borrower's full signature was obtained in each page and also across the fold of the document in such a manner that the signature runs on both the pages.

(k) the borrower's full signature was obtained at the end of each document and also at the end of each schedule attached thereto.

(l) in case there was a change in the ink or pen, a suitable endorsement was recorded at the same point in the document under the full signature of the executants.

(m) in case of documents to be executed by companies, it is essential to ensure that the seal is affixed as required by the Article of Association.

(n) the documents taken were entered in the documents execution register, wherever necessary.

(o) the documents were executed by the borrowers in the proper manner appropriate to their status/capacity.

(p) in respect of partnership firm, all the partners have signed all the documents and that all the partners have also signed individual guarantee agreement.

(q) the date on the promissory note and the date on other documents is the same and that the documents were taken on
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the bank's standard forms wherever available and never on photostat copies.

18. Whether as a post-sanction follow-up in respect of simple mortgage, Mortgage Deed was registered with the Registrar of Assurances within four months from the date of its execution?

19. Whether in respect of company advances, charge was created with the Registrar of Companies under Section 125 of the Companies Act together with the instrument if any, creating or evidencing the charge within 30 days of creation of charge.

20. Whether the branch has adequately insured all the assets including the collateral security charged to the bank and that the Policy is in the joint names of the Borrower and the bank.

21. Whether the insurance policies have been taken with "Bank Clause" wherever the policies were taken solely in the name of the borrower.

22. Whether the branch has obtained periodical search reports from the office of the Registrar of Companies and/or Registrar of Assurances after release of the amount during the time of review or renewal.

23. Whether the branch has obtained revival letter/balance confirmation at periodical intervals.

24. Whether revival letters were obtained before the expiry of limitation period as revival letters obtained after expiry of the limitation period will not revive the documents.

25. Whether revival letters were obtained even in case of term loans within three years from the date of execution to keep the borrower's personal liability in tact so that the bank can also proceed against the other personal assets of the borrower.

26. Whether revival letters were obtained from both the borrowers and the guarantors or their duly authorised agents to extent limitation against both of them.

27. Whether in case of joint borrowers, revival letters were obtained from all the joint borrowers, to extend the limitation against each one of them.

28. Whether in case of more than one guarantor, revival letters were obtained from all the guarantors, to extend the limitation against each one of them.

29. Whether in case of time barred documents, the branch has obtained fresh documents and DP Note for the balance outstanding as on the
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date of execution of fresh set of documents with fresh guarantee deed from the old guarantor, if possible, or from a new guarantor as the case may be.

30. Whether the branch had obtained agreements on a proper stamp paper from the legal heirs of the deceased borrower/guarantor to keep the documents alive.

31. Whether the branch is maintaining the record of due dates of documents for timely obtention of revival letters so that the bank's interest is not jeopardized.

32. Whether the pay-in-slips (credit vouchers) paid into the bank as part payment before expiry of the limitation period were duly signed by the borrower-or by his authorised agent in order to extend the period of limitation.

33. Whether the adhesive stamps were duly cancelled by the branch manager to ensure that they cannot be used again.

34. Whether the contents of the documents were typed on the reverse side of the non-judicial stamp papers.

35. Whether the revenue stamps affixed on a DP note were properly cancelled by signing across the stamp by the executants failing which the document becomes invalid.

36. Whether attestations were obtained for all mortgages from two respectable persons and their addresses recorded along with their signatures.

37. Whether the stamp papers were purchased by the executants in their own name.

38. Whether the date of document is always subsequent to the date of purchase of the stamp paper (or date of embossing of adhesive stamps).

39. Whether the suits were filed in a court which has proper territorial and pecuniary jurisdiction.

40. Whether all suit filed accounts are being properly followed-up with the advocates.

41. Whether in respect of mortgage suits, application for final decree have been filed wherever courts have granted preliminary decree within the limitation period.
42. Whether the branch has filed EPs in respect of all decreed accounts.

43. Whether the branch has filed suits within the period of limitation as applicable to various types of documents.

12.2 While auditing loans to societies, in addition to checking of legal framework, following checks should be carried by the audit team depending on the type of loans/advance.

### 12.2.1 Crop Loans

The auditor should check/examine/confirm/verify the following detailed aspects:-

Whether the bank followed the systems and procedures as prescribed for financing societies for Seasonal Agricultural Operations (SAO) with particular reference to the following:

1. Methodology followed for fixation of Scale of Finance (SoF). Is it in accordance with the guidelines on production oriented system of lending issued by NABARD, whether the SoF fixed as a range showing minimum and maximum amount that can be financed for a particular crop in the particular location.

2. Adoption of SoF fixed by the Technical Group (TG) – whether the SoF was fixed by TG followed uniformly by all the branches/PACS. If the scale of finance fixed by TG was used as indicative, whether the range of variation was reasonable?

3. Proper maintenance of register of rights in lands of members, posting it up-to-date, annual verification of entries therein with revenue records, verification of cropping pattern of borrowing members indicated in the Normal Credit Limit (NCL) Statement with the land records for avoiding inflated/ghost acreage for crops carrying higher scales of finance, etc.,

4. Preparation and submission by the societies of NCL Statement and drawal applications.

5. Whether all the borrowers of crop loans were issued Kisan Credit Card (KCC). If not, the reasons and the extent to which covered under KCC.

6. Whether the drawals of KCC were allowed by branches of DCCBs or by PACS only. If farmers were allowed to operate KCC at branches, whether 'mirror' account was maintained in PACS. The efficacy of the system including the margin sharing may be examined and commented upon.
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7. Were there any restrictions by the bank/societies in the disbursement of cash component? Whether farmers allowed to take kind component in cash subject to production of vouchers.

8. Whether there was undue delay in disbursement of loans to members of societies and making payment/adjustment at the bank's level in respect of the fertilizers and other inputs supplied by marketing societies/other agencies to the PACS on behalf of borrowing members.

9. Disparity in the scales of finance and actual disbursements-specific reasons may be ascertained and commented in cases where the banks had higher scales of finance but disbursements were made at a very low level.

10. If the share croppers/tenants/oral lessees etc., were financed for Seasonal Agricultural Operations (SAO), whether they were financed on the same scales of finance as fixed for owner cultivators? If not, the basis adopted/steps taken by the bank for financing such cultivators.

11. Examine the system of financing Joint Liability Groups (JLG) and bring out the deficiencies observed.

12. Norms of security prescribed/followed by the bank of financing members of societies for SAOs. Limit for issue of surety loan for SAOs and its adequacy vis-a-vis the requirements of the cultivators in the area according to the scales of finance fixed by the bank.

13. If the scheme of linking of credit with marketing had been introduced by the bank in its area of operation, effectiveness or otherwise of its working (with relevant figures of recoveries effected through linking arrangements, etc., and concrete suggestions for improvement, if the arrangement is not effective).


15. Whether separate credit limits were sanctioned to PACS for financing cultivation of oilseeds covered under Oilseeds Production Programme (OPP), pulses under National Pulses Development Programme (NPDP) and Development of Tribal Population (DTP) for financing Tribals.

16. Whether separate Demand, Collection and Balance (DCB) register was maintained for cultivation of oil seeds covered under OPP? If not, reasons thereof.
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17. Whether the norms for identifying small farmers are those fixed by Nationalised Bank? If not, the actual norms followed by the bank.

18. Whether Registrar of Co-operative Societies (RCS) had imposed any restrictions on financing societies? If so, details thereof. Whether such restrictions affected the flow of credit to new and non-defaulting members of PACS.

19. In the case of ineligible PACs, arrangements made for ensuring adequate flow of credit to new and non-defaulting members. Whether RCS had fixed any recovery norms for financing PACS and whether such norms had come in the way of flow of credit to new and non-defaulting members.

20. Examine the Crop Insurance Scheme introduced in the area of operation of the bank covering the following aspects:
   (a) Names of blocks in the district where the scheme is in operation.
   (b) Crops covered.
   (c) Farmers covered - No. of farmers to whom loans were disbursed.
   (d) Area (in hectares) covered crop-wise.
   (e) Amount of loans disbursed crop-wise.
   (f) Sum insured (100% of (e) subject to a maximum limit of ₹10,000 per farmer)
   (g) Insurance charges recovered.

21. Amount of subsidy obtained/to be obtained in the case of small and marginal farmers.

22. Whether insurance premium deducted out of loans has been passed on to the General Insurance Corporation (GIC).

23. On receipt of claim amount from GIC/State Insurance Fund, whether the Central Co-operative Bank (CCB) has passed on the amounts to the concerned PACS giving full details of the notified area/crop to which the claim relates and the percentage of the sum insured or loan which has been reimbursed.

24. On receipt of claim amount, whether PACS had worked out the actual amount of claim relating to each of the loan accounts covered by the claim and credited the amounts to the respective accounts.
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25. Examine as to how the insurance claim received has been adjusted at CCB and PACS level. Whether the adjustments were in conformity with the objectives of the scheme/instructions issued by Nationalised Bank/GoI.

26. In addition to the above, in respect of Interest Subvention Scheme of GoI, the auditor should check the following:

(a) Whether the bank had ensured that the interest charged on crop loans by the societies to the ultimate borrowers was as per the Interest Subvention Scheme of GoI.

(b) Whether the DCCB has compiled the claims for interest subvention correctly and discrepancies, if any, observed.

12.2.2 Medium Term (Conversion)

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Whenever natural calamity occurs, steps taken by the bank to provide relief to the borrowers of co-operative credit system such as issue of land revenue certificate from the district authorities, issue of instructions to the PACS for conversion of ST (SAO) loans into Medium Term (Conversion) Loans, issue of guidelines to the PACS, etc.

2. Examine whether the bank had granted conversion of ST (SAO) loans into Medium Term (Conversion) Loans and the amount converted during the period covered by the inspection.

3. Examine the balance in the Agricultural Credit Stabilisation Fund (ACSF) and the amount utilised by the bank for conversion during the year. In case the balance in the ACSF was not sufficient, how the bank had met their share.

4. Whether the bank had adhered to the criteria and procedures laid down by the RBI/NABARD for granting conversion facilities to the PACS.

5. Whether any ‘overdue’ loans were converted.

6. Whether the bank had ensured that the benefit of conversion had been granted in time to the ultimate borrowers at the society level.

7. Whether the security obtained for conversion loans was in accordance with the norms prescribed by the RBI/NABARD.

8. Whether the bank had met 15% share in conversion. If not, how the share was met.
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9. Whether the recoveries under MT (C) were passed on promptly to the SCB.

10. Whether the bank had ensured that the farmers, for whom conversion was allowed had been granted fresh loan by the PACS concerned.

12.2.3 Medium Term Loans for Agricultural Purposes

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Whether the bank had framed policy and procedures for grant of medium term loans for agricultural purposes.

2. The purposes for which MT loans are generally advanced and adequacy of standard outlays laid down as per unit cost/per acre basis in respect of any item of investment.

3. The manner of working out repaying capacity of borrowers for different types of investment credit.

4. In fixing the repayment schedule, whether the bank had taken into account the repaying capacity of the borrower.

5. Whether economics of the projects was worked out and pre-sanction appraisal was carried out including borrower appraisal.

6. Whether security obtained for various medium term loans were as per the norms fixed by the RBI from time to time.


8. Whether the due dates were fixed in accordance with the cash flow.

9. Whether utilisation/end-use of the credit was monitored and records available for visits carried out by the field staff.

10. Whether insurance of assets acquired was insisted and whether available during the pendency of the loan.

12.2.4 Cash Credits for Non-agricultural Purposes

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Policy followed for sanction of cash credit limits to PACS, Marketing Societies, Processing Societies etc., for meeting working capital requirements.

2. Security and margin – whether as per the norms fixed by RBI/NABARD from time to time.
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3. Adequacy of cover for clean advances.

4. Instructions issued by HO for custody of the goods pledged in case of loans against pledge.

5. HO instructions regarding insurance of stocks and adequacy.

6. Compliance with the directions of RBI on financing sensitive commodities.

7. Whether the loans/limits sanctioned to a single society is within the ‘net owned fund’ of the society. If not, steps taken by the bank for bringing the exposure within the net owned funds over a period of time say, three years.

12.2.5 Salary Earners’ Societies

The auditor should check/examine/confirm/verify the following detailed aspects:-

8. Whether the bank had formulated a policy for financing Salary Earners’ Co-operative Societies and issued policy circular.

9. Examine the major items contained in the policy circular and ensure that they are in tune with the overall policy of the bank.

10. Examine the number of Salary Earners Co-operative Societies functioning in the area of operation of the bank and number of societies borrowing.

11. Whether the bank has obtained all required documents before sanctioning the limits i.e., application in the prescribed format, resolution of the board of the society, financial particulars of the society for the last 2/3 years, audit reports, list of members for whom the society proposes to finance and assessment of financial requirements.

12. Whether drawls were allowed based on requirements and how it is ensured by the HO.

13. Whether the bank had ensured that the outstanding borrowing by the society is fully covered by the outstanding loans to members and how frequently it is watched.

14. During visit to branches, the operations on the limit may be examined and commented.
12.2.6 Financing of Self Help Groups (SHGs)

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Whether the bank had formulated policy and operational guidelines for financing Self Help Groups (SHGs).

2. Examine the guidelines issued by the bank to the branches in this regard and ensure that the same are in conformity with the guidelines issued by NABARD for SHG-Bank Linkage.

3. Examine the application format and appraisal format for SHG financing and comment on the same.

4. Examine the progress in financing SHGs by the bank vis-a-vis number of SHGs having SB accounts.

5. Whether the bank had developed any 'Rating' Model for SHGs and advised the branches.

6. Whether the bank had conducted any evaluation of the SHG-Bank Linkage.

12.2.7 Financing of Joint Liability Groups (JLG)

The auditor should check/examine/confirm/verify the following detailed aspects:-

The inspecting officer may examine the financing of JLGs by the bank keeping in view the following broad aspects:

A Joint Liability Group (JLG) is an informal group comprising of 4-10 individuals coming together for the purpose of availing bank loan on individual basis or through group mechanism against mutual guarantee. Generally, the members of a JLG would engage in a similar type of economic activity in the non farm sector. The members would offer a joint undertaking to the bank that enables them to avail loans. JLG members are expected to provide support to each other in carrying out occupational and social activities.
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12.3 Audit of Loans And Advances Under Retail Credit to Individuals and Others

12.3.1 Advances Against Deposits

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify all loan documents and they are properly obtained, stamped and executed. Confirm that document contain discharged deposit receipts.

2. Verify at random, the lien noting on the deposit receipts as well as in the ledger and confirm that they are authenticated by an officer.

3. Verify whether any loan has been granted against the deposit of other branches and the branch is holding proper lien acknowledgement letters.

4. Verify whether any loan has been granted against term deposit issue from the compensation amount awarded by any tribunal and/or court with specific instruction.

5. Whether deposit section officer is verifying the signature of the depositor.

6. Confirm that all closed loan accounts are authenticated with full signature by the officer.

7. Verify whether any advance is continuing where the deposit remains unadjusted towards the outstanding even after maturity of the deposit.

8. Verify that the branch is maintaining the required margin as per the guidelines.

9. Verify whether the balance exceeds the permissible limit.

10. When loan is arranged against minor’s deposit, the purpose of the loan is to be indicated by the guardian and he has to certify that the advance is for the benefit of the minor/for meeting the necessities of the minor. Verify loans against minor’s deposits and confirm that the branch is following guidelines.

11. When term deposit is withdrawn before completion of a minimum term period interest at commercial rate as communicated from time to time shall be charged on the advances granted against such term deposits. Confirm branch is obtaining undertaking letter from borrower agreeing to pay normal rate of interest on loan/overdraft in such cases.
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12. Verify at random the closed loan/overdraft account documents to confirm that there are no fictitious advances arranged.

13. Verify branch is reporting all the loans/overdrafts sanctioned against third party deposits over a certain amount to head office as per the policy and check the rate of interest on such advances is being charged as per the guidelines issued.

14. Whether the deposit is the refunded at reduced rate of interest before maturity, interest on loan/overdraft shall be charged the prescribed rate. Test check whether the branch is allowing the concession.

15. As per RBI directives, loans and advances cannot be granted against securities on composite basis. Verify from the branch for compliance.

16. In case of deposit standing in joint names, irrespective of the conditions regarding repayment, all the parties to the deposit should discharge the deposit receipt and sign all the papers and documents be executed by borrowers. Verify such account for compliance.

17. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.2 Advances Against Commodities Under Pledge

The auditor should check/examine/confirm/verify the following detailed aspects:

1. Verify whether the movement of keys is properly recorded in the Key Custody Register.

2. Whether the duplicate set of godown keys duly sealed are held under dual control.

3. Confirm holding of the original invoices/lodgement letters and properly executed delivery orders.

4. Confirm that the goods pledged are fully paid for.

5. Verify delivery goods are against payment and not against pledge of goods.

6. The value of the goods pledged is as per the invoices and the invoices are in the borrower’s names.

7. Whether proper stipulated margin is maintained.

8. Confirm that the pledged goods values are not inflated to accommodate excess drawing power.
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9. Identify the accounts secured by long outstanding unsold/stale/obsolete stock. Furnish the steps taken by the bank/branch to close such loans.

10. Examine the suitability of the godown.

11. Confirm that the bank’s name plate is displayed.

12. Whether letter of access is obtained wherever necessary.

13. Verify whether the goods pledged are properly stored and identifiable.

14. Carry out a test check of weight, contents and quality of goods pledged in the presence of the borrower or his representatives.

15. Confirm that there are no other goods/stock stored in the godown other than the goods pledged to the bank.

16. Verify whether godown chart and godown registers are maintained and it is up to date.

17. Whether the drawing power is revised and recorded from time to time.

18. Verify whether advances against commodities like cotton, tobacco requiring licence/permits for dealings/storing/transportation are obtained and held with the bank/branch.

19. Confirm that the goods pledged are properly insured and bank’s interest is noted in the insurance policy.

20. Ensure that the description of goods and godowns agrees with that mentioned in the policy.

21. Verify whether the branch is maintaining market report book for local commodity and recovering the additional margin whenever the prices fall.

22. Verify whether the locks used have the bank’s name engraved there on.

23. Confirm by test check that the goods pledged are as permitted in the sanction.

24. Whether the branch conducts surprise visits to the godown.

25. Confirm whether all the borrowers under the scheme have been admitted as associate members of the bank.

26. Quantity in the godown and size of the godown – any mismatches to be checked.

27. Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.
12.3.3 Advances Against Commodities Under Hypothecation

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether the drawing power is properly fixed by taking into account paid stock as per stock statement on monthly basis.

2. Ensure that there is no inflated valuation of stock to accommodate fixing of higher drawing power.

3. Ensure that the stock shown in the stock statement does not cover unpaid stock, stock which are already under pledge, stocks covered under letter of credit unpaid and stock of no value.

4. Verify whether the stock declared in the stock statements match with that shown in the financial statement, whether the description of the hypothecated stock is given in stock statements.

5. Test check the goods hypothecated with the invoices stock books and confirm that they are in order and up to date.

6. Confirm that the goods hypothecated are fully paid for.

7. Verify whether physical verification of stock is done periodically with reference to stock statement and stock registered and duly authenticated by officer verifying in the stock.

8. Confirm that the goods hypothecated are insured for the full value as per the guidelines.

9. Whether the insurance policies are renewed regularly on due date.

10. Whether details of policy are recorded in insurance policy register.

11. Verify whether the policies are assigned to the bank/ bank’s lien is noted on the policies.

12. Whether the location of the go down is correctly stated in the policy.

13. List out cash credit accounts where the turnover in the account is not satisfactory.

14. Verify the stock statement obtained by the branch/bank and comment on promptness in obtaining stock statement, levying of penal interest for non submission. Whether columns of stock statement are properly filled up.

15. Comment on turnover in the account and stock statement.
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16. Confirm whether all the borrowers under the scheme have been admitted as associate member of the bank.

17. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.4 Vehicle Loan

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether the branch holds the following papers/document:
   (a) True copy of the (Registration Certificate) with bank’s hypothecation charge duly noted there in.
   (b) Copy of the valid route permit (for public vehicles).
   (c) Valid comprehensive insurance policy with bank clause included.
   (d) Duplicate switch key or letter in lieu thereof.
   (e) Original invoice stamped receipt and/or valuation report (for second hand vehicle).
   (f) Whether clause of hypothecation recorded in Registration Certificate.

2. Verify whether loan proceeds are released specifically to the seller/supplier of the vehicle and obtained acknowledgement from the borrower.

3. Whether the latest vehicle inspection report is on record.

4. In case of default in payment of installments whether the branch makes arrangement to seize the vehicle.

5. Confirm whether all the borrowers under the scheme have been admitted as associate members of the bank.

6. Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

7. Whether the branch had conducted periodic verification of the condition of the vehicle.
12.3.5 Advances for Mechanised Boats/Trawlers/Deep Sea Fishing Vessels

The auditor should check/examine/confirm/verify the following detailed aspects:

1. Confirm that the branch is holding the following papers/documents:
   (a) Registration Certificate showing the Bank’s lien.
   (b) Certificate of Registration issued by the Port Authorities.
   (c) Certificate of Registration of Mortgage/Hypothecation Charge.
   (d) Certificate of Life of the Boat/Trawler/Vessel.
   (e) Sea Worthiness Certificate.
   (f) Valid Marine/Fire Insurance Policy with bank clause and risk of insurance with partial losses clause stipulated.
   (g) Periodical Inspection Report.

2. Verify whether the release of fund is made specifically to the suppliers of Boat/Trawler/Vessel.

3. Confirm that the subsidies from the Government are received in all eligible cases and they are duly appropriated to the loan dues.

4. Confirm whether all the borrowers under the scheme have been admitted as associate member of the Bank.

5. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.6 Letter of Credit – Credit Facility

The auditor should check/examine/confirm/verify the following detailed aspects:

1. Whether letter of credit (LC) facility is sanctioned after duly processing the credit needs of the unit/borrower along with overall working capital/term loan requirements.

2. Verify whether the LCs are supported by sanction.

3. Whether all the terms/conditions of the sanction are complied with. If not, identify the cases, reasons thereof/approval sought/obtained etc. and report.

4. Verify whether the LC register has been properly maintained and the outstanding entries therein have been periodically balanced and tallied with the General Ledger.
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5. Verify whether the bills under LCs are retired promptly on presentation of bills/on arrival of goods. If not identify the cases and steps taken to realize the bills.

6. Verify whether the expired LCs are squared up in the books and the contingent liability is reversed after observing formalities in this regard.

7. Whether the dates of expiry of LCs noted in register and action taken to reverse the expired LCs.

8. Ensure that the margin money is refunded only after all the bills drawn under the LC are received and retired.

9. In case of goods directly supplied to the buyers under special arrangements (heavy machinery), verify that the necessary letter of undertaking has been obtained from the buyers and credit provides for prompt advice regarding dispatch of goods by the beneficiary directly to the opening branch.

10. In case of revolving LC verify whether a clause to the effect that the amount of the credit will be restored only on receipt of advice from the opening branch that the earlier bills have been paid, is included in the terms of condition of the LC.

11. Comment on arrangement made, such as, sanction of credit facility earmarking in current account for clearing liability under LC on presentation of documents etc.

12. Confirm whether all the borrowers under the scheme have been admitted as an associate member of the bank.

13. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.7 Unsecured Advances

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Confirm that the overdrawls allowed are as per the HO instructions/procedure, if not, identify the cases and report separately.

2. Verify and list out the parties who are frequently enjoying the clean loans, overdrawals in current account exceeding in over draft account disproportionately and beyond the limits of discretionary powers.

3. Confirm that clean loans, overdrawals in current account, exceeding in overdraft accounts are not arranged/allowed to meet the margin requirement under other secured advance to the borrower, other parties/sister associate concerns, related interested parties.
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4. Confirm that the register of overdrawals is maintained on the lines prescribed and it is up to date.

5. Whether exceeding beyond discretionary powers are reported separately to controlling authority.

6. Verify whether the request letter of overdrawals is obtained and permission recorded therein.

7. In case of demand loans verify whether the branch has sanctioned the same after assessing repayment capacity of the borrowers. Confirm documentation as prescribed is obtained in all cases.

8. Confirm whether all the borrowers under the scheme have been admitted, as an associate member of the bank.

9. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.8 Advances Against Government Securities/NSCs

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Ensure that the signature of endorsers tally letter to letter with the name/s of endorsees in previous endorsements.

2. If there are too many endorsements, insist on renewal of securities by sending them to Public Debt Office of the RBI.

3. Whenever a customer approaches for loan against Government Securities held in demat after ensuring that the same can be taken as security as per HO guidelines, verify whether the branch has complied with all HO guidelines.

4. Verify whether NSCs taken as security has been transferred in the name of the bank and lien is noted in bank’s favour before releasing the loan/overdraft. Verify whether proper margin is maintained.

5. Verify whether all the joint holders of the NSCs have signed the borrowing documents.

6. Verify whether interest is collected on Government securities promptly and a register is maintained for issuing income tax deduction certificates.

7. Verify whether interest is collected on NSCs periodically wherever applicable and steps taken to adjust the same to loan account on due dates.
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8. Verify whether on the date of maturity, the Head Office/Branch has made arrangements to collect the proceeds of NSCs and adjusted towards loan account. Ensure that Head Office/Branch is maintaining due date register.

9. Confirm whether all the borrowers under the scheme have been admitted as an associate member of the bank.

10. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.9 Advances Against Shares, Debentures and Units of Mutual Funds

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether units taken as security do not have any prohibitive clause for pledging the same.

2. Verify whether the branch holds the blank transfer deeds/forms signed by the registered holder.

3. Verify whether the units are transferred in the name of the bank, in the absence of blank transfer forms.

4. Verify whether the branch has obtained a letter of authority from the units holder, authorizing the bank to collect the dividend on the pledged units from the trust/fund on behalf of the borrower and is forwarded to mutual funds with a forwarding letter in the prescribed form.

5. Ensure that the shares/debentures/bonds accepted as security are of reputed companies, regularly quoted, fully paid (as far as possible approved companies) and are in marketable lots and satisfy that the scrips/bonds pledged are bonafide and genuine by verifying latest dividend warrant/interest warrant in the name of the borrower.

6. Verify whether loans against partly/fully convertible debentures, that the shares received on such conversion are taken as security for the advance.

7. Verify and report whether the amount received on the redemption of the debenture is adjusted to the loan accounts.

8. Verify that the shares and debentures are not clubbed together as security to sanction loan/advance as per the RBI directives.
9. Verify that the bank/branch holds valid and endorseable blank transfer forms for each marketable lot/folio and for each certificate odd lots, duly signed and witnessed without date.

10. Verify whether the branch is keeping a watch on the periodical fluctuations in the market rate of shares noting them in share quotation register and revise the drawing power accordingly? Ensure that the stipulated margin is being maintained and shortfall if any, is recovered as per guide lines.

11. Verify whether lien notices have been forwarded by registered acknowledgement due to the companies and their acknowledgement or refusal letters are kept with the loan paper.

12. Ensure that the part of security released has been recorded and acknowledged by the borrower.

13. Ensure that the dividend/interest received from the company/are credited to the concerned borrower’s account.

14. Verify whether dividend mandates have been obtained and registered with the respective companies.

15. Whenever a customer approaches for loans against shares held in demat after ensuring that the shares can be taken as securities as per bank’s approved list and guidelines, the branch shall, after sanction of facility by the competent sanctioning authority, furnish to customers the regions pledge account member with Stock Holding Corporation of India (SHCIL)/National Securities Depository Limited (NSDL), so that customer’s Depository Participants (DP) (either SHCIL or any other DP) can create pledge in bank’s favour. Subsequent to confirmation of creation of pledge the loan can be released.

16. Confirm whether all the borrowers under the scheme have been admitted as an associate member of the bank.

17. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.10 Advances Against Gold Ornaments (Jewel Loan)

The auditor should check/examine/confirm/verify the following detailed aspects:

1. Confirm whether all the borrowers under the scheme have been admitted as an associate member of the bank
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2. Confirm that the officer has followed the instruction/guidelines issued to establish the proof of identity of the borrower before issue of Jewel Loan Application (Ration Card, Driving License, Employer Identity Card, Bank Pass Book, Telephone Bill etc.)

3. Confirm that all the jewels have been appraised by the duly appointed jewel appraiser and also confirm that the jewels are appraised in the branch premises itself.

4. Verify that the appraiser’s seal has been affixed on the knot in such a way that it is not possible to untie the knot without tampering the appraiser seal.

5. Ensure that the jewels received from every borrower shall be separately bunched and kept separately under joint custody.

6. Verify whether the branch is following the stipulation made by Head Office in repayment of interest/principal/any dues and such stipulation is in conformity with RBI instructions.

7. Test check random jewels pledge with regard to number of items, description, gross weight, net weight, appraised value, margin etc.(where interest is in arrears for more than 3 months are to be invariably checked).

8. Confirm that deposit and withdrawal of jewels are being done according to the procedure stipulated and ensure that maintenance of the “Jewel Bags Stock Register” is up to date.

9. Verify whether any jewel loan has been granted to the jewel appraiser or his relatives. If yes, who has appraised the jewels pledged in such loan – comment giving details of such loans.

10. Verify whether the branch has sent periodical statements connected with the issue of jewel loan to Head office.

11. Confirm that the branch has maintained overdue jewel loans register and follow up action is taken.

12. Ensure that the stipulated margin is maintained and furnish a list of over advanced loans. Branch to collect the deficit in margin to maintain necessary margin.

13. Verify the jewel loan register and report whether borrower’s discharge has been obtained at the time of redemption.

14. On repayment of the loan, whether the branch is taking proper care to
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obtain signature of the borrower for taking delivery of jewels pledged and officer delivering the jewels verifies the signature of the borrowers and signs for having delivered the jewels.

15. Verify whether any death claims are pending against pledged items and comment.

16. Verify whether timely action is taken to action the jewel pledged, pertaining to the overdue loan. Confirm whether there are any clean jewel loans after adjustment of auction proceeds.

17. Verify whether action is on irregular loans such as sending registered notices, auction notices etc., are initiated by the bank/branch. Whether all procedures have been followed for conducting the auction and auction proceeds are properly accounted as per procedure.

18. In case of priority sector activity including agriculture, branch to confirm that the borrower is pursuing the relevant activity. Documentary proof to that effect has to be obtained and kept along with loan application. Ensure that applicable interest rates and margin are being followed according to the guidelines stipulated. Verify and comment.

19. Verify jewel loan appraiser’s file and ensure that a condition has been stipulated that the appraiser is solely responsible for the purity, gross and net weight of the jewels.

20. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.11 Cash Credit Limit – Traders

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether the beneficiary is a wholesale/retail trader and possessing a certificate of registration under General Sales Tax Act or a sole proprietor.

2. Verify whether the activity for which cash credit has been sanctioned is in the approved list of General Sales Tax.

3. Verify whether the activity proposed is being undertaken with in the area of operation of sanctioning office.

4. Verify whether the applicant has been admitted as an associate member before sanction of cash credit limit.
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5. Verify whether the renewals of cash credit limits have been made before it is expired and by taking into consideration of the previous years’ performance.

6. Ensure the valuation of stock has been done on the basis of cost price or market price whichever is less.

7. Verify whether the drawing power has been fixed after deducting the margin amount and from the value of paid stocks and permitted level of book debts.

8. Verify whether the outstanding under each cash credit account is within the limits/drawing power prescribed.

9. Verify and ensure that the documentation is in order, viz.,
   (a) Duly executed promissory note.
   (b) Hypothecation/Pledge Deed/Agreement duly executed by the applicant.

10. Verify whether all the documents are in custody of the officer/executive who is authorized for this purpose.

11. Verify whether there is a provision in the agreement to inspect the trading concern.

12. Verify whether the stock in trade has been insured in the joint names of the bank and the trading concern.

13. Verify whether the procedure laid down has been followed to initiate action to regularize the overdues.

14. Verify whether the stock statements are being submitted periodically before the due dates fixed for submission.

15. Verify the charging of interest to the account - frequency - daily/monthly and its correctness.

16. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.12 Salaried Employees

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether the loan has been sanctioned as per the loan policy of the bank.

2. Verify whether the applicant has been admitted as associate member.
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3. Verify whether the applicant has executed an undertaking to the effect that he will not borrow from any financial institutions/co-operative society against his salary until the loan is fully discharged.

4. Verify the take-home salary of the applicant and guarantors and it should not be less the 25% of gross salary.

5. Ensure that the applicant is maintaining savings bank account with the bank.

6. Verify the applicant and guarantor’s remaining period of service, and it should not be less than 2 years.

7. Verify whether the guarantors are his co-employees with good standing.

8. Verify whether the sanction of loan has been as per the terms and conditions laid down by the Head Office.

9. Verify the documents submitted by the applicant along with the loan application and ensure that they are complete and in order viz.,
   (a) Salary certificate of the applicant and guarantors.
   (b) Self declaration duly counter-signed by the pay disbursing officer as to the fact that applicant is working in a non-transferable post.
   (c) Pro-note duly executed jointly by the applicant and guarantors.
   (d) The irrevocable letter produced by the applicant from his employer addressed to the bank to the effect that the monthly installments of principal, accrued interest, penal interest, charges under the loan account will be deducted from the concerned employee’s salary every month and remitted to the bank regularly until the entire loan is cleared.

10. Ensure that the repayment period is within the maximum period as stipulated by HO.

11. Verify whether the details of disbursement have been intimated to pay disbursing officer.

12. Check the rate of interest and ensure that rate is as per the regulations and interest is applied properly.

13. Verify whether the installments are being made regularly on or before the stipulated date and in case of any belated payment, penal interest has been collected.
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14. Verify whether the branch is closely monitoring the recoveries and borrowers who have committed default have been reminded regularly to clear their over dues.

15. Verify whether the defaulted cases have been referred to Head Office for legal action/arbitration proceedings as per the norms prescribed.

16. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.13 Loan Against Mortgage of Property

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify that loan on mortgage of building/property has been granted/sanctioned for any one of the purposes mentioned in the rules/regulation governing the grant of mortgage loans.

2. Verify that loans have been sanctioned to individuals or group of individuals who are owning a building/property.

3. Verify whether the loan sanctioned against building/property is within the area of operation of the bank/branch.

4. Verify whether the amount of loan sanctioned is within the maximum limit prescribed for different type of borrowers.

5. Ensure that whether the loans sanctioned have been restricted/limited to 50% of the estimated value of the property (or as prescribed by the bank).

6. Confirm that the documents obtained by the branch are in order and enforceable.

7. Verify Head-Office/Branch holds the following documents.
   (a) Legal opinion from the approved panel lawyer and got approved from bank’s legal cell/section wherever required.
   (b) List of title deeds.
   (c) Original property documents recited in the legal opinion.
   (d) Blue print plan copy.
   (e) Photograph of the building.
   (f) Valuation report given by two officers of the bank who surveyed the property along with approved valuer.
   (g) Property/water tax payment receipts.
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(h) Comprehensive insurance policy standing in the joint names of the bank/borrower and covering all risks.

8. Age of the building.
9. Ensure that the value of the site has been assessed as per the guidance value.
10. Verify whether the relevant documents are properly filled in/completed with date and executed by the mortgagors/all joint holders of the property/borrowers.
11. Whether the Head Office/branch has incorporated all the clauses as per the guidelines/circulars issued from time to time in this regard.
12. Verify whether the legal adviser (lawyer) has scrutinized the documents and encumbrance certificate for 13 years and confirm that legal opinion has certified that the mortgagor has clear marketable title to the property to be mortgaged.
13. Also verify whether the lawyer has scrutinised the flow of title to the property proposed to be mortgaged to the bank, for a period of 25 years and certified that there is clear title to the property.
14. Ensure that the borrower has mortgaged the property in favour of the bank for the loan amount and registered with the concerned Sub-Registrar’s office before sanction of the loan.
15. Ensure that the borrower has produced further encumbrance certificate of the property for verification after such registration and before getting disbursement of the loan.
16. Ensure that the borrower has given his acceptance/consent to retain all the original documents with the bank pertaining to the property as advised by the legal advisor till the loan is cleared in full.
17. Confirm that the Head-Office/Branch has complied with the provisions of Urban Land Ceiling Act or any other similar Acts, wherever applicable.
18. Verify whether the branch has obtained Encumbrance Certificate (EC) Land Tax receipts periodically and any alteration of property has been noted while sanctioning the EC.
19. Verify whether the Head Office/Branch has inspected the mortgaged property periodically and maintained record for the visits.
20. Ensure that the period of repayment of the loan has not exceeded the period prescribed by the bank.
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21. Ensure that the borrower’s repaying capacity has been properly assessed i.e. his/her monthly income is adequate to repay the monthly installments towards principal and interest and also ensure that the monthly repayment installment should be within his repaying capacity.

22. Ensure that the borrower has been admitted as associated member before sanction of the loan.

23. Verify the loan application and ensure that the borrowers have furnished additional document namely wiz. building permit, plan, estimate of construction etc., as required under the loans scheme in the event of availing the loan for extension/repair/renovation of building.

24. Ensure that Head Office/Branch has obtained a letter of undertaking from the borrower that he will not alter or alienate the property mortgaged to the bank in any form without the prior permission of the bank.

25. Ensure that Head Office/Branch is closely monitoring and follow up action is being taken promptly to avoid loan becoming overdue or NPA.

26. In the event of overdue/NPA Loans, verify whether the Head Office/Branch has initiated step to regularise the bad loans.

27. Verify any legal restrictions for sale of property.

28. Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.14 Housing Loan

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether the member who desires to obtain a loan under Housing Loan Scheme has submitted the application in the prescribed form along in the following documents?
   (a) Title deed in original together with parent deed.
   (b) Encumbrance Certificate (EC) for 13 years till date.
   (c) Opinion of bank’s legal advisor to prove the title to the property.
   (d) Site plan and building plan approved by the competent authority viz., Town Planning Authority in case of construction/out right purchase of house/flat and up gradation where addition to the living space is involved.

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(e) Age proof of the borrower.

(f) Estimates for cost of construction certificate by the approved engineer.

(g) Estimated value of the house/flat certified by the approved engineer along with documentary proof for the life of the building.

(h) Salary certificate from his employer/other income proof as prescribed.

(i) Original agreement with flat promoter in the case of purchase of flat.

(j) Second encumbrance certificate from the date of issue of first encumbrance certificate.

2. Confirm that the documents obtained by the Head-Office/Branch are in order and enforceable.

3. Verify whether the building/flat proposed to be purchased by the borrower has been inspected and report is kept and confirm that the report does not contain adverse features?

4. Verify whether the lawyer has scrutinized the documents and EC for 13 years and confirm that legal opinion has certified that the proposed seller has clear marketable title to the property to be sold?

5. Verify whether any affidavit cum-undertaking has been obtained from the person applying for such credit facility to the effect that he shall not violate the sanctioned plan and construction shall be strictly as per the sanctioned plan?

6. Verify whether the loans are sanctioned directly to individuals who are above 18 years of age and within the maximum age as fixed by the bank?

7. Ensure that the borrower has been admitted as an associate member before sanction of loan.

8. Ensure that the loan has been sanctioned for the construction of house on plots under layouts approved by appropriate authority.

9. Ensure that the house purchased by the borrower under the scheme is in good tenantable condition and normal useful age and remain in such condition at least for a minimum period of 20 years from the date of purchase?
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10. Verify whether the loan sanctioned is within the purview of “purpose” mentioned in the terms of conditions stipulated and satisfied all conditions?

11. Ensure that the quantum of loan sanctioned is within the limits prescribed for different purposes.

12. Ensure that the property offered as security for loan stands in the name of applicant and unencumbered.

13. Verify and comment whether the property is in joint names, all the concerned parties have given consent and join in execution of registered documents.

14. Ensure whether the loan eligibility in favour of each borrower has been properly assessed and sanctioned as per norms prescribed?

15. Ensure that the borrower has satisfied/fulfilled all conditions stipulated by the HO viz., a) Not more than one loan has been granted b) The borrowers are having a regular and adequate source of income. c) Left over service is at least 5 years for attaining the age of superannuation.

16. Ensure that the loanee has mortgaged the plot and the house to be constructed in favour of the bank by registering the same.

17. Ensure that in the case of purchase of flat the undivided share in the land and the flat has been mortgaged by the loanee.

18. Ensure that the mortgage deed is signed by the loanee and two witnesses.

19. Ensure that the original deed is with the head office/Notified Branch as per the policy of the bank.

20. Ensure that evaluation fees has been collected from the loanee.

21. Ensure that Head Office/Branch has obtained an affidavit cum undertaking to the effect that the built up property has been constructed as per the sanctioned plan and/or building bye laws.

22. Ensure that the disbursement of loan has been done in installments as per percentage of loan amount prescribed for each stage of construction.

23. Ensure that in the event of acquiring a house/flat the payments have been made directly to the sellers.

24. Ensure that in the event of up gradation of the existing house whether the loan amount has been disbursed in 2 or 3 installments.
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25. Ensure that the construction of the house/flat or up-gradation in the existing house has been carried out exactly in accordance with the approved plan, specifications estimates on the basis of which the amount of loan has been computed and sanctioned.

26. Ensure that the repayment schedule has been fixed as per the income stream of the borrower but not exceeding the period fixed by the bank.

27. Verify whether there are any cases of default and in such cases penal interest, stipulated under the scheme has been collected over and above the normal rate of interest.

28. Verify that interest charged on the loans is as per the rate fixed by the bank.

29. Ensure that the construction has been completed within the stipulated time from the date of first installment of the loan is paid to the borrower.

30. Verify whether the annual inspection is being carried out in respect of houses constructed by availing loan from the Branch/Head Office to ensure that the House is maintained well.

31. Ensure that the original documents of title to the plot and property under mortgage have been obtained from the mortgagor and kept in safe custody along with mortgage deed.

32. Whether the house/flat constructed/purchased and house/flat in which upgradation has been made out of the loan sanctioned by the bank has been insured in the joint names of the borrower and the bank with the insurance company against fire, flood, cyclone and earthquake etc.

33. Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

34. Ensure that the housing loan granted is as per the RBI/NABARD guidelines.

Housing Loan Orders of the Delhi High Court Implementation of Directions

Ref:- RBI/2006 -07/187 RPCD. R.F. B.C. 35/07.40.06/2006-07 Dated 22/11/06 (the circular is given in the CD along with the Guidance Note). The Monitoring Committee constituted by the Hon'ble High Court of Delhi regarding unauthorized construction, misuse of properties and encroachment on public land has issued the following directions:-
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A. Housing Loan for Building Construction

(i) In cases where the applicant owns a plot/land and approaches the banks/financial institutions for a credit facility to construct a house, a copy of the sanctioned plan by competent authority in the name of a person applying for such credit facility must be obtained by the banks/financial institutions before sanctioning the home loan.

(ii) An affidavit cum undertaking must be obtained from the person applying for such credit facility that he shall not violate the sanctioned plan, construction shall be strictly as per the sanctioned plan and it shall be the sole responsibility of the executants to obtain completion certificate within 3 months of completion of construction, failing which the bank shall have the power and the authority to recall the entire loan with interest, costs and other usual bank charges.

(iii) An architect appointed by the bank must also certify at various stages of construction of building that the construction of the building is strictly as per sanctioned plan and shall also certify at a particular point of time that the completion certificate of the building issued by the competent authority has been obtained.

Ensure that the above conditions are satisfied.

B. Housing Loan for Purchase of Constructed Property/Built Up Property

(i) In cases where the applicant approaches the banks/financial institutions for a credit facility to purchase the built up house/flat, it should be mandatory for him to declare by way of an affidavit-cum-undertaking that the built up property has been constructed as per the sanctioned plan and/or building Bye-laws and as far as possible has a completion certificate also.

(ii) An architect appointed by the bank must also certify before disbursement of the loan that the built up property is strictly as per sanctioned plan and/or building Bye-laws.

C. No loan should be given in respect of those properties which fall in the category of unauthorized colonies unless and until they have been regularized and development and other charges paid.

D. No loan should be given in respect of properties meant for residential use, but which the applicant intends to use for commercial purposes and declares so while applying for loan.

All the banks have been advised to strictly comply with the above directions.
12.3.15 Loan for Purchase of Consumer Durables

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether the loans for purchase of consumer durables under the bank’s scheme have been sanctioned only after obtaining signature of two guarantors who satisfy the prescribed eligibility norms.

2. Ensure that loans sanctioned to persons as per the policy of the bank.

3. Verify whether the borrower and guarantors have been admitted as associate members before sanctioning the loan?

4. Verify the articles enlisted in the Invoice, submitted along with the loan application are eligible for purchase under the bank’s scheme and also verify whether the Invoices are obtained from authorized dealers/co-operative super markets.

5. Verify whether the applicant is eligible as per the scheme formulated by the bank.

6. Verify the guarantors’ networth and ensure that he/she has the repaying capacity in case of default by the borrower.

7. Verify whether the following documents have been furnished:
   (a) Certificate issued by the employer duly signed by the competent authority.
   (b) Pro-note executed by the applicant and guarantors jointly.
   (c) Hypothecation deed/agreement duly executed by the applicant and guarantors jointly.
   (d) Proforma Invoice from an authorized dealer/co-operative super market.
   (e) Other than the salaried employees viz., business people and professionals have to submit copy of Income Tax. returns/assessment order for the past 3 years.

8. Ensure that all documents are with the custody of person authorized for the purpose.

9. Verify whether the loan has been sanctioned by competent authority.

10. Verify whether the eligibility criteria has been arrived on the basis of salary/income of the applicant.
Guidance Note on Audit of StCBs & DCCBs

11. Verify whether the applicant has remitted margin money as stipulated under the scheme.

12. Verify whether the repaying capacity of the borrower has been properly assessed to fix the loan installments to be repaid under Equated Monthly Instalments (EMI).

13. Verify whether the payment has been made directly to supplier/manufacturer out of the loan sanctioned to the applicant.

14. Verify whether the loan repayment period under EMI has been restricted within the period stipulated by the bank.

15. Verify whether the EMI has been arrived after charging interest at the rate prescribed.

16. Verify the repayments made under the scheme are regular and is there any overdue payments (made after due date) in such cases whether the bank has collected penal interest as prescribed.

17. In cases where default persists, continuously for 3 months, whether the bank has exercised the right to recall the loan and send notice to take possession of the articles purchased with the bank’s advance.

18. Verify whether the goods have been properly insured by the borrower as prescribed.

19. Verify whether the over due recovery procedure has been followed to regularize the over dues as prescribed.

20. Verify whether the bank/branch has initiated action to file arbitration proceedings in cases whether the loan recoveries are not forthcoming even after giving sufficient time to regularize.

21. Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.16 Advances against Inland Bills/Cheques Purchased/Discounted

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Ensure that discount facility has been extended to customers only against the bills/cheques issued by the Government departments, reputed companies and Bank Drafts.
2. Verify cases where bills have been purchased/discounted in excess of the limits and ensure that the excess have been promptly reported to the higher authorities.

3. Verify whether the cheques/bills discounted/purchased are being dispatched promptly as per mode stipulated, depending upon the amount of the cheque/bill. In case of bills accompanied by Lorry Receipt (LR)/Railway Receipt (RR), they are invariably sent by registered post.

4. Incase of return/dishonour of bills/cheques, whether notice of dishonour has been served and the amount of dishonoured bills/cheques being recovered with interest promptly and a distinct note is made against the bills in the concerned register.

5. Verify whether branch is continuing the practice of debiting returned bills to cash credit/over draft accounts by over drawing these account or to current accounts causing debit balance.

6. Verify whether the consignments of the returned bills are got rebooked, if they remain unadjusted.

7. Verify whether any cheque discounted returned item is being time barred/pending recovery. Full details are necessary for fixing up accountability.

8. Verify whether the cheques discounted are not for accommodation. If so, identify the cases and steps taken by the branch. (any kite flying involved to be seen).

9. Verify whether immediate credit facility is segregated from general discounting. Whether self drawn cheques are discounted under this arrangement.

10. Verify whether discount/purchase charges have been collected in addition to commission charges for collecting the bills/local and outstation cheques as prescribed by the bank from time to time.

11. Verify whether the following documents have been collected from the parties to whom a bills purchase limit is granted.

   (a) Application for sanction of bills/cheques
   (b) Stamped bills purchase agreement
   (c) Demand promissory note
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(d) Securities such as FD Receipts, NSC Certificate, Title Deeds etc.

12. Verify whether the person has been admitted as an associate member before extending this facility.

13. Ensure that this facility has been extended to a customer who is maintaining an account in his own name to the satisfaction of the bank at least for a period of one year or such other period prescribed by the bank.

14. Verify whether this facility extended to customer within the ceiling permitted.

15. Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.17 Advances against Life Insurance Policies

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Confirm that life insurance policies assigned to the bank are in the names of borrowers/parties to the borrowing transactions and assignments are duly registered with LIC.

2. Ensure that the life insurance policies are not under the Married Women’s Property Act, 1974, Children Endowment, Children Deferred Policies etc.

3. Whether the age is admitted in life insurance policies and is inscribed on the face of the policy.

4. Whether the branch has maintained the prescribed margin.

5. Whether the premium, on all the assigned policies is paid up to date and the receipts are properly held.

6. Whether premia are paid promptly.

7. Ensure that loan or advances have been granted to customers of good standing against endowment life insurance policy.

8. Ensure that following precautions have been taken/observed while granting advances against insurance policies.
   (a) Insurance must be in force.
   (b) Premia on the policies has been paid up to date.
   (c) Latest premium receipt has been obtained and kept in record.
Verification and Audit of Advances

(d) The original policy duly stamped and signed by the issuing authority should be obtained.

(e) If the duplicate policy is produced by the borrower it should be got confirmed from LIC before the grant of advance.

(f) Policy should be free from encumbrances.

(g) A nomination will be cancelled by a subsequent transfer or assignment.

(h) Verify whether it contains any clause which restricts its assignment.

(i) Verify whether any advance/loan have been granted against the following policies since they are not eligible for advances.

   (i) A policy in which a minor is recited as a NOMINEE.
   (ii) Policy which has been assigned to MINOR.
   (iii) Children endowment are children deferred policies.
   (iv) A policy taken by a partnership concern.
   (v) A policy which restricts its assignment.

(j) Verify whether the terms and conditions prescribed under the scheme has been followed while fixing the limit in relation to percentage of the surrender value.

(k) Verify whether the advance is granted only after policy is assigned in favour of the bank and duly attested by a person other than the relative.

(l) Verify whether the notice of assignment and the policy have been sent to LIC for registration and collected it back. There should be a condition clause in agreement that the assured should pay all the future premia and in case of default, the advance will be treated as overdue and recalled.

(m) Verify the repaid loan and advances and ensure that in such cases polices have been reassigned in favour of the policy holder only.

(n) In case the policy matures, verify whether the bank has sent completed claim voucher together with the policy duly discharged to LIC to receive the amount.

(o) Upon receipt of the amount, whether the bank has adjusted the same to loan account.
Guidance Note on Audit of StCBs & DCCBs

(p) Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

12.3.18 Temporary Overdraft (TOD)

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify whether the overdraft has been sanctioned to a valued customer with regular and satisfactory operations.
2. Ensure that no cash draws have been permitted under TOD Account.
3. Ensure that no TOD has been allowed to staff members.
4. Verify the letter of request submitted by the customer with a specific request to sanction temporary accommodation.
5. Ensure, that the customer who availed TOD facility has been admitted as associate member of the bank before extending the facility.
6. Whether the customer has executed pro-note for the amount required as temporary accommodation.
7. Ensure that a fresh pro-note has been obtained as and when TOD is entertained.
8. Ensure that the temporary overdraft has been sanctioned only by the officer/executive who is competent to sanction TOD.
9. Verify whether the outstanding in the TOD accounts are within the delegated limits prescribed by Head Office from time to time to different category of Officers/Executives.
10. Verify whether the temporary accommodation availed by the customers are regularised by making remittances within the stipulated time limit.
11. Verify whether the interest has been charged to the Current Account holders who have availed the facility of temporary accommodation as per the guidelines issued by Head Office from time to time.
12. In the event of Overdue accounts, ensure whether the penal interest has been charged as per the regulations prescribed over and above the regular rate of Interest.
13. Verify whether the Head Office/Branch has insisted the borrower to provide security by way of assigning LIC Policy, NSC, FD receipts
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etc., if so, whether proper lien has been marked in the Deposit Ledgers with appropriate authority.

14. Verify the TOD accounts and ensure that outstanding in the account has not exceeded the TOD limit fixed in favour of each customer, even after charging interest to the account at monthly rests.

15. Ensure that Head Office/branch has followed the time gap limitation as specified under this facility while renewing/sanctioning of TOD for second and subsequent times.

16. Ensure that the classification of overdues has been done properly as per guidelines issued and prompt action has been initiated against defaulters to clear the outstanding by issuing demand notices/final demand notices within the time frame work prescribed.

17. In the event, outstanding is not cleared even after final demand notice has been issued, ensure whether Head Office/branch has initiated legal action by referring the matter to legal department at head office is respect of all overdue loans.

18. Ensure that right to recall the advance condition clause has been incorporated in the terms and conditions to sanction TOD and communicated the same to customer.

19. Ensure that temporary overdraft register has been updated with all details viz., name of the customer to whom TOD limit is sanctioned, date of availment, amount availed, due date for repayment etc.

20. Verify whether the periodical return on the loans sanctioned has been sent by the branch to the HO.

12.3.19 Educational Loan

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Verify the purpose and ensure that the purpose mentioned in the application is in line with the purpose for which the scheme has been designed.

2. Verify the course mentioned in the application to obtain loan under the scheme and ensure that whether it is under the enlistment of courses eligible for sanction.

3. Verify whether the college/polytechnic/Institution in which the borrower has admitted his son/daughter/ward has been approved and
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recognized by the State Government University/University Grant Commission (UGC) as well as the degree/diploma to be awarded is recognized by the University and any other agency namely All India Council for Technical Education (AICTE)/Government.

4. Whether proper appraisal has been made to assess the repaying capacity of the borrower to pay loan installments as per schedule.

5. Verify whether the bank/branch has obtained the certificate from the college, Institute or University as the case may be confirming the studentship, the course admitted, duration of the course, the approximate expenditure towards the entire course with annual break-up.

6. Verify the loan amount sanctioned is as per the provisions of the scheme viz., percentage of the total cost, maximum amount prescribed for each course etc.

7. Verify the security aspect for the loan disbursed and ensure that the deeds executed by sureties are as per the stipulations made under the scheme.

8. Verify the valuation certificate issued by the competent authority and ensure that the property value is equal to the loan amount, if the security offered is property.

9. Verify the period and procedure fixed for repayment and ensure that it is as per the regulations laid down.

10. Verify the agreement executed and confirm that it is in order.

11. Verify the interest charged/collected from the borrower whether it is as per the procedure prescribed and if any deviation is noticed call for explanation and record the same.

12. Verify whether any rebate in interest has been as per the scheme of GoI/State Government to students and if so, verify whether the rebate has been extended in such cases.

13. Verify whether proper follow up action has been initiated in default/over due cases.

14. Ensure that the education loan is sanctioned as per RBI instructions.

15. Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.
12.3.20 Swarnajayanti Gram Swarozgar Yojana (SGSY)

The auditor should check/examine/confirm/verify the following detailed aspects:-

1. Ensure that the beneficiaries identified under SGSY are duly approved by the Gram Sabha.

2. Verify the list of beneficiaries prepared includes, landless labourers, educated unemployed and disabled as per the scheme.

3. Verify the repayment period has been fixed as stipulated in the scheme after giving due consideration for gestation.

4. Verify the system of formation of a group with the main objective of poverty reduction.

5. Ensure that subsidy extended and received under the scheme is kept separately and passed on the benefit to the members only after settlement of all dues to the bank.

6. Verify whether the preference has been given for group activities.

7. Verify whether the initiative has been taken to bring every assisted family above the poverty line by providing income generating assets.

8. Whether the main objective of build up mutual trust and confidence between the bankers and the rural poor has shown any encouragement.

9. Whether the philosophy of the linkage has established expected results viz., the poor has capacity to save, the poor is bankable, the credit follows the thrift etc.

10. Verify whether the groups formed are within the optimum level i.e. between 15 and 20 members.

11. Whether the bank has extended financial assistance in a quick and flexible manner.

12. Whether any initiative has been taken by the bank to open SB account in favour of SHGs members to promote savings habit. Verify whether the SB accounts have been opened in favour of SHG only.

13. Study the percentage of recovery of dues from out of the loans extended to SHGs by comparing the percentage of recovery of dues from others.

14. Verify whether the loans have been extended to SHGs who have satisfied all eligible criteria.
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15. Verify the system and procedure followed by the bank in credit rating to ensure that it is as per the regulations laid down and selection of group has been made accordingly.

16. Verify whether the quantum of loan sanctioned to groups is linked to savings.

17. Verify whether financial assistance has been extended either under loan or cash credit facility or under both the facilities to group.

18. Verify whether the bank and SHGs have executed agreement before sanction of loan.

19. Verify whether the disbursements of loan by the bank to SHG and SHG to members are simultaneous.

20. Verify whether any provision has been made in the agreement with regard to repayment of loans to bank by SHG. If so, ensure that the period of repayment should not exceed 5 years.

21. Verify that documents executed by the SHG to bank at the time of availing Loan/C.C.

22. Verify whether any District Level Monitoring Review Committee has been formed to monitor the performance of SHGs.

12.4 Irregularities to be Verified and Taken Care of during the Reporting

<table>
<thead>
<tr>
<th>Item</th>
<th>IRREGULARITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CREDIT APPRAISAL</td>
</tr>
<tr>
<td>1.1</td>
<td>Loan application not on record at branch</td>
</tr>
<tr>
<td>1.2</td>
<td>The appraisal form was not filled up correctly and thereby the appraisal and assessment was not done properly</td>
</tr>
<tr>
<td>1.3</td>
<td>Loan application is not in the form prescribed by head office</td>
</tr>
<tr>
<td>1.4</td>
<td>The bank did not receive certain necessary documents and annexures required with the application form</td>
</tr>
<tr>
<td>1.5</td>
<td>Basic documents such as Memorandum &amp; Articles of Association, Partnership Deed, etc., which are a pre–requisite to determine the status of the borrower, not obtained</td>
</tr>
<tr>
<td>1.6</td>
<td>Certain adverse features of the borrower not incorporated in the appraisal note forwarded to the management</td>
</tr>
</tbody>
</table>
### Verification and Audit of Advances

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<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>1.7</td>
<td>Industry/group exposure and past experience of the bank is not dealt in the appraisal note sent to the management for sanction</td>
</tr>
<tr>
<td>1.8</td>
<td>The level for inventory/book debts/creditors for finding out the working capital is not properly assessed</td>
</tr>
<tr>
<td>1.9</td>
<td>Techno–economic feasibility report, which is required to know the technical aspects of the borrower’s business, is not obtained from technical cell</td>
</tr>
<tr>
<td>1.10</td>
<td>Credit report on principal borrowers and confidential report from their banks are not insisted from the borrowers</td>
</tr>
<tr>
<td>1.11</td>
<td>The opinion reports of the associate and/or sister concerns of the borrower are not scrutinised</td>
</tr>
<tr>
<td>1.12</td>
<td>The opinion reports of the associate and/or sister concerns of the borrower are not called for</td>
</tr>
<tr>
<td>1.13</td>
<td>The opinion reports of the associate and/or sister concerns of the borrower are not updated</td>
</tr>
<tr>
<td>1.14</td>
<td>The opinion reports of the associate and/or sister concerns of the borrower are not satisfactory</td>
</tr>
<tr>
<td>1.15</td>
<td>The procedure/instructions of head office regarding preparation of proposals for grant not followed</td>
</tr>
<tr>
<td>1.16</td>
<td>The procedure/instructions of head office regarding preparation of proposals for renewal of advances not followed</td>
</tr>
<tr>
<td>1.17</td>
<td>The procedure/instructions of head office regarding preparation of proposals for enhancement of limits, etc. not followed</td>
</tr>
<tr>
<td>1.18</td>
<td>No exposure limits are fixed for forward contract for foreign exchange sales/purchase transactions</td>
</tr>
</tbody>
</table>

### Sanctioning and Disbursement

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Credit facility sanctioned beyond the delegated authority or limit of the branch</td>
</tr>
<tr>
<td>2.2</td>
<td>Certain proposals were sanctioned pending approval of higher authorities wherever required</td>
</tr>
<tr>
<td>2.3</td>
<td>Adhoc limits were granted for which sanctions were pending since long</td>
</tr>
<tr>
<td>2.4</td>
<td>Facilities were disbursed before completion of documentation</td>
</tr>
<tr>
<td>2.5</td>
<td>Facilities were disbursed without following sanction terms</td>
</tr>
<tr>
<td>2.6</td>
<td>Facilities were disbursed without any sanction</td>
</tr>
</tbody>
</table>
### Guidance Note on Audit of StCBs & DCCBs

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.7</td>
<td>Sanction letter was missing in the branch</td>
</tr>
<tr>
<td>2.8</td>
<td>Guarantor as required in the sanction letter was not obtained</td>
</tr>
<tr>
<td>2.9</td>
<td>Required promoters stake not invested before disbursement of loan</td>
</tr>
<tr>
<td>2.10</td>
<td>Sanctions were made without proper appraisal</td>
</tr>
<tr>
<td>2.11</td>
<td>Security charge not created before disbursement as required by sanction letter/renewed letter</td>
</tr>
<tr>
<td>2.12</td>
<td>Full disbursement of the facility not made</td>
</tr>
<tr>
<td>2.13</td>
<td>Sanction terms were not complied with or were not recorded</td>
</tr>
<tr>
<td>2.14</td>
<td>Disbursement made without proper sanction</td>
</tr>
<tr>
<td>2.15</td>
<td>Term loan was disbursed by creating the cash credit or savings account of the borrower</td>
</tr>
</tbody>
</table>

### DOCUMENTATION

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>The security against which the advance was sanction was not available/ was not on record</td>
</tr>
<tr>
<td>3.2</td>
<td>Mortgage for the property given as security is not created</td>
</tr>
<tr>
<td>3.3</td>
<td>Mortgage for the property given as security created, was inadequate, as compared to terms of sanction</td>
</tr>
<tr>
<td>3.4</td>
<td>Second charge as required, on assets is not created in favour of the bank</td>
</tr>
<tr>
<td>3.5</td>
<td>Documents of second charge on assets is not on the record</td>
</tr>
<tr>
<td>3.6</td>
<td>Documents pertaining to registration of charges with ROC or any other concerned authority requiring charging of assets is not obtained</td>
</tr>
<tr>
<td>3.7</td>
<td>Copies evidencing lodgment of the original conveyance/ sale deeds with the Sub–Registrars for registration not on record</td>
</tr>
<tr>
<td>3.8</td>
<td>Authority letter/ power of attorney to the bank to collect the original documents from the Sub–Registrar not on record</td>
</tr>
<tr>
<td>3.9</td>
<td>Documents pertaining to consortium advances not yet executed/ not available with bank</td>
</tr>
<tr>
<td>3.10</td>
<td>Documents signed by persons not duly authorised to sign or who have signed in other capacity accepted by the bank</td>
</tr>
<tr>
<td>3.11</td>
<td>Signatures of the executants were not found on all the pages of the documents</td>
</tr>
<tr>
<td>3.12</td>
<td>Some of the documents on record were blank, without signatures of branch manager, witnesses, or guarantors, etc</td>
</tr>
<tr>
<td>3.13</td>
<td>Revival letters in respect of documents to be reviewed from the borrowers not received</td>
</tr>
<tr>
<td>3.14</td>
<td>Guarantors have expired</td>
</tr>
<tr>
<td>3.15</td>
<td>Guarantors not on record</td>
</tr>
<tr>
<td>3.16</td>
<td>Guarantors not renewed</td>
</tr>
<tr>
<td>3.17</td>
<td>Guarantors not assigned</td>
</tr>
<tr>
<td>3.18</td>
<td>Worth of the guarantors not available</td>
</tr>
<tr>
<td>3.19</td>
<td>Stamping not as per the amended Stamps Act</td>
</tr>
<tr>
<td>3.20</td>
<td>Documents have become mutilated, soiled, time barred or not obtained</td>
</tr>
<tr>
<td>3.21</td>
<td>Opinion report by the field officer for the borrowers not found on record</td>
</tr>
<tr>
<td>3.23</td>
<td>“Nil Encumbrance Certificate/s” or “No Dues Certificate/s” or “No Lien Letters” not obtained for the mortgage/s</td>
</tr>
<tr>
<td>3.24</td>
<td>Advances for vehicle loans, registration certificate, transfer certificate, etc. not obtained</td>
</tr>
<tr>
<td>3.25</td>
<td>Work completion certificate, sale deeds, share certificates in societies, etc. not on record for housing loans</td>
</tr>
<tr>
<td>3.26</td>
<td>Documents are not duly attested/ signed by concerned officials/not renewed</td>
</tr>
<tr>
<td>3.27</td>
<td>The agreements for hypothecation do not contain details regarding goods hypothecated</td>
</tr>
<tr>
<td>3.28</td>
<td>Copy of Bills/receipts, on the basis of which the amount was disbursed not found on record. For e.g. vehicle loans, plant &amp; machinery</td>
</tr>
<tr>
<td>3.29</td>
<td>Charge on main or collateral securities not created in terms of sanction letter</td>
</tr>
<tr>
<td>3.30</td>
<td>Original security papers/sale deed/lease deed/title deed/agreement of sale not available on record</td>
</tr>
</tbody>
</table>
### Guidance Note on Audit of StCBs & DCCBs

| 3.31 | TDR are not discharged or renewed |
| 3.32 | Control returns not sent to the HO. |
| 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 breakup 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 |
## Verification and Audit of Advances

<p>| | |</p>
<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>4.12</td>
<td>Wide discrepancies observed in the stock statements and stock figures in the annual audited financial statements</td>
</tr>
<tr>
<td>4.13</td>
<td>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</td>
</tr>
<tr>
<td>4.14</td>
<td>Many branches have not adhered to the prescribed frequency of physical verification of securities given against loans &amp; advances</td>
</tr>
<tr>
<td>4.15</td>
<td>Drawing power limits are not revised as per market value of shares for advances against security of shares</td>
</tr>
<tr>
<td>4.16</td>
<td>End-use of funds not ensured/not known funds utilised for purpose other than for which granted</td>
</tr>
<tr>
<td>4.17</td>
<td>The projections submitted by the borrower stay far beyond the actual performance. Further, no explanation for the same is taken from the borrower</td>
</tr>
<tr>
<td>4.18</td>
<td>Major sale proceeds of the borrower not routed through the bank</td>
</tr>
<tr>
<td>4.19</td>
<td>Audited statements of non-corporate borrowers having limit beyond ₹10 lacs not received</td>
</tr>
<tr>
<td>4.20</td>
<td>Renewal proposals of advances not received on time and in many cases the limits are not renewed</td>
</tr>
<tr>
<td>4.21</td>
<td>Application of wrong rate of interest, processing charges, commission, other charges, etc. resulting in income leakage/excess booking of interest of the bank</td>
</tr>
<tr>
<td>4.22</td>
<td>Insurance cover for stock/property is inadequate/not on record/not renewed/not endorsed in favour of the bank</td>
</tr>
<tr>
<td>4.23</td>
<td>Inspection/physical verification of security charged, not been carried out</td>
</tr>
<tr>
<td>4.24</td>
<td>Expired bills/foreign currency sight bills which are outstanding, have not been crystallized</td>
</tr>
<tr>
<td>4.25</td>
<td>EBW statements on write-off of overdue export bills of ECM not found on record</td>
</tr>
<tr>
<td>4.26</td>
<td>Confirmation as to genuineness of export transactions not obtained from bank’s foreign offices/correspondents/customs department</td>
</tr>
<tr>
<td>4.27</td>
<td>Import credit, bill of entry evidencing import of goods not found</td>
</tr>
<tr>
<td>4.28</td>
<td>Documents are not obtained for bills discounted under letter of credit</td>
</tr>
<tr>
<td>-------</td>
<td>------------------------------------------------------------------------</td>
</tr>
<tr>
<td>4.29</td>
<td>Advances, which are eligible for whole turnover packing credit guarantee cover of ECGC, are not brought under its cover though Government Guaranteed Accounts are irregular since long, the issue of invocation of guarantee does not seem to have been considered</td>
</tr>
<tr>
<td>4.30</td>
<td>Prescribed margins not maintained as per sanctions</td>
</tr>
<tr>
<td>4.31</td>
<td>Allocated limits, full terms of sanctions, stock statements, inspection reports, margin, etc. not available at monitoring branches</td>
</tr>
<tr>
<td>4.32</td>
<td>For allocated limits, inordinate delays were noticed in responding to transfer by the allocator branch</td>
</tr>
<tr>
<td>4.33</td>
<td>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</td>
</tr>
<tr>
<td>4.34</td>
<td>Individual members of the consortium are not advised about the quarterly operating limits/ DP allocated to each one of them</td>
</tr>
<tr>
<td>4.35</td>
<td>Minutes of the consortium meetings not found on record/not been held as per norms</td>
</tr>
<tr>
<td>4.36</td>
<td>Inspection report from the consortium members not obtained</td>
</tr>
<tr>
<td>4.37</td>
<td>The capital of the borrower has eroded/ net worth is negative/ decreasing. Close monitoring needs to be done</td>
</tr>
<tr>
<td>4.38</td>
<td>The drawing power is calculated wrongly and/or hence the borrower is allowed to enjoy excess credit than actually eligible</td>
</tr>
<tr>
<td>4.39</td>
<td>Signboard of the bank is not displayed in godown, where the pledged/ hypothecated stock is stored</td>
</tr>
<tr>
<td>4.40</td>
<td>Limit not fully utilised by the borrower/no commitment charge is levied for the limit not fully utilised by the borrower</td>
</tr>
<tr>
<td>4.41</td>
<td>Loan against TDR/ STDR, which is matured, is neither renewed nor credited to loan account</td>
</tr>
<tr>
<td>4.42</td>
<td>The stock and debtors audit report not found on record. No audit has been done for accounts of the borrower</td>
</tr>
</tbody>
</table>
### Verification and Audit of Advances

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.43</td>
<td>The valuation report in respect of tangible security from government approved valuer have not been obtained</td>
</tr>
<tr>
<td>4.44</td>
<td>Guarantees, opinion reports financial statements, IT assessment orders and etc. of the guarantor are not found on record</td>
</tr>
<tr>
<td>4.45</td>
<td>Opinion report on guarantor is not obtained</td>
</tr>
<tr>
<td>4.46</td>
<td>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</td>
</tr>
<tr>
<td>4.47</td>
<td>Pre–sanctions and/or post–sanctions inspection reports were not on record</td>
</tr>
<tr>
<td>4.48</td>
<td>The account was overdue for repayment and/or no credit was received from the borrower for a long time</td>
</tr>
<tr>
<td>4.49</td>
<td>The borrower is absconding or deceased and legal formalities are incomplete and there is willful default from the borrower. Either establishment was closed or security was disposed off or no action taken by the branch</td>
</tr>
<tr>
<td>4.50</td>
<td>Subsidy claim process was incomplete or subsidy was yet to be received or needs follow–up</td>
</tr>
<tr>
<td>4.51</td>
<td>Security disposed off/ entity closed by borrower and no action taken by the branch</td>
</tr>
<tr>
<td>4.52</td>
<td>Irregularity not advised to controllers</td>
</tr>
<tr>
<td>4.53</td>
<td>Letter of subordination of deposits not taken</td>
</tr>
<tr>
<td>4.54</td>
<td>Secured and unsecured portion not segregated properly in advance return of the branch</td>
</tr>
<tr>
<td>4.55</td>
<td>Renewal of limits was done before the receipt of financial statements</td>
</tr>
<tr>
<td>4.56</td>
<td>Heavy cash withdrawal for which consent of corporate guarantor is not taken</td>
</tr>
<tr>
<td>4.57</td>
<td>Proper valuation of stock not done/ needs critical scrutiny</td>
</tr>
<tr>
<td>4.58</td>
<td>Security obtained is inadequate/lower as compared to amount of outstanding/ no collateral security</td>
</tr>
</tbody>
</table>
Guidance Note on Audit of StCBs & DCCBs

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4.59</td>
<td>The party was dealing with other bank also though it was not permitted</td>
</tr>
<tr>
<td>4.60</td>
<td>Sticky accounts require close follow–up by the management</td>
</tr>
<tr>
<td><strong>5</strong></td>
<td><strong>BAD AND DOUBTFUL ADVANCES</strong></td>
</tr>
<tr>
<td>5.1</td>
<td>The IRAC norms for classification of advances were not followed and the same is implemented through memorandum of changes by auditors during audit</td>
</tr>
<tr>
<td>5.2</td>
<td>Instalments were not received from the borrowers</td>
</tr>
<tr>
<td>5.3</td>
<td>Interest was not received from the borrowers</td>
</tr>
<tr>
<td>5.4</td>
<td>Legal action for recovery of advances was not taken although authorised by the Board/ Controlling Authority</td>
</tr>
<tr>
<td>5.5</td>
<td>Discontinuance of application of interest not followed although authorised by the Board/ Controlling Authority</td>
</tr>
<tr>
<td>5.6</td>
<td>Government guarantees have expired and fresh guarantees not obtained/not renewed</td>
</tr>
<tr>
<td>5.7</td>
<td>Terms of the BIFR scheme not complied</td>
</tr>
<tr>
<td>5.8</td>
<td>Payment from Government not received although guarantees were unconditional, irrevocable and payable on demand</td>
</tr>
<tr>
<td>5.9</td>
<td>Delays in the settlement/ repayment in respect of sanctioned proposals</td>
</tr>
<tr>
<td>5.10</td>
<td>The repayment accepted in case of compromise cases inadequate vis–à–vis value of security</td>
</tr>
<tr>
<td>5.11</td>
<td>Compromise proposals pending at various levels where Local Government/ outside agencies are involved as guarantors</td>
</tr>
<tr>
<td>5.12</td>
<td>Copy of search report not on record</td>
</tr>
<tr>
<td>5.13</td>
<td>Decree awarded but no further steps taken for recovery</td>
</tr>
<tr>
<td>5.14</td>
<td>DICGC claims submitted/ rejected/ pending data not available</td>
</tr>
<tr>
<td>5.15</td>
<td>Irregular/ sticky advance not reported to the controlling authority promptly</td>
</tr>
<tr>
<td>5.16</td>
<td>Compromise/ One Time Settlement (OTS) proposal is recommended and is under negotiation since long but not finalised. Suit is filed in the court/ Debt Recovery Tribunal (DRT) and pending to be finalized</td>
</tr>
<tr>
<td>5.17</td>
<td>ECGC claim not submitted/ lodged for recovery</td>
</tr>
</tbody>
</table>
Chapter 13
Verification of Investments

13.1 Introduction

Investment is deployment of funds in order to derive future income in the form of interest, dividends and/or appreciation in the value of securities. Apart from above, every investment has some amount of risk. It requires "pre certain sacrifice" for "future uncertain benefits".

Successful investment requires clear cut objectives based on current information as well as thorough knowledge of the characteristics of the chosen investment avenues. In this unit, we shall discuss concepts relating to Investment management and how they influence investment decisions.

Investment management has to face and deal with price fluctuations, alternative investment currency fluctuations, policies of Government and regulatory authorities, seen or unforeseen forces that affect the economy and the competition from other investors. Investment management deals with the manner in which investors analyze, select and evaluate investments in terms of their risks and expected returns.

13.2 Investment Outlook of Banks

Banks do not lend all their resources but do investments of some part of the resources. Some investment is required to be done by the banks as statutory or regulatory requirements also.

In general, while making investment decisions, investors should consider the three components of investment that can have an effect on their anticipated income and spending. The components are rate of interest, the rate of expected inflation and the risk perception. Bank should consider all of them while taking investment decisions.

13.3 Liquidity Requirements

Liquidity planning is a major aspect of investment management. Liquidity essentially means the ability to meet all contractual obligations as and when they arise, as well as the ability to satisfy funds requirements to meet new business opportunities. Liquidity planning involves analysis of all major cash
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flows that arise in the bank as a result of asset and liability transactions and projecting these cash flows over the future. Liquidity analysis involves an analysis of the maturity profile of existing assets and liabilities over which the impact of transactions that are planned for the future are superimposed.

13.4 Concept of Risk in Investment

The real rate of interest represents the rate which the investor earns on the investment irrespective of the effects of other factors such as expected inflation and risk. In addition to seeking compensation for the period of investment, investors also seek protection from expected inflation. In other words, all investments should have these two elements present in their required rates of return. The factor that distinguishes one investment's required return from another's is the element of risk.

Risk is uncertainty about future rate of return on investments. Since the future is unknown, there is always some risk.

Risks are classified into two major categories:

1. **Systematic Risks:** These risks arise out of external and uncontrollable factors such as policy change, nature of industry, state of economy, etc. Some of the systematic risks are:
   (i) Market Risk
   (ii) Interest Risk
   (iii) Purchasing Power Risk
   (iv) Exchange Rate Risk

2. **Un-systematic Risks:** These risks arise out of known and controllable factors which are internal in nature. Some of the un-systematic risks are:
   (i) Business Risk
   (ii) Financial Risk
   (iii) Default or Insolvency Risk

13.5 Expected Rate of Return

There are several causes of uncertainty in future returns from securities that can be identified and generalized about. In estimating the risk element in a security, it is necessary to recognize these different causes to estimate how they are likely to affect future returns from that security.
Verification of Investments

Investment in a security carries a certain amount of risk. The investor expects to be compensated for the risk he is exposed to. This is referred to the risk premium. The equity investment carries a greater risk vis-a-vis debt security investment.

In brief, investment reasoning lies in evaluating investments and their potential impact on returns. That there are three major ingredients present in any investment decision- (i) real rate of interest, (ii) expected inflation rate and (iii) risk premium. Thus, required rate of return = real rate + expected inflation + premium.

13.6 Valuation of Investment

The Board has to ensure that the valuation of investments has been done as per guidelines issued by the RBI from time to time. RBI vide its circular RPCD. No. BC. 154/ 07.02.08/94-95 dt 23.05.95 addressed to all StCBs and DCCBs advised them as under:

1. Permanent investments should be valued at cost and in case the cost price is higher than the face value, the premium should be amortised over the remaining period of the maturity of the security and where the cost price is less than the face value, the difference should be ignored.

2. Investment should be shown in the balance sheet, net of depreciation. However, the bank can show the book value of investment, the depreciation there against and the net amount of investments separately.

3. Investment under current category should be carried at lower of cost or market value on a consistent basis.

4. Any gain in the sale of securities in the permanent category should be first taken to the Profit and Loss Account and thereafter it could be appropriated to the ‘Capital Reserve’ Account.

13.7 RBI Guidelines on Investment

Considering the high risk involved in investment portfolio and the smaller strength of the co-operative banks in absorbing such shocks, risk minimizing instructions are imposed on banks by RBI and NABARD. The important guidelines issued by RBI and NABARD in this regard are as under:

1. Authorities of the bank for taking investment decisions and for noting the decisions taken by higher authorities should be specified.
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2. Since investment transactions are very sensitive in nature, co-operative banks should develop internal skills to handle this portfolio.

3. Constant market watch, independent of various market available advices, should be done.

4. Every co-operative bank should frame its own investment policy approved by its Board of Directors and the policy should be reviewed every year.

5. The investment policy of the bank should clearly define the authority to put through the investment deals, procedure to be followed for obtaining sanction of the appropriate authority, fixing various prudential exposure limits and reporting system.

6. A copy of the investment policy framed by the bank should be forwarded to the Regional Office of the RBI along with a certificate that the policy is in accordance with the prescribed guidelines issued by the RBI and the co-operative department, if any. Subsequent changes, if any, made in investment policy should be also informed to the Regional Office of the RBI.

7. No sale transaction should be put through by banks without actually holding the security in its investment account.

8. Bank should not undertake any purchase/sale transaction with broking firms or other intermediaries on principal to principal basis.

9. For purchase of securities from the RBI through Open Market Operations (OMO), no sale transaction should be contracted prior to receiving the confirmation of the deal/advice of allotment from the Reserve Bank of India.

10. The concurrent auditors of the bank should specifically verify the compliance of regulatory/statutory requirements. The auditor should report about this in the monthly report to the Chairman, Managing Director/Chief Executive Officer of the bank. Half yearly review of the observations of the concurrent auditors should be placed before the Board. If the auditor observes any regulatory or other serious violation in investment dealings of the bank, it should be immediately reported to the concerned Regional Office of the RBI and to the Public Debts Office (PDO).

11. For Government securities, including those traded through Negotiated Dealing System (NDS), are made available by RBI on its website and
Verification of Investments

Clearing Corporation of India Ltd. (CCIL) makes available to all market participants the details of the transactions as received from NDS. The back office of the bank as well as auditors should make use of this information for price and other checks.

12. Bank can take scheduled commercial bank, a primary dealer, a financial institution, primary urban co-operative bank, insurance company, mutual fund or provident fund as counterparty for their transactions. Direct deal may be done with the counter parties.

13. Prices of the sale-purchase transactions should be checked with other banks or Primary Dealers (PDs) with whom bank is maintaining Constituent Subsidiary General Ledger Account (CSGL).

14. CSGL accounts should be used for holding the securities and such accounts should be maintained in the same bank with which the cash account is maintained.

15. For all transactions, delivery against payment should be insisted and strictly observed. The fund account and the investment account must be tallied on each day before closure of business.

16. Officers deciding about purchase and sale transactions should be separated from those responsible for settlement and accounting.

17. No transaction in Government security should be undertaken in physical form.

18. In all security dealings, it must be ensured, before concluding the deal, the ability of the counterparty to fulfill the contract, particularly when the counterparty is not a bank.

19. In order to avoid concentration of risk, banks should have a diversified investment portfolio.

20. While dealing with Government securities, SEBI guidelines also become applicable to the banks. Therefore, extant regulatory guidelines of SEBI should also be observed.

21. The inter bank securities transactions should be undertaken directly between the banks without engaging the services of any broker in such transactions.

22. Banks may, however, undertake securities transactions among themselves or with non-bank clients through members of the National Stock Exchange (NSE), Bombay Stock Exchange (BSE) or Over The
Guidance Note on Audit of StCBs & DCCBs

Counter Exchange of India (OTCEI) directly and without the use of brokers.

23. Purchase of permissible shares and PSU bonds in the secondary market, other than inter-bank transactions, should be only through recognized stock exchanges and registered stock brokers.

24. Service of only SEBI registered brokers who are authorized by the permitted exchanges such as NSE/BSE/OTCEI should be utilized to the extent permitted by the regulators. Bank should prepare a panel of brokers with the approval of the Board of Directors. Brokers should be empanelled after verifying their credentials such as SEBI registration, membership of BSE/NSE/OTCEI for debt market, market turnover in the preceding year as certified by the exchanges, market reputation, etc. Bank should also check websites of SEBI and respective exchanges to ensure that the broker has not been put in the banned list.

25. If the deal is put through with the help of broker, the role of broker should be restricted to that of bringing the two parties to the deal together. Under no circumstances, banks should give power of attorney or any other authorization to the broker/intermediary to deal on their behalf in the money and securities markets.

26. If the deal is facilitated through broker, disclosure of counterparty should be insisted upon.

27. Contract confirmation from the counterparty should be insisted upon.

28. Banks should not do a disproportionate part of the business through only one or a few brokers. Banks should fix aggregate contract limits for each of the approved brokers and ensure that these limits are not exceeded. A limit of 5% of total transactions, both purchase and sales, entered into by the bank during a year should be treated as the aggregate upper contract limit for each of the approved broker. If for any reason the 5% ceiling of the broker is exceeded by the authority empowered to put through the deals, a written note to the Board must be placed mentioning the reasons and circumstances in which the limit was exceeded and a post-facto approval from the board must be obtained.

29. Bank should never purchase a security under any buy-back arrangement.
Verification of Investments

30. UCBs are not allowed to subscribe to the initial or subsequent issue of shares, debentures of private sector companies or bodies organizations, other than the co-operative sector unless specifically permitted by the RBI.

31. Scheduled Co-operative Bank should not keep deposit with Non-scheduled Co-operative Bank.

32. Non-scheduled Co-operative Bank should keep deposit with only strong Scheduled Co-operative Bank that has complied with prescribed level of CRAR, net NPA of such bank is less than 7%, bank has not defaulted in maintenance of CRR/SLR for last two years and bank is complying with RBI directives on income recognition, asset classification and provisioning, exposure ceilings loans and advances to directors.

33. Non-SLR investments should be limited to 10% of total deposits of the bank.

34. Investments in units of mutual funds, except debt mutual funds and money market mutual fund should not be done.

35. Exposure to any single bank should not exceed 2% of the depositing bank’s DTL as on 31st March of the previous year.

36. Non-SLR securities are mostly in the form of credit substitutes. Therefore, for non-SLR investment banks should,

(a) subject all their investment proposals to credit appraisal on par with their credit profile irrespective of the fact that the proposed investments are in rated securities.

(b) make their own internal credit analysis and rating without relying on rating of securities by external agencies only.

(c) strengthen the internal rating systems which should also include building up of a system of regular, quarterly or half yearly, tracking of the financial position of the issuer with a view to ensure continuous monitoring of the rating migration from the rating done/awarded by the bank while taking investment decision.

(d) stipulate minimum entry level timing/quality standards and industry-wise, maturity-wise, duration-wise, issuer-wise limits to mitigate the adverse impact of concentration and the risk of liquidity.
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37. The bonds/debentures received by the bank as sale consideration towards sale of financial assets to Securitization Company (SCO) or Reconstruction Company (RC) are classified as non-SLR investment, and all RBI norms for non-SLR investment for classification, provisioning, valuation, etc. are applicable to them. Bank should not make direct investment in security receipts, certificates, bonds and debentures issued by SCO/RC.

13.8 Check List Regarding Verification of Investments

13.8.1 Non-SLR Investment

If the bank invested their genuine surplus funds in non-SLR securities without taking prior approval from RBI, whether the following conditions have been complied:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>Yes/No</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Whether the bank has complied with Non Overdue Cover discipline stipulated by NABARD.</td>
<td>YES/NO</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>All legitimate credit needs of the co-operatives in the State/District should have been fully met.</td>
<td>YES/NO</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>There are no defaults in repayment of dues to NABARD and in the maintenance of the stipulated CRR and SLR.</td>
<td>YES/NO</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>There exists a provision for the proposed investment in the State Act and the Registrar of Co-operative Societies have no objection for the banks making such investment.</td>
<td>YES/NO</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>The bank has complied with the Section 11(1) of the B. R. Act, 1949 (AACS).</td>
<td>YES/NO</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>The bank is not placed under directions under Section 35A of the B.R.Act, 1949 (AACS) or issued a</td>
<td>YES/NO</td>
<td></td>
</tr>
</tbody>
</table>
## Verification of Investments

<table>
<thead>
<tr>
<th>verification</th>
<th>YES/NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>show cause notice under any section of the B.R.Act, 1949 (AACS).</td>
<td></td>
</tr>
<tr>
<td>The bank has kept the concerned Regional Office of RBI apprised of the non-SLR investment.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>Whether the investment in non-SLR is within the overall limit of non-SLR investment, which is fixed at 10 percent of the bank's total deposits as on March 31 of the previous year with a sub-ceiling of 5 per cent as stated in paragraph 2 of our aforesaid circular.</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>

### 13.8.2 Bonds of Public Sector Undertakings (PSU)

If the bank has invested their surplus funds in the PSU bonds, whether the following conditions have been complied:

<table>
<thead>
<tr>
<th>condition</th>
<th>YES/NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>The investment in PSU bonds is within 10% of their deposits.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>The bank should has complied with the minimum involvement, requirements of No Dues Certificate discipline stipulated by NABARD.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>All legitimate credit needs of the co-operatives in the State/District should have been fully met.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>There are no defaults in repayment of dues to NABARD and in the maintenance of the stipulated CRR and SLR.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>Are there any investments in non-PSU bonds without seeking prior permission from RBI.</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>
### 13.8.3 Transactions in Securities

#### Ready-Forward (buy-back) deals

<table>
<thead>
<tr>
<th>No.</th>
<th>Description</th>
<th>YES/NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Whether the bank has undertaken inter-bank ready-forward deals in dated Government and approved/trustee securities.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Whether any existing deals in dated securities are being completed on due dates without resorting to any extension or roll-overs.</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Whether inter-bank ready-forward transactions are now being undertaken only in treasury bills (of all maturities).</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Whether all double ready-forward deals in Government securities including treasury bills are not dealt with.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Whether no ready-forward and double ready-forward deals are put through even among banks and even on their own investment accounts in any other securities, such as PSU bonds and units.</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Whether no ready-forward and double ready-forward deals are put through in any security including Government securities, on behalf of Portfolio Management Services client's Accounts or on behalf of other constituents including brokers.</td>
<td></td>
</tr>
</tbody>
</table>

### 13.8.4 Transactions in Government Securities

<table>
<thead>
<tr>
<th>No.</th>
<th>Description</th>
<th>YES/NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Whether all transactions in Government securities for which</td>
<td></td>
</tr>
</tbody>
</table>
### Verification of Investments

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>YES/NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SGL facility is available are put through SGL accounts only.</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Before issue of SGL transfer forms covering their sale transactions, whether the bank ensures that they have sufficient balance in their respective SGL accounts.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>3</td>
<td>Whether a SGL transfer form issued by the bank in favour of another bank has bounced for want of sufficient balance in the SGL account.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>4</td>
<td>Whether the purchasing bank issues the cheques only after receipt of the SGL transfer forms from the selling banks.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>5</td>
<td>Whether the SGL transfer form received by purchasing banks are deposited in their SGL accounts immediately.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>6</td>
<td>Whether any sale is effected by way of return of SGL form held by the bank.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>7</td>
<td>Whether SGL transfer forms are signed by two authorised officials of the bank whose signatures are recorded with the respective Public Debt Office (PDO) of RBI and other banks.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>8</td>
<td>Whether the SGL transfer forms are in the standard format prescribed by the RBI and printed on semi-security paper of uniform size.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>9</td>
<td>Whether the SGL forms are serially numbered and there is a control system in place to account for each SGL form.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>10</td>
<td>If the SGL transfer form bounces for want of sufficient balance in the SGL</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>
### Guidance Note on Audit of StCBs & DCCBs

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<thead>
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<tbody>
<tr>
<td>account, whether the amount of the SGL form (cost of purchase paid by the purchaser of the security) is debited immediately to the current account of the selling bank with the RBI.</td>
<td></td>
<td>YES/NO</td>
</tr>
<tr>
<td>11</td>
<td>In the event of an overdraft arising in the current account following such a debit of bounced SGL, whether penal interest is paid to RBI on the amount of the overdraft at a rate of 3 percentage points above the discount and Finance House of India's call money lending rate on the day in question.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>12</td>
<td>Whether the bouncing of the SGL form has ever occurred thrice and whether the bank has been debarred from trading with use of the SGL facility for a period of six months from the occurrence of the third bouncing.</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>

### 13.8.5 Bank Receipts (BRs)

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<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Whether any BR has been issued under in respect of transactions in Government securities for which SGL facility was available.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>2</td>
<td>Whether any BR is issued where the scrips are yet to be issued by the issuer and the bank is holding the allotment advice.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>3</td>
<td>Whether any BR is issued when the security is physically held at a different centre and the bank is in a position to physically transfer the security and give delivery thereof, within a short period.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>4</td>
<td>Whether any BR is issued when the security has been lodged for</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>
## Verification of Investments

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>YES/NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>transfer/interest payment and the bank is holding necessary records of such lodgments and will be in a position to give physical delivery of the security within a short period.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Whether any BR has been issued on the basis of a BR (of another bank) held by the bank and whether any transaction has taken place on the basis of a mere exchange of BRs held by the bank.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>6</td>
<td>Whether any BR has been issued by the bank for covering transactions relating to either the accounts of Portfolio Management Services (PMS) clients or other constituents accounts including brokers.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>7</td>
<td>Whether any BR has remained outstanding for more than 30 days.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>8</td>
<td>Whether the BRs are issued on semi-security paper, in the standard format (prescribed by IBA), serially numbered, and signed by two authorised officials of the bank, whose signatures are recorded with other banks.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>9</td>
<td>Whether separate registers of BRs issued and BRs received are maintained and arrangements are put in place to ensure that these are systematically followed up and liquidated within the stipulated time limit.</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>

### 13.8.6 Internal Control System

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>YES/NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Whether there is a clear functional separation of (a) trading, (b) settlement, monitoring and control, and (c) accounting.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>2</td>
<td>Whether there is a functional</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>
**Guidance Note on Audit of StCBs & DCCBs**

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Separation of trading and back office functions relating to bank's own investment accounts, PMS clients' accounts and other constituents (including brokers).</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>While providing PMS to their clients, whether the bank strictly follows the guidelines on the subject and PMS clients' accounts are subjected to a separate audit by external auditors.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>4</td>
<td>Whether for every transaction entered into, the trading desk prepares a deal slip which contains data relating to nature of the deal, name of the counterparty, whether it is a direct deal or through a broker, and if through a broker, name of the broker, details of security, amount, price, contract date and time.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>5</td>
<td>Whether the deal slips are serially numbered and controlled separately to ensure that each deal slip has been properly accounted for.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>6</td>
<td>Once the deal is concluded, whether the dealer immediately passes on the deal slip to the back office for recording and processing.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>7</td>
<td>Whether for each deal, there is a system of issue of confirmation to the counterparty.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>8</td>
<td>When the bank ensures timely receipt of requisite written confirmation from the counterparty, which includes all essential details of the contract and is monitored by the back office.</td>
<td>YES/NO</td>
</tr>
<tr>
<td>9</td>
<td>Once a deal has been concluded, whether there is any substitution of the counterparty bank by another bank.</td>
<td>YES/NO</td>
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</table>
### Verification of Investments

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<table>
<thead>
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<tbody>
<tr>
<td><strong>bank by the broker, through whom the deal has been entered into.</strong></td>
<td></td>
<td>YES/NO</td>
</tr>
<tr>
<td><strong>10</strong></td>
<td>Once a deal has been concluded, whether the security sold/purchased in the deal is substituted by another security.</td>
<td>YES/NO</td>
</tr>
<tr>
<td><strong>11</strong></td>
<td>On the basis of vouchers passed by the back office (which should be done after verification of actual contract notes received from the broker/counterparty and confirmation of the deal by the counterparty) whether the accounts section independently maintains the books of accounts.</td>
<td>YES/NO</td>
</tr>
<tr>
<td><strong>12</strong></td>
<td>In the case of transactions relating to PMS clients’ accounts (including brokers) whether all the relative records give a clear indication that the transaction belongs to PMS clients/other constituents and does not belong to bank’s own investment account and the bank is acting only in its fiduciary/agency capacity.</td>
<td>YES/NO</td>
</tr>
<tr>
<td><strong>13</strong></td>
<td>Whether records of Subsidiary General Ledger (SGL) transfer forms issued/received are maintained.</td>
<td>YES/NO</td>
</tr>
<tr>
<td><strong>14</strong></td>
<td>Whether the balances as per bank's books are reconciled at quarterly intervals with the balances in the books of PDOs and if the number of transactions so warrant, the reconciliation should be undertaken more frequently, say on a monthly basis.</td>
<td>YES/NO</td>
</tr>
<tr>
<td></td>
<td>Question</td>
<td>YES/NO</td>
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</tr>
<tr>
<td>15</td>
<td>Whether the reconciliation of balances are also periodically checked by the internal audit department.</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Whether a record of BRs issued/received is maintained by the bank.</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Whether a system for verification of the authenticity of the BRs and SGL transfer forms received from other banks and confirmation of authorised signatories is put in place.</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Whether the bank has put in place a reporting system to report to the top management on a weekly basis, the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks and BRs outstanding for more than one month and review of investment transactions undertaken during the period.</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Whether the bank draws cheques on their account with RBI for third party transactions including inter-bank transactions instead of bankers, cheques/pay orders.</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Whether the Internal Audit Department audits the transactions in securities on an ongoing basis and monitors compliance with the laid down management policies and prescribed procedures and reports the deficiencies directly to the top management of bank.</td>
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</tbody>
</table>
### 13.8.7 Dealings through Brokers

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>YES/NO</th>
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<tbody>
<tr>
<td>1</td>
<td>If a deal is put through with the help of a broker, whether the role of the broker is restricted only to that of bringing the two parties to the deal together.</td>
<td></td>
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<tr>
<td>2</td>
<td>While negotiating the deal, the broker is not obliged to disclose the identity of the counterparty to the deal; however, on conclusion of the deal, whether he discloses the counterparty and whether his contract note clearly indicates the name of the counterparty.</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>On the basis of the contract note disclosing the name of the counterparty, whether the settlement of deals between banks, viz., both fund settlement and delivery of security, is made directly between the banks and the broker has no role to play in the process.</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>With the approval of their top management, whether the bank has prepared a panel of approved brokers which is being reviewed annually or more often, if so warranted.</td>
<td></td>
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<tr>
<td>5</td>
<td>Whether clear-cut criteria has been laid down for employment of brokers, including verification of their credit worthiness, market reputation, etc.</td>
<td></td>
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<tr>
<td>6</td>
<td>Whether a record of broker-wise details of deals put through and brokerage paid, has been maintained.</td>
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<td>7</td>
<td>Whether a disproportionate part of</td>
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<td></td>
<td>the business is being transacted through only one or a few brokers.</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Whether the bank has considered fixing aggregate contract limits for each of the approved brokers to ensure that these limits are not exceeded.</td>
<td>YES/NO</td>
</tr>
</tbody>
</table>
Chapter 14
Other Areas of Bank Working & Functioning

14.1 Introduction
The performance of a bank is examined by the auditors with a view to assess the bank’s working in its totality rather than merely bringing out operational and financial deficiencies and legal irregularities.

14.2 Internal Checks and Controls
The auditor should check/examine/confirm/verify the following detailed aspects:-

(a) Quality of maintenance of various registers/ledgers and other important books of account.

(b) Procedures adopted by the bank to protect itself from shortcomings, if any, that may eventually result in loss.

(c) Delegation of powers – systems to ensure adherence to delegated powers, use of discretionary powers.

(d) System of internal checks and control and to bring out shortcomings therein with reference to:

(i) custody and periodical verification, by an official, of investments, securities, bills, parcels, vouchers, blank cheque books, unused stock of fixed deposit receipts/cash certificates/draft forms, pass books, godown keys etc.

(ii) daily independent checking of previous day’s entries from vouchers,

(iii) periodical balancing of deposit ledgers, loan/overdraft/CC ledgers, bills purchased/discounted, pay orders, DD/MT/TT registers, suspense and sundry deposit registers, investment ledger etc., by a person other than those writing them,

(iv) balancing of books by surprise,

(v) rotation of duties among the staff and

(vi) long outstanding items pending adjustment/reconciliation in the suspense/sundry registers and bank accounts reconciliation register.
Guidance Note on Audit of StCBs & DCCBs

(e) Maintenance of CRR/SLR.
(f) Working out DTL, deficiencies observed.
(g) System followed regarding adherence to caution advices from RBI/NABARD.
(h) Inspection of branches and societies.
(i) Regularity of submission of returns to RBI/NABARD – chronic deficiencies including false reporting etc.
(j) Review of frauds – modus operandi, amounts recovered, action taken to avoid recurrence, prompt reporting to NABARD, submission of quarterly returns to NABARD, suggestions for improvement in internal checks etc. should be pointed out return-wise with adequate details.
(k) Regularity or otherwise in submission of various statutory and non-statutory returns to the Head Office/Regional Office. Chronic deficiencies including false reporting etc. should be pointed out return-wise with adequate details.
(l) Setting up of vigilance cell – preventive vigilance.
(m) Concurrent audit system – compliance of observations.
(n) Methodology for disposal of complaints (Complaint Redressal Mechanism).
(o) MIS – its adequacy, usefulness. How the top management/Board uses the MIS.

14.3 KYC Norms

The auditor should check/examine/confirm/verify the following detailed aspects:

(a) Branches are expected to act with due diligence and adhere to appropriate Know Your Customer (KYC) norms/guidelines at the time of opening accounts and permitting high value transactions through such accounts. Give the particulars of violation of KYC norms, if any.

(b) Confirm that Permanent Account Number [PAN], or Form No. 60/61 is obtained for running accounts viz., current account, savings bank account, overdraft account. This is applicable to all types of customers like individuals, firm, company, trust, association, society, etc. and also while accepting the term deposit of more than Rs. 50,000/-. In case of renewal matured term deposits also confirm that PAN/or declaration in Form No.60/61 is obtained.
Other Areas of Bank Working & Functioning

(c) Whether any document is produced to confirm the correctness of the address before opening the account.

(d) Whether the branch is making independent confirmation of the address of the account holder.

(e) Whether branch follows instructions with regard to obtaining photographs for opening accounts.

(f) Whether branch is ensuring that the customers are introducing only genuine persons known to them and displaying this caution at the notice board of the branch as per guidelines.

14.4 Deposits Accounts

The auditor should check/examine/confirm/verify the following detailed aspects:-

(a) Whether operational instructions, cheque series, address and other particulars have been noted in the ledger/register.

(b) Whether closed account opening forms are removed and filed separately.

(c) Whether all new accounts are properly authenticated.

(d) Whether branch is destroying the unused cheque books/leaves of closed accounts and endorsement to this effect is made in the respective ledger folios.

(e) Whether customer's standing instructions are carried out properly.

(f) Whether incidental charges are collected for non-maintenance of minimum balance.

(g) Whether branch is charging the incidental charges half yearly in case of current accounts.

(h) Whether any of bank employees is operating third party account on power of attorney without prior permission from competent authority.

(i) Comment on the issue of cheque books and verify whether:-

   (i) confirmation has been obtained in case the cheque books are issued through third persons.

   (ii) it is properly regulated and the signature on the requisition slip is verified before issuing them.
Guidance Note on Audit of StCBs & DCCBs

(iii) in case cheque books are issued against other than requisitions slip, whether proper care is exercised.

(iv) comment on the maintenance of cheque books register.

(j) Comment on maintenance of “stop payment” register.

(k) Comment on maintenance, preservation, and renewal of the signature cards and verification of drawer’s signature on cheques before passing and affixing the seal thereon to the effect.

(l) Whether TDS on interest paid to non-resident accounts and domestic deposits.

(m) At random check the interest paid on various deposits periodically/on maturity and confirm that the rate applied and the calculations made are in order.

(n) Whether non-operative current accounts and savings bank accounts are periodically transferred to separate ledgers and necessary control has been exercised as per the guidelines.

(o) Whether branch maintains a register for recording details of cash deposits/withdrawals of Rs. 10.00 lakh and above. Whether such transactions are reported to controlling office/ head office on a fortnightly basis.

(p) Whether any counterfeit currency was detected and if so, whether it has been reported to HO promptly.

14.5 Examination of Records

The auditor should check/examine/confirm/verify the following detailed aspects:

(a) Whether the revenue was recognized in accordance with Accounting Standards issued by ICAI.

(b) Whether adequate cut-off procedures exist to ensure that revenue relating to the period under audit is fully recognized and that revenue not relating to the period under audit is not recognized.

(c) Obtain list of interest received on loans and advances. Verify a sample of selected entries in the loan ledger (interest and loan accounts) with cash/bank book and general ledger to ensure that interest is correctly recorded.

(d) Select a sufficiently large sample of entries in the loan ledger accounts and verify them with supporting documents like loan
Other Areas of Bank Working & Functioning

agreements, security provided by the borrower and interest rates to ensure that interest is properly charged and accounted in the books of accounts.

(e) If EMIs are received from the borrowers, verify and ensure that the interest portion of EMI is correctly calculated and credited to interest account.

14.6 Ledger Scrutiny

Following ledgers should be scrutinized/checked/examined/verified:

(a) (i) General ledger, (ii) debtors’ ledger, (iii) creditors’ ledger, (iv) loan ledger, (v) deposit ledger, (vi) other subsidiary ledgers, (if any).

(b) List out the year-end balances of these ledgers with break-up in precise terms.

(c) Check the expenses accounts to ensure that only expenses relevant to the period under audit have been entered. If expenses are not paid but incurred, ensure such expenditure is duly provided for in the books by appropriate provisioning.

(d) Check the revenue accounts to ensure that all revenues accrued during the year are duly accounted for and that credit has not been taken for any revenue not accruing during the year.

(e) Check the assets and liabilities accounts to ensure that all assets and liabilities have been properly accounted for.

14.7 Analytical Procedures

Analytical procedures that may be helpful in the audit process to strengthen the audit assertions are:

(a) Comparison of interest receipts by type of loan for the current year with the corresponding figures for previous 2 years; similarly, comparison of other receipts for the current year with the corresponding figures for previous 2 years.

(b) Comparison of Net Interest Income (NII) = Total interest received – Total interest paid for the current year with the corresponding figures for previous years.

(c) Comparison of Net Interest Margin (NIM) = NII – Expenditure related to loaning business for the current year and previous two years.
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(d) Comparison of sales margin and discounts, (if any) for the current year with corresponding figures for previous years.
(e) Comparison of interest income received for the current year with the corresponding figures for previous years.
(f) Comparison of ratio of income on deposits and investments to average investments for the current year.
(g) Comparison of ratio of salaries and wages to total sales and deposits for the current year and for two previous years.
(h) Comparison of ratio of overall expenditure of StCBs and DCCBs to its working capital for the current year and for previous two years.

14.8 Management

(a) General Body: The auditor should check/examine/confirm/verify the following detailed aspects:

(i) Whether the annual general meeting was held regularly by the bank during the period covered by the audit. If not, reasons therefor.
(ii) Comments on major decisions including important amendments to Bye-laws effecting policy changes in the working of the bank.

(b) Board of Directors and Committees: The auditor should check/examine/confirm/verify the following detailed aspects:

(i) Composition of the Board–vacancies, if any, in the Board. Deficiencies/irregularities in constitution of the Board/Committees and their functioning. (See amended Co-operative Society Act (CSA) provisions post Vaidyanathan Committee (VC-I).
(ii) Number of Board meetings required to be held and actually held. Names of directors who have been absenting/not attending the Board meeting consecutively on more than three occasions – action taken against them.
(iii) Whether the bank has been adopting the list of agenda items to be placed before the Board as suggested by NABARD. Deviations, if any, may be indicated.
(iv) Adoption of ‘Fit and Proper’ criteria by the Board.
(v) Steps taken by the bank to induct professionals in the Board.
(vi) Whether the bank has constituted Audit Committee by inducting a Chartered Accountant, if required.
Other Areas of Bank Working & Functioning

(vii) Various committees constituted by the Board, their functions, meeting periodicity, number of meetings required to be held and actually held.

(viii) Proceedings of the Board of Management.

(ix) Action taken in diversifying the loan portfolio especially in the non-farm activities and expanding the business of the bank as well as the mobilisation of deposits.

(x) Inadequacy or failure to place other important information/data/statement etc., required to be placed in the Board/Committee’s meetings.

(xi) Whether there were any representatives from defaulting societies on the Board/Committees.

(xii) Vacancies in the Board not filled up since long (with reasons therefor).

(xiii) Important aspects of the bank’s functions and working not included in the agenda for Board/Committee’s discussions in the meetings.

(c) Chief Executive Officer and other Executives: The auditor should check/examine/confirm/verify the following detailed aspects:

(i) Comment on whether the CEO fulfills 'fit and proper' criteria in the State that had signed MoU for implementation of Revival Package under VC-I.

(ii) Comments on the powers vested in/delegated to the Chief Executive Officer (CEO) of the bank and whether such powers were adequate and properly exercised.

(d) Staffing Pattern: The auditor should check/examine/confirm/verify the following detailed aspects:

(i) Managerial strength available at HO and branch levels (adequacy or otherwise).

(ii) Whether the staff in different categories possessed the prescribed qualifications and whether they have received training in co-operative banking suitable to the posts held by them.

(iii) Whether the duties of staff particularly in executive cadres included developmental functions for expanding the business of the bank by involving themselves in scheme preparation for term lending for agricultural and allied purposes, such as, animal husbandry, fisheries, poultry, dairy, etc.
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(iv) Whether the bank has any technical staff for dairy, fisheries, poultry, etc. and also for guiding industrial co-operatives, preparing/appraising schemes for them and processing their applications for financial accommodation.

(v) Whether the bank has chalked out a programme for recruiting and training young officers to take up senior level positions in the course of time.

(vi) Whether the organisational structure of the bank is satisfactory and adequate to serve its needs.

14.9 Asset-Liability Management (ALM)

The auditor should check/examine/confirm/verify the following detailed aspects:-

(a) Whether the bank has been identified by NABARD for implementation of ALM. If so, whether the bank has taken necessary action as indicated in NABARD guidelines.

(b) Are the bank's operations computerised to capture the data required for ALM exercise.

(c) Has the bank identified Nodal Officer for the purpose.

(d) Whether Asset Liability Committee (ALCO) has been set up and how it is working.

(e) Whether the bank has been able to compile and generate residual maturity and interest rate sensitivity statements and gap summary.

14.10 Risk Management Systems

The auditor should check/examine/confirm/verify the following detailed aspects:-

(a) Whether the bank has put in place the policies and procedures to mitigate various risks as indicated in NABARD circular dated 6th April, 2005 and subsequent guidelines on Credit Risk and Operational Risk Management.

(b) Whether the Board had constituted Risk Management Committee and how effective it is.

(c) Credit Risk, Interest Rate Risk and Operational Risk faced by the bank may be assessed and indicated with suggested remedial measures.
14.11 Developmental Initiatives

The auditor should check/examine/confirm/verify the following detailed aspects:

(a) Preparation of Development Action Plan (DAP), execution of MoU.
(b) Implementation of DAP.
(c) In case the bank was not complying with the provisions of Section 11(1) of the B.R.Act, 1949 (AACS), the action Plan for compliance with the said section, progress made/shortcomings may be examined and commented.
(d) Review of the action plan by the bank’s Board/top management.
(e) Examine the financial position of affiliates and comment.
(f) Supervision over primaries.
(g) Efforts of bank in development of primaries, steps taken by the bank to implement financial inclusion, business correspondent and business facilitator schemes, undertaking of agency business for insurance, etc.
(h) Other developmental initiatives such as promotion and linkage of Self Help Groups (SHGs), formation of Farmers’ Clubs, participation in Government sponsored programmes, etc.

14.12 Recovery of Non-performing Assets

(a) Assess the quality of the assets of the bank and the auditor should comment on the following:
   (i) Volume of unsecured advances and its trend.
   (ii) Depletion in value of securities, loss of security, fraudulent transactions taking place, etc.,
   (iii) Number of cases where references are made to initiate arbitration/legal action.
   (iv) Number of cases relating to conversion/restructuring which has taken place and amount involved therein.
   (v) Overdrawls permitted in current account remaining unpaid after due dates.
   (vi) No. of discounted instruments returned, devolved Letter of Credits (LCs) and initiated bank guarantees remaining unpaid.
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(b) The auditor should verify the following:

(i) Whether bank/branch categorizes special monitoring accounts as required under policy guidelines and takes effective steps for regularisation/recovery.

(ii) Undertake comparative study of classification of advances as per credit risk code allotted in comparison to previous year and comment on migration.

(iii) Undertake comparative study of NPA level at the branch/bank and compare with the previous year and comment.

(iv) Study ratio of NPA to total advances and comment.

(v) Study the movement of NPA accounts and comment.

(vi) Whether the branches have achieved the annual recovery targets and comment on achievements.

(vii) Recovery efforts - check points

1. Exceeding sanctioned limits pending beyond permitted periods.

2. Overdraws in current account pending beyond specified days.

3. Discounted cheques/clean instruments pending beyond prescribed period.

4. Bills discounted pending beyond due date.

5. LCs invoked/paid to be rewarded outstanding.

14.13 Branch Control

The auditor should check/examine/confirm/verify the following detailed aspects:-

(a) Whether branch expansion programmes, if any, had been drawn up keeping in view the potential for banking business and viability aspects.

(b) Performance of newly opened branches during the period covered by the inspection.

(c) Powers and functioning of the Branch Advisory Committee, if constituted by the bank.

(d) Whether the powers vested in/delegated to the branch managers were adequate to ensure smooth and effective functioning of branches.
Other Areas of Bank Working & Functioning

(e) Manner in which discretionary powers (vested/delegated) were exercised by the branch managers.

(f) Whether the duties of the staff are clearly defined and periodically reviewed. Whether the duties of staff are so organised that the work of an employee is not allowed to remain unchecked and that he does not have absolute control over any financial operations of important nature.

(g) The adequacy or otherwise of various returns prescribed-obtained by the HO from the branches so as to have an effective control over the working of branches.

(h) Scrutiny and follow-up action by HO on various returns received.

(i) False reporting, etc.

(j) Periodicity prescribed and followed for reconciliation of inter branch account.

(k) Entries pending whether unresponded for unduly long periods i.e. for over 6 months. Give full details such as number of cases, amount involved, period-wise classification of pending amount and a few individual items involving large amounts.

(l) Methodology adopted by the bank for charging interest on funds lent by HO to the branches and allowing interest to funds borrowed from the branches with a view to evaluate their viability. (Transfer Pricing Mechanism – TPM)

(m) Periodicity of inspection of branches by the HO.

(n) Arrears of branch inspection.

(o) Quality and coverage of inspection report.

(p) Adequacy or otherwise of follow-up action on inspection reports to ensure that the defects pointed out are promptly rectified by the branches.

(q) Whether branch inspection report /gist of major findings are placed before the Board of Directors/Executive Committee.

14.14 Management Information System (MIS)

Since MIS is an important tool to aid managers in solving problems and making decisions, it should be very effective and accurate.
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The auditor should check/examine/confirm/verify the following detailed aspects:

(a) Whether the MIS developed by the bank is complete in nature and provides the information for making decisions regarding the integration of the organisation through the process of management.

(b) Whether the data collected is having clarity and consistency to make correct decisions.

(c) Whether the right information has been provided in the right form and at the right time.

(d) Whether the bank is able to control the operations of the sub-systems of the bank with the data collected under MIS.

(e) Conduct test check and ensure that the data furnished under various returns are accurate and reliable.

(f) Data collected should be relevant to the problem/issue to be solved for which MIS has been designed.

(g) Whether the project development team and users have communicated the issue effectively.

(h) While designing the MIS whether the project development team has clear mission and vision of the purpose for which it has been designed.

(i) MIS cannot establish, repair or modify the management system, as this can be done only by managers/users therefore the concerned personnel should be trained properly. Whether the personnel have been trained and trainings organised for implementation.

(j) Whether proper implementation procedure has been developed and adopted.

(k) Whether the hardware, software and other materials acquired have been able to take care to install and implement the MIS designed/proposal.

(l) Whether the form designed for a specific MIS is adequate and serve the purpose.

(m) Whether testing has been properly carried out before implementing the system.

(n) Whether key personnel are taking steps to implement the system effectively to achieve the end results.
Other Areas of Bank Working & Functioning

(o) Whether MIS helps the management in formal review, formulation of an action plan, and follow up of the decisions taken.

(p) Whether periodical returns prescribed under MIS to be submitted by PACS, Field Manager of CCB, Branch of CCB and CCB in order to stabilise the monitoring system, have been reviewed periodically to take decisions to improve the effectiveness of management.
Chapter 15

Audit in a Computerised Environment – Special Considerations

15.1 Introduction

StCBs and DCCBs records keeping may be divided into three broad categories based on the level of computerisation:

(a) Non-computerised banks/branch 
(b) Partially computerised 
(c) Fully computerised 

In view of the above, audit in a computerized environment in StCBs and DCCBs should generally follow the standard test procedures detailed in the Guidance Note. In addition, the following factors need to be considered by the auditors.

15.2 Accounting and Record Keeping

(a) Review the process of creating heads of accounts to ascertain there are adequate controls on opening and closing of accounts. Obtain a list of new accounts opened and those which were closed during the year of audit and verify the adherence to the process and controls.

(b) Review the nature and title of heads of accounts and map the same with the main heads in the financial statements.

(c) In fully computerized environment, balancing of books need not be verified. However, where sub-ledgers are maintained manually, the control accounts on the system needs to be properly verified to ensure the balances in the sub ledgers tally with control accounts.

(d) Review the process of actual recording of transactions in various books and the usage of correct vouchers. Verify that transaction authorization controls are properly followed and no unauthorized entries exist in the books of accounts.

(e) Check whether there are any transactions adjusted “out of books” at the year-end while finalizing the financial statements. Ensure these are properly authorized and carried through the books of accounts.
Audit in a Computerised Environment – Special Considerations

(f) Check whether the financial statements (Profit & Loss Account and Balance sheet) including the trial balance are correctly generated. Does the trial balance tally. Ensure that the trial balance is generated for full set of accounts and not just for those accounts having a debit/credit balance.

15.3 Basic Software and Hardware Checks

(a) Whether the hardware like the basic computers, external drives, CD writers etc. are in good working condition.

(b) Check the number of times the hardware failed and/or shut down for maintenance. How was the data processing done during those times.

(c) Check the software register and ensure that all softwares used are properly entered in the register and maintained computer-wise.

(d) Check whether the software is a licensed version.

(e) Check that the software is fully installed as per the rights purchased.

(f) Check the manuals and physical versions (CDs) of the softwares.

(g) Examine, if the hardware and software are covered under an annual maintenance contract.

15.4 Verification of Data Integrity, Data Safety and Safeguarding of Assets

(a) Whether there is a proper EDP department or an authorized officer in-charge of the data processing activities. Is the officer properly trained. Whether the system administrator identified and authorized.

(b) Whether all available features for data safety been installed.

(c) Check by whom the access levels are granted. Is there a formal process.

(d) Whether the users have a minimum access based on their job needs.

(e) Whether the access level of users restricted to specific applications/files/menus and/or servers.

(f) Whether file maintenance on the systems restricted to EDP in-charge or distributed? If distributed, are those persons appropriately authorized.

(g) Whether the password (of users) encrypted.
**Guidance Note on Audit of StCBs & DCCBs**

(h) Are the access levels periodically reviewed by secretary/authorized officials of StCBs and DCCBs.

(i) How the modem usage is controlled.

(j) Are there specific internet access controls.

(k) Whether firewalls/system protection software installed in all systems.

(l) Whether backup of data is periodically properly taken. Whether its stored within StCBs and DCCBs (on site) or outside StCBs and DCCBs (offsite). If within StCBs and DCCBs, whether is it in the custody of authorized officials of StCBs and DCCBs and if outside the StCBs and DCCBs, who authorizes the storing of data.

(m) Whether backup data is tested periodically for recovery.

**15.5 Access to the System**

(a) Verify whether the computer system is protected against unauthorized and unlimited attempts of booting/access.

(b) Verify whether the operating system/application is protected against unauthorized and unlimited attempts/trials of access.

(c) Verify whether the operating system/application generates the access log.

**15.6 Password Controls**

(a) Are users sensitized to use a password that will be difficult to guess by others;

(b) Whether secrecy of password is maintained by all users;

(c) Passwords for the following activities should only be with the secretary/system administrator:

   (i) Taking backups;
   (ii) Entering into/updating the operating systems;
   (iii) Creating/editing master records;
   (iv) System shutdowns and rebooting;

(d) Check if users change their passwords regularly;

(e) Check that passwords are not shared.
15.7 **User-ID/Password Maintenance**

(a) Verify whether a User-ID register is maintained and the custody of the register is appropriate.

(b) Verify whether passwords are changed periodically and at stipulated intervals.

(c) Verify whether the system forces the user periodically to change password.

(d) Verify whether the same password can be repeated, if yes, after what interval.

(e) Verify whether User-ID of employees/officials transferred/resigned/retired etc. are deleted/de-activated.

(f) Verify whether officers and operators do use their own User-ID and password for operations.

(g) Verify whether separate User-ID and passwords are being provided to supervisor and manager.

(h) Verify whether any digital certificate/smart card/access card was issued to the branch staff. If so, verify whether the same have been returned to the branch under proper noting, on transfer/resignation etc., of the employee. Also comment on safe keeping of such items and receipt/return of the same to Head Office.

15.8 **Database Management**

(a) Whether transaction dates in the system are properly authorized;

(b) Whether there exist controls to accept only current date entries. There is either no provision for back dated entries or the back dated entries are properly authorized;

(c) Whether the unused terminals are being switched off.

15.9 **Transaction Processing**

(a) Verify whether interest on debit balance in current account is debited when the account comes to credit.

(b) Verify whether all the slips/vouchers entered on the system bear the transaction number generated by the system with due initials of clerical/supervisory staff for having entered/checked.
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15.10 Controls on application of Interest Rates & Interest Calculation

(a) Obtain interest rates keyed into system and match with rates prescribed by the management.
(b) Obtain log of interest rate changes and match with changes prescribed by the management.
(c) Ensure that interest rate changes are duly authorized.
(d) Test check few calculations.
(e) Obtain cases of interest default and ensure that reversals have been properly done.
(f) Verify whether products can be changed. If yes, whether any authorization is registered and audit trail produced. Verify audit trail, for product change.
(g) Verify whether rate of interest on overdraft is modified as per circulars issued from time to time.
(h) Verify whether TDS rate on interest on deposits is modified as per circulars issued from time to time.
(i) Verify whether the interest to be applied in different modules is correct for variety of accounts and for the duration of interest application.
(j) Verify whether the branch keeps proper record of the interest calculations on quarterly/half yearly basis.

15.11 Levying of Various Charges

Verify whether incidental charges, service charges etc., are levied as per the latest circulars.

15.12 GL Operations

(a) Verify whether day book postings, day book, GL, reported are duly verified and authenticated.
(b) Verify whether any on-line help is available for the required codes.
(c) Verify whether the correction of any error/data required authorization.
Audit in a Computerised Environment – Special Considerations

(d) Verify whether system prints the day book after matching automatically before the day end.
(e) Verify whether the matched day book report is being checked and authenticated by Officer/Manager.
(f) Verify whether system prints any GL matched reports.
(g) Verify whether GL matched report generated by the system is checked and authenticated.
(h) Verify whether system prints GL automatically or option is there to view it/print it on screen whenever required.
(i) Verify whether special functions at half-year-end are taken care of by the package automatically.

15.13 Clearing Module

(a) Verify whether the software provides for clearing module.
(b) If yes, verify whether the following aspects are taken care of -
   o warning for the operator before day-end procedure in case the clearing module is not executed.
   o in case of execution of clearing module any report is produced in respect of number of instruments and amount posted.
(c) Verify whether clearing credits are accorded regularly.
(d) Verify whether charges for clearing returns are debited manually.
(e) Verify whether interest/charges for passing cheques against clearing are debited regularly.

15.14 Cheque Management

(a) Verify whether stop payment option is provided for a single cheque or group of cheques.
(b) Verify whether validation is performed for closed/dormant/frozen accounts.
(c) Verify whether cheque books issued are entered in the system regularly (scrutinize the exceptional transactions report).
**15.15 Demand Draft Module**

Whether demand draft module is implemented, if yes, observe the following-

(a) **Access Controls.** If access to programs and data is primarily controlled through passwords, whether procedures are adequate.

(b) **Audit Trail Facility.** Does the computer system maintain a log of access activity.

(c) **Security and Recovery.** Whether plans and procedures exist in a controlled manner to prevent a short term or partial failure and are the same documented. Are the concerned officers aware of the same.

**15.16 NPA Recognition**

(a) Check whether the system identifies the NPA or is it manually entered in the system.

(b) If the system identifies NPAs, the auditor should verify and understand the process of identification Non-performing Asset (NPA) under various types of facilities.

(c) The auditor should verify that the bank has the process of identifying NPA borrower-wise and not facility wise.

**15.17 Operational Review**

(a) Verify that all software licenses are available and only authorised software is being used.

(b) Verify whether the operator logs out of the system while leaving the seat.

(c) Verify whether proper access controls are in place for computer hardware, software, media, records etc. Also comment on exercise of proper control on computer service personnel and any third party involved in data-entry/networking/telecommunication etc., services.

(d) Verify whether apparently unusable media and computer printouts of waste nature are destroyed in a secure and safe manner.

**15.18 Computer Environmental Review**

(a) Verify whether the UPS is used only for the Computer Systems and Networking Equipments. Verify, if any other power consuming equipment is connected to the UPS.
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(b) Verify whether the batteries of UPS are properly kept in a rack.

(c) Verify whether AMC/warranty is valid in respect of -
(i) UPS/Batteries.
(ii) Computer System (Servers, PCs, Nodes), Printers etc.
(iii) Networking Equipments eg., Modems, Switches, Routers etc., if any.

(d) Check whether the vendor's representative visits installations periodically for preventive maintenance of (i) UPS/Batteries, (ii) Computer Systems & Printers, (iii) Networking Equipments. Date of last visit, in each case may be commented upon.

(e) Verify the visit register/call reports and note the details of serious breakdowns, if any.

(f) Check whether fire extinguishers are provided. If yes,
   (i) Whether fire extinguishers provided are suitable for computer installation.
   (ii) Whether operating staff is aware of its usage.
   (iii) Whether it is being serviced and tested periodically.
   (iv) Whether the manual of instructions for operations of all the applications is supplied by head office and is available for ready reference.

(g) Whether the procedure manual for Computer Applications is provided? Also verify that operating system, drivers and application software CDs/floppies are properly recorded and kept safely.

(h) Whether any computer hardware is available in the branch, which are not installed/not in use? If yes, the reasons therefor.

(i) Whether the branch ensures creating separate back-up and proper deletion of branch's data from the hard disk(s), before a computer is shifted to other branch or is taken by the vendor for repairs/replacement of any part thereof.

(j) Whether the supervisors and operations staff have received the training of software/hardware applications.

(k) Whether all branch staff are trained in operations of branch systems/applications.
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(1) Whether usage of systems facilities, networking, group wise, internet, e-mail is proper and justified.

15.19 Standing Instructions

Verify whether:

(a) Validation for closed/stopped/frozen/dormant account is provided.
(b) Standing instructions are executed.
(c) Provision for addition/deletion/modification of standing instructions is provided.
(d) Authority for addition/deletion/modification or execution of standing instructions is provided.
(e) Audit trails are produced for all the above operations.
(f) Standing instructions due on a holiday are executed on the prior working day.
(g) Service charges for standing instructions are collected and modified as per revised guidelines, if any.
(h) Service charges for standing instructions are entered while entering standing instructions.

15.20 Data Migration

(a) Check that the data migration from one platform to another platform to ensure that the same was error free.
(b) Check whether errors spotted during the migration have been properly sorted out and the effect, if any, has been properly carried to the new system.
(c) Check and ensure that the migration account balance is nil, if not, the auditor should ask for the reconciliation or explanation from the authority concern in respect of the differences.

15.21 Reports

(a) Verify whether detailed sub-day book is printed daily at day-end.
(b) Verify whether balances are printed daily.
(c) Verify whether day-end reports like exception reports, MIS report, access log, User-ID report, parameter changes, sensitive GL head
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report (in CBS branches) etc. are printed and authenticated/signed by the branch-head/authorised person and are filed separately.

(d) Verify whether ledger printing and statement of accounts options are provided.

(e) Verify whether ledger extracts are taken regularly and stored, as per the bank's latest guidelines or printouts are taken and preserved after binding (SB, CA/OD, Loan).

(f) Verify whether branch tallies "All OK" statement on daily basis in case of TBM branches and total of all accounts of the individual modules tallies with GL, in ALPM Branches.

(g) Verify whether, parking GL is nil in case of CBS Branches.

15.22 Back-Up

(a) Verify whether regular back-ups are taken and preserved Daily - before day- end and after day-end, Monthly.

(b) Adhoc backup on HDD/Floppies/DAT etc. (Adhoc Back-up need not be preserved, but to be kept safely).

(c) Verify whether these back-ups have been tested for restoration at any point of time (preferably immediately after completion of the back-up and before proceeding ahead for any other operation).

(d) Verify whether daily back-up is taken on separate media and marked for the day.

(e) Verify whether the back-ups are stored in other premises as a measure of disaster recovery.

(f) Verify that latest back-up is stored, off-site.

15.23 Verification of IT-related Registers

(a) Standing instructions register.

(b) Stop payment register.

(c) Cheque book issue register.

(d) Cheque return register.
16.1 Introduction

NPA has become a very vital area for any bank. Turning account as NPA erodes the profit and at subsequent stage, if not controlled, the capital also. In awarding gradation to the banks by the statutory auditors and RBI.

16.2 Income Recognition, Asset Classification and Provisioning

In order to reflect bank's actual financial health in its balance sheet and as per recommendation made by the Narasimham Committee, the RBI has introduced prudential norms for,

(a) Income recognition, asset classification and provisioning for the advances and investment portfolio and

(b) Valuation of foreign exchange transactions.

The policy of income recognition is based on the record of recovery. This objective criterion is to be applied to the loan accounts and asset accounts consistently and uniformly. Availability of security or net-worth of the borrower/guarantor should not be taken into account for the purpose of treating an advance as NPA. RBI has further advised that if the applicable Co-operative Societies Act and/or Rules made thereunder or any other applicable statutory provisions are stringent than prescribed by RBI, they shall continue to be applicable.

The RBI is giving guidelines on this subject to the co-operative banks from time to time by issuing circulars. Norms and procedural instructions get changed from time to time. Therefore, auditors are advised to refer to various RBI circulars in this regard. However, based on the existing instructions, the present norms are indicated below:
16.3 Classification of Asset as Non-Performing Assets (NPA)

An asset becomes non-performing when it ceases to generate income for the bank. Earlier an asset was considered as Non-Performing Asset (NPA) based on the concept of 'Past Due'. However, with effect from 31st March, 2001, the concept of 'Past Due' has been dispensed with. Now, an advance becomes NPA when:

i. Interest and/or installment of principal remain overdue for a period of more than 90 day in respect of a term loan.

ii. The account remains 'out of order' for a period of more than 90 days, in respect of any type of working capital (CC/OD).

iii. The bill remains overdue for a period of more than 90 days in case of bills purchased and discounted.

iv. In respect of direct agricultural advances, the following norms will be applicable:

(a) A loan granted for short duration crops will be treated as NPA, if the instalment of the principal or interest thereon remains unpaid for two crop seasons beyond the due date.

(b) A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains unpaid for one crop season beyond the due date.

(c) 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.

(d) The crop season for each crop, which means the period upto harvesting of crops raised would be as determined by the State Level Bankers' Committee in each State. (Ref. RPCD.CO.RF.BC.No.3/07.37.02/2003-04 dated 12th July, 2004).(The circular is given in the CD along with the Guidance Note).
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The specified agricultural advances referred at point no. (iv) are,

(a) Direct finance to farmers for agricultural purposes:
   i. This includes loans for raising crops i.e. crop loans. Additionally, advances up to Rs. 5.00 lakhs to farmers against pledge/hypothecation of agricultural produce including warehouse receipt for such produce for a period not exceeding twelve months and such loan is given for raising crop and loan is availed only from one bank.
   ii. Medium and long-term loans given directly to the farmers for financing production and development needs.

(b) Purchase of agricultural implements and machinery such as:
   i. Iron ploughs, harrows, hose, land-levelers, bund-formers, hand tools, sprayers, dusters, haypress, sugarcane crushers, thresher machines etc.
   ii. Tractors, trailers, power tillers, tractor accessories like disc ploughs etc.
   iii. Trucks, mini-trucks, jeeps, pick-up vans, bullock carts and other transport equipments etc. to assist the transport of agricultural inputs and farm products.
   iv. Ploughing animals.

(c) Loans for development of irrigation potential:
   i. Construction of shallow and deep tube wells, tanks etc. and purchase of drilling unit. Construction, deepening and clearing of surface wells, boring of wells, electrification of wells, purchase of oil engines, installation of electric motors and pumps.
   ii. Purchase and installation of turbine pumps, construction of open or underground field channels.
   iii. Construction of lift irrigation project.
   iv. Installation of sprinkler irrigation system.
   v. Purchase of generator sets for energization of pump-sets used for agricultural purposes.
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(d) Reclamation land and development schemes:
Bunding and leveling of farm land, terracing, development of irrigable land, wasteland development, development of farm drainage, reclamation of soil land, prevention of salinization, purchase of bulldozers etc.

(e) Construction of farm building and structure.

(f) Construction and running of storage facilities like, godowns and loans granted to farmers for establishing cold storages used for storing own produce, etc.

(g) Production and processing of hybrid seeds for crops.

(h) Payment of irrigation charges, hired water charges from wells and tube wells, canal water charges.

(i) Maintenance and upkeep of oil engines and electric motors.

(j) Payment of labour charges, electricity charges, marketing charges, service charges to customers service units, payment of development cess etc.

Other types of direct loans to farmers

1. Short term loans for traditional and non-traditional plantations and horticulture.

2. Medium and long term loans for development of all plantations, horticulture, forestry and wasteland.

3. Financing of small and marginal farmers for purchase of land for agricultural purposes.

Out of Order Accounts (refer to point No. (ii) above)

A cash credit/overdraft account is classified as NPA if the account is ‘out of order’ for more than 90 days. An account is treated as out of order is the balance outstanding is continuously in excess of the sanctioned limit or drawing power (whichever is lower) or where the outstanding balance in the principal operating account is within the sanctioned limit or drawing power, but there are no credits continuously for 90 days as on the date of balance sheet, or credits made are not enough to cover the interest debited during the same period.

16.3.1 Identification of NPA

(a) Banks are required to evolve system that ensures identification of
Guidance Note on Audit of StCBs & DCCBs

NPA is done on an on-going basis and doubts in asset classification due to any reason, are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per prescribed norms.

(b) However, in case of StCBs and DCCBs, the NPA classification is done as on Balance Sheet Date i.e., 31st March of the respective year.

16.3.2 Charging of Interest at Monthly Rests

(a) Banks are required to charge interest at monthly rests in the context of adopting 90 days norms for recognition of NPA from the year ending 31st March, 2006.

(b) The existing practice of charging and compounding of interest on agricultural advances would be linked to crop seasons and the instructions regarding charging of interest on monthly rests shall not be applicable to agricultural advances.

(c) For short duration crop loans and allied agricultural activities, banks need to keep in mind the due dates of the advances on the basis of liquidity with the borrowers keeping in mind harvesting/marketing season.

16.4 Treatment of Advances Account as NPA

(a) The treatment of an asset as NPA should be based on the record of recovery.

(b) If the account classified as NPA is regularized by repayment of overdue amounts through genuine sources and not by sanction of additional facilities or transfer of funds between accounts, the account need not to be then treated as NPA. In such cases, however, it has to be ensured that the account remain in order subsequently and a solitary credit entry which recovers the overdue amount of interest or installment is not taken into account as the sole criteria for treating the account as a standard asset.

(c) In respect of advances granted for agricultural purposes where interest and/or installment of principal remains unpaid after it has become overdue for two crop seasons or one crop season, as approved by State Level Bankers’Committee (SLBC), such an advance should be treated as NPA. The above norms should be
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made applicable to all direct agricultural advances. In respect of other agricultural advances including allied activities, assessment of NPA would be done as in case of non-agricultural advances.

(d) In cases of conversion or rescheduling, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as NPA. The asset classification of these loans would thereafter be governed by the revised terms and conditions and would be treated as NPA if interest and /or installment of principal remains unpaid after it has become overdue, for two/one crop seasons, as applicable. However, term loans which have been rephrased/rescheduled after they have become NPA, should continue to be classified in the same category. (Rescheduling/Rephasement will not change the status of NPA)

(e) If the borrower has more than one facility with a bank and if only one or more particular facility or facilities become irregular and all facilities being provided by the bank to that particular NPA, then that borrower is required to be declared as NPA and not that particular one which has been classified as NPA.

(f) Where natural calamities disturb the repaying capacity of agricultural borrowers, banks, may on declaration of Annewari by the State Government decide, as a relief measure, to convert the short-term production loan into a term loan or re-schedule the repayment period and can also sanction fresh short-term loans. In such case, the converted or re-scheduled loan need not be classified as NPA.

(g) In case of housing loan or similar loan granted to staff members of the bank where interest is payable after recovery of principal, the interest is not to be considered as overdue. If the principal or interest is not recovered on due dates, then only the account will be treated as NPA.

(h) Credit facilities guaranteed by Government of India/State Government.
   i. The credit facilities backed by a guarantee of the Central Government though overdue should not be treated as NPA.
   ii. However, the above exemption is for classification of NPA, but un-recovered interest on such advance is not to be considered as income while considering income recognition on the advances.
iii. Advances sanctioned against State Government Guarantee need to be classified as NPA in usual applicable norms for that advances.

(i) When the advance is given, allowing moratorium for payment of interest, the interest becomes due after the moratorium or gestation period is over. So while applying NPA norms, moratorium period is to be excluded.

(j) Advances against term deposits, NSCs eligible for surrender, Indira Vikas Patra, Kisan Vikas Patra and life policies assigned to the bank are not required to be classified as NPA even though interest thereon is not paid for more than 90 days provided adequate margin is available in the accounts.

(k) For gold loans for non-agriculture purpose,

• banks have to fix monthly/quarterly installments for repayment of loan taking into account the pattern of income generation and repayment capacity of the borrower. Thereafter, the gold loans are to be classified as NPA or otherwise applying usual norms of overdue concept.

• as regards gold loans granted for agricultural purposes, interest is required to be charged on yearly basis and repayment has to coincide with the harvesting of crops. Accordingly, due date and overdue concepts are to be applied in usual way.

Income Recognition on Investment

The investments made by the bank, are also subject to the prudential norms on income recognition. Bank cannot book income on accrual basis in respect of any security irrespective of the category in which it is included, where the interest/principal are in arrears for more than 90 days.

16.5 Asset Classification

A. Classification

StCBs and DCCBs are required to classify their assets into the four categories:

(i) Standard Assets

(ii) Sub-standard Assets
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(iii) Doubtful Assets
(iv) Loss Assets

B. Definitions

I. Standard Asset: Standard Asset is one which is not an NPA. It does not disclose any problems and does not carry more than normal risk attached to the business.

II. Sub-Standard Asset

(i) Sub-standard Asset is one which has remained overdue for a period of more than 90 days in case of non agricultural advances and overdue for more than two/one crop season, as the case may be, in case of agricultural advances.

(ii) In case of sub-standard asset, the current net worth of the borrowers/guarantors or the current market value of the security charged is not enough to ensure recovery of the dues to the bank in full. As such, these assets bear a credit weakness that can jeopardize the liquidation of the debt. In these cases, there is clear possibility that the bank will sustain a loss if the deficiencies are not corrected in time.

(iii) The assets, where the terms and conditions of the loans regarding payment of interest and repayment of principal have been renegotiated or rescheduled, after commencement of production, should be classified as sub-standard and should remain so in category for at least one year of satisfactory performance under the renegotiated and rescheduled terms. In other words, the classification of asset should not be upgraded merely as a result of rescheduling unless there is satisfactory compliance of the above condition.

III. Doubtful Asset: An asset is required to be classified as doubtful, if it has remained overdue for more than 3 years after the due date. A loan classified as doubtful asset has all the weaknesses as they are in sub-standard asset but it has added one more characteristic that the weaknesses make realization of bank dues highly questionable and improbable.

IV. Loss Asset: A loss asset is one where loss has been identified by the bank or by the internal or external auditors or by the co-operation department or by the NABARD inspection but the amount has not been written off, wholly or partly. Such an asset is considered as uncollectible and of such little asset value that its continuation as a doubtful asset is not
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worthwhile, therefore treated as a loss asset. Such loss assets will be included in overdue loans in following cases:-

(i) Where decrees or execution petitions have been time barred or documents are lost or no other legal proof is available to claim the debt,

(ii) Where the members and their sureties are declared insolvent or died leaving no tangible assets,

(iii) Where the members have left the area of operation of the society (refer to borrower in whose name the respective loan account is there with StCBs and DCCBs) leaving property and their sureties have also no means to pay the dues.

(iv) Where the loan is fictitious or when gross misutilisation is noticed, and

(v) Amounts which cannot be recovered in case of liquidated societies.

C. Special Consideration

(i) In case of accounts where there are potential threats in recovery on account of erosion in the value of security and existence of other factors such as fraud committed by the borrower, it will not be prudent for the bank to classify the advance first as sub-standard and then as doubtful and then as loss asset. Such accounts can be straightaway classified as doubtful asset or loss asset, as is appropriate, irrespective of the period for which it has remained as NPA.

(ii) If for any unit, loan facilities are already classified as sub-standard or doubtful, any additional facilities sanctioned under the rehabilitation package, the old facilities will continue as it is for classification purpose. Merely on reason that rehabilitation package is sanctioned, the loan asset quality will not improve or get upgraded. For the additional facilities granted under the package, the income recognition and asset classification norms will become applicable after one year from the date of disbursement of additional facilities.

16.6 Internal System for Classification of Assets as NPA

1. Banks are required to establish appropriate internal systems to eliminate the tendency to delay/postpone the identification of NPAs, especially in respect of high value accounts. The banks may have a minimum
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cut-off point to decide what would constitute a high value account depending upon the respective business levels. The cut off point should be valid for the entire accounting year.

2. Banks are required to fix responsibility and validation levels for ensuring proper asset classification.

3. There should be a system to ensure that doubts in asset classification due to any reason are routed through specified internal channels within a short time from the date on which the account have been classified as NPA as per the extant guidelines.

16.7 Income Recognition

(i) The policy of income recognition has to be objective and based on the record of recovery. Income from non-performing assets is not to be recognized on accrual basis, but is to be booked as income only when it is actually received.

(ii) Fee, commission and other income may be treated as income only when the account is classified as “Standard”. Besides, a matching provision should be created to the extent such items were treated as income in the previous year but not realized in the subsequent year.

(iii) However, interest on advances against term deposits, NSCs, IVPs, KVPs and Life Policies are taken to income account on the due date, provided adequate margin is available in the accounts.

(iv) Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts are required to be recognized on an accrual basis over the period of time covered in renegotiated or rescheduled extension of credit.

(v) If Government guaranteed advances become overdue and are thereby becoming NPA, the interest on such advances cannot be taken to income account unless the interest has been realized. The exemption granted is only for the purpose of asset classification and not for income recognition.

(vi) The investments made by the bank, are also subject to the prudential norms on income recognition. Bank cannot book income on accrual basis in respect of any security irrespective of the category in which it is included, where the interest/principal are in arrears for more than 90 days.
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(vii) Accrued interest on investments may be taken to Profit & Loss Account till maturity. However, the same has to be provided for fully, if interest is not realized on due date/date of maturity.

16.8 Reversal of Income on Account Becoming NPA

(i) If any advance including bills purchased and discounted become NPA as at the end of any year, interest accrued and credited to income account in the corresponding previous year, needs to be reversed, if the same is not realized. This will apply to Government guaranteed accounts also.

(ii) In respect of fees, commission and similar incomes that have been accrued and credited to income account in the corresponding previous year, should be reversed or provided for with respect to past periods, if uncollected.

16.9 Interest Application

(i) In case of NPAs where interest has not been received for 90 days or more, as a prudential norm, there is no use in debiting/charging the said account as interest is not being received. It is simultaneously desirable to show such accrued interest separately or park in a separate account so that interest receivable on such NPA account is computed and shown as such though not accounted as income of the bank for the period.

(ii) The interest accrued in respect of performing assets may be taken to income account as the interest is reasonably expected to be received. However, if interest is not actually received for any reason in these cases and the account is to be treated as NPA as per the guidelines, then the amount of interest so taken to income has be reversed or should be provided for in full.

(iii) With a view to ensure uniformity in accounting the accrued interest in respect of both the performing and non-performing assets, the following guidelines may be adopted by the banks notwithstanding the existing provisions in the respective State Co-operative Societies Act:

a. Interest accrued in respect of non-performing advances should not be debited to borrowal accounts but shown separately under 'Interest Receivable Account' on the Assets side of the...
balance-sheet and corresponding amount shown under 'Overdue Interest Reserve Account' on the 'Capital and Liabilities' side of the balance sheet.

b. In respect of borrowal accounts; which are treated as performing assets, accrued interest can be debited to the borrowal account and credited to interest account and taken to income accounts. In such case, if interest is not actually received before the end of the accounting year viz. 31st March or the account needs to be treated as NPA as per the guidelines, equivalent amount corresponding to such unrealized interest should be reversed by debit to profit and loss account and credit to 'Overdue Interest Reserve' Account.

16.10 Partial Recovery in NPA
Interest realized on NPA may be taken to income account provided the credits in the accounts towards interest are not out of fresh/additional credit facilities sanctioned to the borrower concerned.

16.11 Booking of Income on Investments in Shares and Bonds
(i) As a prudent practice and in order to bring about uniform accounting practice among banks in booking of income on units of UTI and equity of All India Financial Institutions, such income has to be booked on receipt basis and not on accrual basis.

(ii) In respect of income from Government Securities, Bonds of Public Sector Undertakings and All India Financial Institutions, where interest rates on the instruments are pre-determined, income may be booked on accrual basis, provided interest is serviced regularly and is not in arrears.

16.12 Provisioning Norms
Norms for Provisioning on Loans and Advances
(i) In conformity with the prudential norms, provisions are required to be made on the non-performing assets on the basis of classification of assets into prescribed categories as detailed above.
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(ii) Taking into account the time lag between an account becoming doubtful of recovery and its recognition as such, the realization of the security and erosion in the value of security charged, the bank has to make provision against loss, doubtful and sub-standard assets as stated below:

a. Loss Assets
   (a) The entire assets should be written off after obtaining necessary approval from competent authority and as per the provisions of the applicable Co-operative Societies Act & Rules. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for.
   (b) In respect of an asset identified as a loss asset, full provision at 100% should made irrespective of the expected salvage value of the security.

b. Doubtful Assets
   (a) Full provision at 100% of the extent to which the advance is not covered by the realizable value of the security to which the bank has a valid recourse, should be made.
   (b) In regard to the secured portion, provision may be made on the following basis, rates ranging from 20% to 100% of the secured portion depending upon the period for which the asset has remained doubtful.

<table>
<thead>
<tr>
<th>Period for which the advance has remained in doubtful category</th>
<th>Percentage of provision on secured portion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 1 year or overdue 3 to 4 years</td>
<td>20%</td>
</tr>
<tr>
<td>Overdue above 4 years upto 6 years</td>
<td>30%</td>
</tr>
<tr>
<td>Overdue over 6 years</td>
<td>100%</td>
</tr>
</tbody>
</table>

c. Sub-Standard Asset
   A general provision of 10% on total outstanding should be made without making any allowance for considering DICGCI cover and securities available.

Provision on Standard Asset
i. Banks have to make a general provision of minimum of 0.40% on standard assets. However, direct advances to agriculture and SME
The provision made has to be shown separately as "Contingent Provision against Standard Assets" under "Other Funds and Reserves" in the Balance sheet.

16.13 Verification of NPAs

The auditor should check/ensure the following:

- Obtain a statement of classification of loans and advances and an NPA statement;
- Prepare/obtain a statement of age-wise overdue loans;
- Examine and verify the overdue statements and the recoverability of these overdue debts, estimate the bad and doubtful debts and ensure necessary provisions are made against such debts;
- Enquire and verify any legal action taken or proposed to be taken against defaulting borrowers; if legal action is pending, then the auditors may comment on the same in the auditors' report;
- Independently compute the provisioning required for various types of loans as per the prescribed guidelines and ensure that the same has been provided for in the accounts.

16.14 Income Recognition and Verification of Interest Overdue

The auditor should check/ensure the following:

- Interest is segregated between overdue and normal interest; apply the norms prescribed by NABARD to determine the portion of "overdue" interest;
- Appropriate reserve is created for the overdue interest;
- All interest as well as fees and commission, if any, on non performing loans is reversed or alternatively, a provision is created in the books to fully cover interest & other income overdue on non performing assets;
- Interest is not credited to P&L Account on non performing assets of earlier years.
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16.15 Verification of Loans written off

The auditor should check/ensure the following:

- The legal process against the borrower and the sureties are fully exhausted prior to such write off;
- Procedural lapses or irregularities by StCBs and DCCBs in recovery of such loans and verify if the responsibility is fixed on any StCBs’ and DCCBs’ staff for act of neglect; verify, if any, recovery proceedings are initiated against those staff members;
- The write offs as approved are done against the bad and doubtful debts reserve existing in the books;
- Examine, if any, loan is recovered by sale of the security pledged by the borrower; in such cases ensure that the net write off is only adjusted against the Bank Deposit Rating (BDR).

16.16 Verification of Rescheduled/Restructured Loans

- Obtain/prepare a schedule of restructured/rescheduled accounts and ensure they are appropriately classified as per the prevailing asset classification guidelines of NABARD;
- Verify compliance with circular/s issued by NABARD/RBI (if any) for rescheduling/ restructuring of commercial loans and advances;
- Verify if the interest, in addition to the principal, has also been rescheduled with sacrifice or without any sacrifice. If there is a sacrifice, examine that the requirements of any circulars/directions issued by NABARD/RBI are complied with.
- Examine if the interest involved is either written off or provided for by a debit to the Profit & Loss Account. This provision should not be merged with any other provision and should be held in a separate account;
- Where sacrifice is involved, it should be computed on every balance sheet date until completion of all repayment obligations and full repayment by the borrower; this recomputed sacrifice must be examined with existing provision/write off to ensure excess/shortfall in such provisions;
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- Ensure that the asset has been restructured either before the asset has been classified as sub standard or after it has been classified as sub standard or doubtful;
- Select a sample of restructured accounts and examine the process employed by StCBs and DCCBs in taking up accounts for restructuring/reschedulement. Loans can only be restructured/rescheduled if there is a reasonable assurance of their recovery as per the terms of restructured package;
- Verify that the asset classification of restructured/rescheduled advances continues with the one prior to such restructuring;
- Verify that the upgradation of advances to the standard category, if any, is done only after observing the satisfactory performance for the period of one year from the date when first instalment of interest/principal fall due under the restructured/rescheduled terms;
- Interest on restructured advances should be recognized on accrual basis if those assets fall under "standard" category; otherwise interest on such advances should be recognized on cash basis.

16.17 Debt Waiver and Debt Relief Schemes

- Whether the norms prescribed by NABARD/RBI vide their prevailing circulars/directions, if any, have been correctly and fully complied by the StCBs and DCCBs in granting the waiver/relief;
- Ensure that interest in excess of the principal amount, or unapplied or unrecognized interest, penal charges legal charges, inspection and miscellaneous charges, if any, are not recovered from the borrower. All such interest and charges are to be borne by the StCBs and DCCBs;
- Interest, if any, on NPA loans should not be claimed from the borrower;
- If the scheme mandates relief on the amounts paid, examine that the eligible amounts are credited to the borrower accounts;
- Amounts receivable from Government/NABARD, if any, under the waiver/relief schemes, should be transferred to a separate account “Amount receivable from Government/NABARD”; this asset may be treated as performing asset provided adequate provision is made for loss in Present Value (PV) terms.
Chapter 17
Capital Adequacy Norms

17.1 Audit Procedures

(a) The auditor needs to adopt essentially similar approach to audit the capital of banks as he follows while auditing the same (in case of a company), however, subject to performing certain additional audit procedures that become necessary due to the distinguishing features of capital of banks.

(b) The auditor must ensure that the laws governing banks contain provisions relating to capital which must be complied with. The requirements are somewhat different for different types of banks.

(c) The auditor should verify the opening balance of capital with reference to the audited balance sheet of the previous year. In case, there has been an increase in capital during the year, the auditor should examine the relevant documents supporting the increase. For example, in case there is an increase in the authorised capital of a banking company, the auditor should examine the special resolution of shareholders and the registered bye-laws of the bank.

(d) Certain types of banks have been required by the RBI to maintain at least a minimum capital adequacy ratio (the term 'capital' for this purpose includes reserves). Hence, the auditor should also check the compliance with capital adequacy requirements for banks as mentioned in the following paragraphs.

17.2 Capital Adequacy

(a) Objectives

Banks have several operational risks. The shock of risk can be mitigated if bank has sufficient capital. So, there should be some linkage or ratio between risk weighted assets and capital. Capital acts as a buffer in times of crisis or poor performance by the bank. Sufficiency of capital also ensures depositors' confidence. As such, adequacy of capital is one of the pre-conditions for licensing a new bank as well as continuance of the business for the existing bank. The fundamental objective behind introducing Capital
to Risk Weighted Asset Ratio (CRAR) framework is to strengthen the soundness and stability of the rural co-operative banks.

(b) Statutory Requirements

In terms of the provisions contained in Section 11 of Banking Regulation Act 1949, no co-operative bank shall commence or carry on banking business in India unless the aggregate value of its paid up capital and reserves is not less than one lakh of rupees. In addition, under Section 22 (3) (d) of the Banking Regulation Act, 1949, Reserve Bank of India prescribes the minimum entry point capital, entry point norms, from time to time.

(c) Share Linking to Borrowings

Co-operative banks increase their share capital by linking the same to the borrowings of the members. The RBI has prescribed the following share linking norms:

(i) 5% of the borrowings, if the borrowings are on unsecured basis.

(ii) 2.5% of the borrowings, in case of secured borrowings.

(iii) In case of secured borrowings by Small Scale Industries (SSIs), 2.5% of the borrowings, of which 1% is to be collected initially and the balance of 1.5% is to be collected in the course of next 2 years.

(d) Capital Adequacy Norms Applicability to StCBs and DCCBs

In order to assess the capital structure of the StCB State and DCCB, in the context of financial stability of the whole system, it is proposed in Paragraph 149 of the Mid Term Review of Annual Policy Statement for the year 2007-08 that, they should disclose the level of CRAR as on March 31, 2008 in their balance sheet. Accordingly, all state and central co-operative banks were advised by RBI vide their circular No. RBI/2007-08/203-RPCD.CO. RF.BC.40/07.38.03/2007-08 dated 4th December, 2007 to disclose their CRAR as on March 31, 2008 and thereafter every year in “Notes on Accounts” to their balance sheets.

(e) Risk Weight

Essentially, under the capital adequacy framework, the balance sheet assets, and off-balance sheet items have been assigned weights according to the prescribed risk weights as indicated in Annex I of circular RBI/2007-08/203; RPCD.CO.RF. BC.40/7.38.03/2007-08 dated 4th December, 2007. (The
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circular is given in the CD along with the Guidance Note). The value of each asset item shall be multiplied by the relevant weights to arrive at the risk-adjusted values of assets and off-balance sheet items. The aggregate will be taken into account for calculating the minimum capital ratio.

Banks are required to maintain minimum 'Capital Funds' equivalent to the prescribed ratio on the aggregate of risk weighted assets and other off-balance sheet exposures on an ongoing basis. However, the StCBs and DCCBs have not been prescribed any CRAR but are required to disclose the same by way of notes to the accounts.

(f) Capital Funds

It may be noted that 'Capital funds' for the purpose of capital adequacy standard consist of both Tier I and Tier II Capital. Tier I Capital, otherwise known as core capital, provides the most permanent and readily available support to a bank against unexpected losses whereas; the Tier II capital consists of the elements that are less readily available.

(g) Tier I Capital/Core Capital

Tier I Capital included the following items:

- Paid up share capital collected from regular members of bank having voting powers.
- Free reserves.
- Capital reserve representing surplus arising out of sale proceeds of assets.
- Any surplus (net) in profit and loss account i.e. balance after appropriation towards dividend payable, education fund, other funds whose utilisation is defined and loss, if any, etc.

It must be noted that the amount of intangible assets, losses in current year and those brought forward from previous years, deficit in NPA provisions, income wrongly recognized on non performing assets, provision required for liability devolved on bank etc., will be deducted from Tier I Capital.

(h) Tier II Capital

i) Undisclosed Reserves

These often have characteristics similar to equity and disclosed reserves. The reserves have the capacity to absorb unexpected losses and can be included in capital, if they represent accumulation of profits and not encumbered by any known liability, should not be used for absorbing normal loss or operating losses.
ii) **Revaluation Reserves**

These reserves often serve as a cushion against unexpected losses, but they are less permanent in nature and cannot be considered as 'Core Capital'. Revaluation reserves arise from revaluation of assets that are undervalued in the bank's books. The typical examples in this regard are bank premises and marketable securities. The extent to which the revaluation reserves can be relied upon as a cushion for unexpected losses depends mainly upon the level of certainty that can be placed on estimates of the market values of the relevant assets, the subsequent deterioration in values under difficult market conditions or in a forced sale, potential for actual liquidation of those values, tax consequences of revaluation, etc. Therefore, it would be prudent to consider revaluation reserves at a discount of 55% while determining their value for inclusion in Tier II capital i.e. only 45% of revaluation reserve is available for inclusion in Tier II capital. Such reserves will have to be reflected on the face of the balance sheet as revaluation reserves.

iii) **General Provisions and Loss Reserves**

These include such provisions of general nature appearing in the books of the bank which are not attributed to any identified potential loss or a diminution in value of an asset or a known liability. Adequate care must be taken to ensure that sufficient provisions have been made to meet all known losses and foreseeable potential losses before considering any amount of general provision as part of Tier II capital as indicated above. To illustrate, excess provision in respect of bad and doubtful debt, general provision for standard assets etc. could be considered for inclusion under this category. Such provisions which are considered for inclusion in Tier II capital will be admitted up to 1.25% of total weighted risk assets.

iv) **Investment Fluctuation Reserve**

Balance, if any, in Investment Fluctuation Reserve of bank. It may be noted that the total of Tier II elements will be limited to a maximum of 100 percent of total Tier I elements for the purpose of compliance with the norms.
17.3 Risk Adjusted Assets and Off-Balance Sheet Items

Risk adjusted assets would mean weighted aggregate of funded and non-funded items. Degrees of credit risk expressed as percentage weights which have been assigned to balance sheet assets and conversion factors to off-balance sheet items. The value of each asset item shall be multiplied by the relevant weights to produce risk-adjusted values of assets and off-balance sheet items. The aggregate will be taken into account for reckoning the minimum capital ratio.

17.4 Risk Weights for Computation of CRAR

The risk weights are subject to change from time to time from RBI and hence, the circular issued by RBI and NABARD to this effect should be referred from time to time. The weight given in the Annexure 1 of the circular earlier mentioned is applicable during the year 2008-09 onwards (The circular is given in the CD along with the Guidance Note).

The capital adequacy is influenced by

1. Prevailing and expected economic conditions of the country and operational area.
2. Quality and liquidity of bank’s assets.
3. Quality of bank’s management.
4. Public confidence in banking system.
5. Bank’s trend of earning and retention.
6. Quality of ownership.
7. Effectiveness of operational procedures.
8. Volatility in deposit structure.
9. Competition faced.

The framework attempted to relate the bank’s capital needs to its risk profile. Besides serving to strengthen the soundness and stability of the banking system, it also sought to give banks an incentive to hold lower-risk assets, incorporate off-balance sheet exposures explicitly into capital assessments, and achieve greater uniformity in application of capital standards to banks across different countries.
17.5 Computation of Capital Adequacy Ratio

The capital adequacy ratio is computed as below:

\[
\frac{\text{Capital funds}}{\text{Risk weighted assets and off balance sheet items}} \times 100
\]

17.6 Minimum Capital Adequacy Norm

All Indian scheduled commercial banks (excluding regional rural banks) as well as foreign banks operating in India have to maintain positive capital adequacy ratio at a minimum of 9%. However, no such minimum Capital Risk Weighted Adequacy Ratio (CRAR) has been prescribed presently for StCBs and DCCBs except the requirement of making the disclosure in the balance sheet and also filing the returns on the closure of the accounts to the Designated Regional Office of NABARD.

17.7 Submission of Returns on CRAR to NABARD

Banks are required to furnish an annual return to Regional Office of RBI/NABARD, indicating capital funds and risk assets ratio, in the format given in Annexure 2 of the above mentioned circular. The return should be signed by two officials who are authorised to sign the statutory returns submitted to the RBI.

The statement as per the said format indicating the position as on 31st March should be furnished to the Regional Office of RBI/NABARD under whose jurisdiction the bank is located, as soon as the annual accounts are finalised.
Chapter 18
SLR and CRR Norms

18.1 Introduction

The banks run on the deposits kept by the public. People keep this money with bank on trust. Depositors do not have any security from the bank for having kept the money. To maintain the faith and trust intact on banking system it is necessary that banks have adequate liquidity and reserves. Bank can not lend or invest at its choice all the money collected by way of deposits. There are some statutory provisions to keep some money in the reserves in the form of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR). As such, some parts of collected deposits remain as reserves. This brings financial stability to bank and also controls economy in some way.

18.2 CRR/SLR - Statutory Provisions

All urban co-operative banks, scheduled as well as non-scheduled, are required to maintain stipulated level of CRR and SLR.

Scheduled Co-operative Banks are governed by provisions of Section 42 (1) of the Reserve Bank of India Act, 1934 for CRR. Non-scheduled Co-operative Banks for the purpose of CRR are governed by Section 18 of the Banking Regulation Act, 1949 (as applicable to Co-operative Societies).

For SLR purposes, for both scheduled as well as non-scheduled co-operative banks, provisions of Section 24 of the Banking Regulation Act, 1949 (AACS) are applicable.

In order to monitor the day-to-day position of liquidity of the bank, all co-operative banks are required to maintain a register as per format given in Annexure - 8 of the Banking Regulation (Co-operative Societies) Rules, 1966, showing the daily position of cash reserve and liquid assets maintained under Sections 18 and 24 of the B. R. Act, 1949 (AACS). Various forms and returns required to be maintained/submitted to RBI in respect of cash reserve are given in the Banking Regulation (Co-operative Societies) Rules, 1966.
18.3 Cash Reserve for Scheduled Co-operative Banks

In terms of Section 42(1) of RBI Act, 1934, RBI prescribes the CRR rate which every scheduled bank has to maintain with the RBI from time to time depending on liquidity scenario of the country. CRR to be kept with RBI is calculated as a percentage of Total Demand and Time Liability (DTL) as on the last Friday of the second preceding fortnight. Whenever money is in excess in the market/monetary systems in the country that may increase the inflation. So the excess money needs to be squeezed from the systems. At such time RBI prescribes higher rate of CRR and money is taken out from circulation in the market. In reverse case, the CRR rate is lowered and money is allowed to come and circulate in the market. Thus, cash reserve prescription is one of the important tools in the hands of RBI to keep monetary stability in the country and also for monitoring inflation.

As a measure of simplification and better cash management by the banks, a lag of two weeks has been introduced in maintenance of stipulated CRR by the scheduled banks. The prescribed CRR during a fortnight has to be maintained by every bank based on its NDTL as on the last Friday of the second preceding fortnight. Further, in order to provide flexibility to banks and enable them to an optimum strategy of holding reserves depending on their intra period cash flow, banks are allowed to maintain on average daily balance, a minimum of 70% of the prescribed CRR balance of their NDTL, as on last Friday of the second preceding fortnight.

18.4 Cash Reserve for Non-scheduled Co-operative Banks

As per Section 18 of the B. R. Act, 1949 (AACS), every non-scheduled co-operative bank is required to maintain cash reserve of minimum 3% of its DTL as on the last Friday of the second preceding fortnight. These banks are also required to submit prescribed returns about CRR to RBI. Non submission of returns or late submission as well as not maintaining CRR balance attracts penal provisions under the B. R. Act, 1949 (AACS). Cash reserve balance needs to be maintained by non-scheduled co-operative bank by way of balance in a current account with RBI or the StCB of the District concerned or one or more of the aforesaid ways. Balances maintained by non-scheduled co-operative banks in accounts with State Bank of India or its
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subsidary banks and a corresponding new bank is treated as cash or balance in current account for the purpose of both CRR and SLR.

18.5 Computation of Net Demand and Time Liability (NDTL)

Liabilities payable by the bank are in the form of demand or time deposits or borrowings or other miscellaneous items of liabilities. Demand liabilities include all liabilities which are payable on demand, mainly the balances in savings and current account come under these categories. Time liabilities are those which are payable otherwise on demand. Mainly deposits of different maturity duration come under this category. As per Section 42 of RBI Act, 1934, liabilities of a bank may be towards banking system or towards others. In terms of Section 42(1)(c) of the said Act, RBI is authorized to classify any particular transaction as liability on the bank.

For computation of NDTL, following broad things must be noted.

(i) Average daily balance mean the average of the balances held at the close on each day of a fortnight;

(ii) Fortnight mean the period from Saturday to second following Friday, both days inclusive.

(iii) Liabilities do not include paid-up capital, reserves, credit balance in profit & loss account, loans from Government, RBI, IDBI, EXIM Bank, NABARD, SIDBI, NHB etc. and any credit arrangement drawn or availed of against approved securities.

(iv) Liabilities include deposits, borrowings from banks such as call money and notice deposits, interest accrued on deposits and any other liability. Similarly, amounts received by the bank for remittance purpose is a liability till the beneficiary of the remittance receive the amount from the bank paying the amount. Example of this is draft purchased by the customer that is still unpaid.

18.6 Maintenance of Cash Reserve Balance and Penal Provision

Every scheduled co-operative bank is required to maintain a principal account with the Deposit Accounts Department (DAD) of the RBI for the purpose of maintaining CRR balance. RBI does not pay interest to the bank on this balance.
Every scheduled bank is required to submit periodic returns regarding NDTL and maintenance of CRR in terms of Section 42(2) of the RBI Act, 1934 in Form B (Annexure 2) format, as at the business on each alternate Friday. If there is variation exceeding 20% between the sources of funds in such return than the previous return, bank is required to give RBI reason for such variation.

Failure to maintain CRR on daily basis at the rate of 70% stated here in above attracts penalty of 3% above bank rate on defaulted amount on the first day and at 5% above bank rate next day. In the latter eventuality, beside the said penalty, every director, manager, secretary; scheduled co-operative bank responsible for the default comes under penal provisions given in Section 42 (3) of the RBI Act, 1934. If the default continues, the RBI has powers to give directions to the bank to stop accepting fresh deposits.

18.7. Statutory Liquidity Ratio (SLR)

In terms of Section 24(1) and 24(2A) of the Banking Regulation Act, 1949 (AACS), every co-operative bank is required to maintain, on daily basis, liquid assets to the extent of minimum 24% of its DTL balance of the last Friday of the second preceding fortnight. This percentage can be increased by RBI to maximum of 40%.

Computation of DTL for the purpose of SLR is in the same way as for CRR. The SLR has to be maintained in any one or more of the following ways:

(i) in cash or
(ii) in gold valued at a price not exceeding the current market price or
(iii) in unencumbered approved securities valued at a price determined as specified.

Besides the above, following are considered as cash maintained in India:

(a) any excess balance maintained by the bank with RBI over and above CRR requirements.
(b) any cash or balance maintained by the bank with itself or with StCB of the State concerned or DCCB of the District concerned.
(c) any net balance in the current account.
(d) unencumbered deposit kept with StCBs.
18.8 Audit Approach & Procedures

(a) The auditor is expected to comment on the following aspects of the system for ensuring compliance with the SLR/CRR requirement:
   • System of compiling weekly DTL position from branches.
   • Records maintained for the above.

(b) The auditor should examine the system for compilation of DTL position, including verification of returns and their consolidation by the bank. The auditor should obtain a compilation from the management and any weaknesses in the system of compilation of DTL and its reporting in the prescribed form should be reported by the auditor, alongwith suggestions, if any, to overcome such weaknesses.

(c) The auditor may examine compliance with SLR/CRR requirements with reference to the eligible assets maintained by the bank.
Chapter 19

Asset - Liability Management (ALM) System

19.1 Introduction

The management of the co-operative banks may have to make their business decisions based on a dynamic, integrated and comprehensive risk management system and process, driven by a corporate strategy. Due to the competitive and volatile conditions prevailing in the financial market, co-operative banks will have to tackle these risks by introducing structured and comprehensive measures. A system of Asset-Liability Management (ALM) may, therefore, be necessary to enable them to measure, monitor and manage the liquidity, interest rate and other risks mentioned above. The objective behind all these measures is to make banks fully prepared to face the emerging challenges.

ALM, among other functions, is also concerned with risk management and provides a comprehensive and dynamic framework for measuring, monitoring and managing liquidity, interest rate, foreign exchange, equity and commodity price risks of a co-operative bank that need to be closely integrated with the banks' business strategy. It involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.

The initial focus of the ALM function would be to enforce the risk management discipline viz. managing business after assessing the risks involved. In addition, in managing the spread and risk, the ALM function is more appropriately viewed as an integrated approach which requires simultaneous decisions about asset/liability mix and maturity structure.

19.2 ALM Concept in Co-operative Banks

One of the areas of concern in the functioning of co-operative banks has been the management of funds. In the absence of a good system to assess the liquidity requirements, maintenance of large amounts of idle funds in the form of cash and current account balances has been a common feature in many co-operative banks. A well-operated ALM, should, among other things, provide a framework for measuring, monitoring and managing the liquidity and interest rate risks as also the market risk so as to help the bank in
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enhancing yields and at the same time, meeting the liquidity requirements. This system should, therefore, be integrated with the bank’s business strategy. The system should be developed into a strategic tool for the bank’s management which clearly specifies the risk policies and tolerance limits. The broad guidelines given hereunder are intended to facilitate the introduction of an ALM system in the co-operative banks.

19.3 ALM and its Scope

ALM processes encompass the following:

- Planning, directing and controlling the flow, mix, cost and yield of the consolidated funds of banks.
- Assessing various asset mixes, funding combinations, price volume relations and their implications on liquidity, income and capital ratio.
- Planning procedure which accounts for all assets and liabilities of a bank by rate, amount and maturity.
- Managing the Net Margin to ensure that its level and risk are comparable with the risk/return objectives of the institution.
- Managing both assets and liabilities simultaneously for the purpose of mitigating the impact of the interest rate risk, providing liquidity, and enhancing the market value of equity.

The financial management process in banks involves simultaneously managing the different rates of return on the assets and the rate paid on monies used to fund these assets. Hence, the management of spread, (defined as the difference between the rate of return earned on the assets and the cost of liabilities) is of critical importance to bank for achieving profitability objectives.

In view of the above convention, one of the major issues in the ALM process at financial institutions is the problem of managing the income spread and controlling the risk associated with generating spread.

In the normal course, co-operative banks are exposed to (i) credit risk, (ii) market risks, viz., interest rate risk and liquidity risk, (iii) equity/commodity price risk and in certain cases foreign exchange risk, etc., in view of the asset-liability transformation. With liberalisation in the Indian financial markets over the last few years and the growing integration of domestic markets with external markets, the risks associated with banks’ operations
have become complex and large, requiring strategic management. Banks are now operating in a fairly deregulated environment and are required to determine on their own, interest rates on deposits and advance in both domestic and foreign currencies, on a dynamic basis. The interest rates on banks’ investments in Government and other securities are also now market-related. It is, therefore, important that banks should introduce effective risk management systems that address the issues related to interest rate, currency and liquidity risks.

19.4 Pillars of the ALM
The ALM rests on three pillars as given below:-

- ALM Information Systems
- ALM Organisation
- ALM Process

19.4.1 ALM Information Systems
ALM operates within the contours drawn by the management philosophy which spells out the trade offs between the risks and returns. Risk policies and tolerance limits have to be specified. The information system is the backbone of the ALM process. MIS has to be evolved aiming at capturing the risk parameters, measurements of identified risks and their management. There are several risk measurement systems. The simplest being the Gap Statement Method. The highly sophisticated and data-intensive Risk Adjusted Profitability Measurement method is at the other extreme of this spectrum. Timely collection of accurate, adequate and relevant information is a pre-requisite for ALM. The management of the co-operative banks will have to put in place an effective MIS for the purpose. Absence of full scale computerisation may pose challenges, which needs to be addressed.

ALM involves analysis of information, based on residual maturity and behavioral pattern of various assets and liabilities. At present, the co-operative banks do not have adequate computerisation and other support systems for collection of the requisite information. There would, thus, be a need to prepare a step-by-step, time-bound action plan for the purpose. Based on ABC analysis, the following approach may be adopted:

- Identify sample branches accounting for significant business.
- Analyse the behaviour of assets and liability products in the sample branches.
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- Make rational assumptions about the way assets and liabilities would behave in other branches.
- Collect information pertaining to investment portfolio and money market operations.
- Refine data and assumptions over time in the light of experience gained in conducting business within an ALM framework.
- Enhance computerisation to help in accessing data.

For an efficient resource allocation with financial discipline, information through traditional accounting system viz., balance sheet, income and expenditure account and cash flow statements need to be supplemented by risk disclosures. 'Balance Sheet' and 'Profit and Loss Account' may have to be made more transparent and reflective of their true financial health.

19.4.2 ALM Organisation

- Successful implementation of the risk management process would require strong commitment on the part of the senior management in the bank, to integrate basic operations and strategic decision-making with risk management. The Board should have overall responsibility for management of risks and should decide the risk management policy of the bank and set limits for liquidity, interest rate and equity price risks.

- The Asset-Liability Committee (ALCO) consisting of the bank’s senior management including CEO should be responsible for ensuring adherence to the limits set by the Board as well as for deciding the business strategy of the bank (on the assets and liabilities side) in line with the bank’s budget and decided risk management objectives.

- The ALM support groups consisting of operating staff should be responsible for analysing, monitoring and reporting the risk profiles to the ALCO. The staff should also prepare forecasts (simulations) showing the effects of various possible changes in market conditions related to the balance sheet and recommend the action needed to adhere to bank’s internal limits.

- The ALCO is a decision making unit responsible for balance sheet planning from risk-return perspective including the strategic management of interest rate and liquidity risks. Each bank will have to decide on the role of its ALCO, its responsibility as also the decisions to be taken by it. The business and risk management
strategy of the bank should ensure that the bank operates within the limits/parameters set by the Board.

- The business issues that an ALCO may decide/work upon include:-
  - product pricing for both deposits and advances,
  - desired maturity profile and mix of the incremental assets and liabilities, etc.,
  - monitoring the risk levels of the bank,
  - review the results and progress in implementation of the decisions made in the previous meetings,
  - articulation of the current interest rate view of the bank and basing its decisions for future business strategy on this view.

- Individual banks will have to decide the frequency for holding their ALCO meetings.

- ALM is an important tool for profit-planning and risk management. It is a dynamic activity and requires constant monitoring. Banks are, therefore, expected to form ALCO to meet regularly in order to monitor and control the size of balance sheet.

19.4.2.1 Typical Business of ALCO

- Reviewing the impact of the regulatory changes on the industry;
- Overseeing the budgetary process;
- Reviewing the interest rate outlook for pricing of assets and liabilities (loans and deposits);
- Deciding on the introduction of any new loan/deposit product and their impact on interest rate/exchange rate and other market risks;
- Reviewing the asset and liability portfolios and the risk limits and thereby, assessing the capital adequacy;
- Deciding on the desired maturity profile of incremental assets and liabilities and thereby assessing the liquidity risk; and
- Reviewing the variance in actual and projected performances with regard to Net Interest Margin (NIM), spreads, and other balance sheet ratios.
19.4.2.2 Composition of ALCO
The size (number of members) of ALCO would depend on the size of each institution, business mix and organisational complexity, to ensure commitment of the top management and timely response to market dynamics, the CEO/MD or the GM should head the Committee. The Chiefs of Investment, Credit, Resources Management or Planning, Funds Management/Treasury (domestic), etc., can be members of the Committee. In addition, the Head of the Computer (Technology) Division should also be an invitee for building up of MIS and related computerisation. Bank may even have Sub-Committees and/or Support Groups.

19.4.2.3 Committee of Directors
The Managing Committee of the Board or any other Specific Committee constituted by the Board should oversee the implementation of the system and review its functioning periodically.

19.4.3 ALM Process
The scope of ALM function can be described as follows:

1. Liquidity risk management
2. Management of market risks
3. Trading risk management
4. Funding and capital planning
5. Profit planning and growth projection

However as stated earlier, presently, ALM in co-operative banks is intended to address the liquidity and interest rate risks.

19.4.3.1 Liquidity Risk Management
Measuring and managing liquidity needs are vital for effective operation of co-operative banks. By assuring a bank’s ability to meet its liabilities as they become due, liquidity management can reduce the probability of developing an adverse situation. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on other co-operative banks in general and neighboring co-operative banks in particular. Bank’s management should measure not only the liquidity position of co-operative banks on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions. Experience indicates that assets commonly considered as liquid like Government
securities and other money market instruments could also become liquid when the market and the players are unidirectional. Therefore, the liquidity is tracked through maturity or cash flow mismatches. Many co-operative banks need to put in place a system for ascertaining their cash flow mismatches periodically. For measuring and managing net funding requirements, the use of a maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates is adopted as a standard tool. The format of the Statement of Structural Liquidity is given in Appendix I.

The Maturity Profile as given in Appendix I could be used for measuring the future cash flows of co-operative banks in different time buckets. The time buckets, given the Statutory Reserve cycle of 14 days may be distributed as under:

- 1 to 14 days
- 15 to 28 days
- 29 days and upto 3 months
- Over 3 months and upto 6 months
- Over 6 months and upto 1 year
- Over 1 year and upto 3 years
- Over 3 years and upto 5 years
- Over 5 years

The investments in SLR securities and other investments are assumed as liquid due to lack of depth in the secondary market and are therefore, required to be shown under respective maturity buckets, corresponding to the residual maturity. The investment portfolio of StCBs/DCCBs is classified into 'permanent' and 'current categories'. Therefore, as per the extant instructions, securities held in the 'current' category are to be carried at lower of the cost or market value, on a consistent basis and the valuation has to be done, on a quarterly basis. However, some of the co-operative banks may be maintaining securities in the 'current category', which are kept distinct from other investments made for complying with the statutory reserve requirements and for retaining relationship with customers. Securities held in the 'current category' are subject to certain pre-conditions like:

- The composition and values are clearly defined;
- Maximum maturity/duration of the portfolio is restricted;
- The holding period should not exceed 90 days;
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- Defeasance period (product-wise) i.e. time taken to liquidate the position on the basis of liquidity in the secondary market is prescribed;
- ‘Marking to market’ may be done as per the guidelines contained in RBI's Circular No,DBOD,BP.BC.8/21.04.098/99 dated 10 February 1999 (The circular is given in the CD along with the Guidance Note).

Banks which maintain such ‘current category’ investments and comply with the above conditions are permitted to show the trading securities under 1-14 days, 15-28 days and 29-90 days buckets on the basis of the defeasance periods. The Board/ALCO of the co-operative banks should approve the volume, composition, holding/defeasance period, cut-loss, etc., of the ‘current category’ and copy of the policy note thereon should be forwarded to the Department of Supervision, NABARD, HO, Mumbai and Rural Planning and Credit Department (RPCD), RBI, Central Office, Mumbai under advice to their respective Regional Offices.

Within each time bucket, there could be mismatches depending on cash inflows and outflows. While the mismatches upto one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short-term mismatches viz., 1-14 days and 15-28 days. Banks, however, are expected to monitor their cumulative mismatches (running total) across all time buckets by establishing internal prudential limits with the approval of the Board/Management Committee. The mismatches (negative gap) during 1-14 days and 15-28 days in normal course may not exceed 20% of the cash outflows in each time bucket. If a bank in view of its current asset-liability profile and the consequential structural mismatches needs higher tolerance level, it could operate with higher limit sanctioned by its Board/Management Committee giving specific reasons on the need for such higher limit. The discretion to allow a higher tolerance level is intended for a temporary period.

The Statement of Structural Liquidity (Appendix I) may be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while a maturing asset will be a cash inflow. While determining the likely cash inflows and outflows, banks have to make a number of assumptions according to their asset-liability profiles. Co-operative banks with large branch network can (on the stability of their deposit base as most deposits are rolled-over) afford to have larger tolerance levels in mismatches in the long term if their term deposit base is quite high. While determining the tolerance levels, the co-operative banks may take into account all relevant factors, based on their asset-liability base, nature of business, etc.
Since co-operative banks are not handling foreign exchange business in a big way, their balance sheets are not exposed to the movements (mismatched currency position) in exchange rate and country risk and settlement risk. Therefore, this aspect has not been dealt in detail here.

**Dynamic Liquidity Assessment:**
In order to enable the banks to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1-90 days, banks may estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes.

**19.4.3.2 Interest Rate Risk (IRR)**
The phased deregulation of interest rates and the operational flexibility given to co-operative banks in pricing most of the assets and liabilities imply the need for the co-operative banking system to hedge the Interest Rate Risk. Interest Rate Risk is the risk where the changes in market interest rates might adversely affect a bank’s financial condition. The changes in interest rates affect banks in a larger way. The immediate impact of the changes in interest rates is on bank’s earnings (i.e. reported profits) by changing its Net Interest Income (NII). A long-term impact of changing interest rates is on bank’s Market Value of Equity (MVE) or Net Worth as the economic value of bank’s assets, liabilities and off-balance sheet positions get affected due to variation in market interest rates. The Interest Rate Risk when viewed from these two perspectives is known as ‘earning perspective’ and ‘economic value’ perspective, respectively. The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM). In the absence of proper Management Information System (MIS) and the total deregulation in the co-operative banks, the traditional Gap Analysis is considered as a suitable method to measure the Interest Rate Risk. It is the intention to move over to the modern techniques of Interest Rate Risk measurement like Duration Gap Analysis, Simulation and Value at Risk (VaR) over time when the co-operative banks acquire sufficient expertise and sophistication in acquiring/handling MIS.

The Gap or Mismatch Risk can be measured by calculating Gaps over different time intervals as at a given date. The Gap Analysis measures the mismatches between rate sensitive liabilities and rate sensitive assets (including off-balance sheet positions). An asset or liability is normally classified as rate sensitive if:

(a) Within the time interval under consideration, there is a cash flow;
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(b) The interest rate resets/reprices contractually during the interval;

(c) The RBI changes the Interest Rates (i.e. Interest Rates on Savings Bank Deposits, DRI Advances, Refinance, CRR Balance, etc.) in cases where interest rates are administered; and

(d) It is contractually pre-payable or withdrawal before the stated maturities.

The Gap Report should be generated by grouping rate sensitive liabilities, assets and off-balance sheet positions into time buckets according to residual maturity or next repricing period, whichever is earlier. The difficult task in Gap Analysis is determining rate sensitivity of all investments, advances, deposits, borrowings, purchased funds, etc., that mature/reprice within a specified time frame. Similarly, any principal repayment of a loan is also rate sensitive if the bank expects to receive it within the time horizon. This includes final principal repayment and interim instalments. Certain assets and liabilities envisage receipt/payment of rates that vary with a reference date these assets and liabilities are repriced at pre-determined intervals and are rate-sensitive at the time of repricing. While the interest rates on term deposits are fixed during their currency, the advances portfolio of the co-operative banking system is basically floating. The interest rates on advance could be repriced any number of occasions, corresponding to the market rate or the changes in Prime Lending Rate (PLR), as and when introduced in co-operative banks.

The Gaps may be identified in the following time buckets.

- 1-28 days
- 29 days and upto 3 months
- Over 3 months and upto 6 months
- Over 6 months and upto 1 year
- Over 1 year and upto 3 years
- Over 3 years and upto 5 years
- Over 5 years
- Non-sensitive

The various items of rate sensitive assets and liabilities and off-balance sheet items may be classified as explained in Appendix II and the reporting format for interest rate sensitive assets and liabilities is given in Appendix II.
19.4.3.3 Gap

The Gap is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time bucket. The positive Gap indicates that it has more RSAs than RSLs whereas the negative Gap indicates that it has more RSLs.

The Gap reports indicate whether the institution is in a position to benefit from rising interest rates by having a positive Gap (RSA > RSL) or whether it is in a position to benefit from declining interest rates by a negative Gap (RSL > RSA). Thus, Gap can be used as a measure of interest rate sensitivity.

Each co-operative bank should set prudent limits on individual Gaps with the approval of the Board/Management Committee. The prudential limits should have a bearing on the Total Assets, Earning Assets or Equity. The banks may work out Earnings at Risk (EaR) or Net Interest Margin (NIM), based on their views on interest rate movements and fix a prudent level with the approval of the Board/Management Committee.

The classification of various components of assets and liabilities into different time buckets for preparation of Gap Reports (Liquidity and Interest Rate Sensitive) may be done as indicated in Appendices I & II as a sort of benchmark. Co-operative banks which are better equipped to reasonably estimate the behavioral pattern, embedded options, rolls-in and rolls-out, etc., of various components of assets and liabilities on the basis of past data/empirical studies could classify the same in the appropriate time buckets, subject to approval from the ALCO/Board. A copy of the note approved by the ALCO/Board may be sent to the Department of Supervision, HO, NABARD, Mumbai and Rural Planning and Credit Department (RPCD), RBI, Central Office, Mumbai under advice to their respective Regional Offices.

The present framework does not capture the impact of embedded options, i.e., the customers exercising their options (premature closure of deposits and prepayment of loans and advances) on the liquidity and interest rate risk profile of co-operative banks. The magnitude of embedded option risk at the time of volatility in market interest rates is quite substantial. Co-operative banks should, therefore, evolve suitable mechanism, supported by empirical studies and behavioral analysis to estimate the future behaviour of assets, liabilities and off-balance sheet items to the changes in market variables and estimate the embedded options.
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A scientifically evolved 'internal transfer pricing model' by assigning values on the basis of current market rates to the funds provided/used is an important component for effective implementation of ALM system. The 'Transfer Price Mechanism' (TPM) can enhance the management of margin i.e. lending or credit spread, the funding or liability spread and mismatch spread. It also helps centralising interest rate risk at one place which facilitates effective control and management of interest rate risk. A well defined 'transfer pricing system' also provides a rational framework for pricing of assets and liabilities. All the co-operative banks are advised to follow this pattern at the earliest, so as to derive the benefits of ALM.

19.4.3.4 Gap Reports

The Gap Reports may be prepared encompassing the following:-

Segregations of assets and liabilities into various time bands.

a) Maturity-wise
b) Interest-wise
c) Calculation of gaps within the band.
d) Calculation of cumulative gaps.
e) Review assets and liabilities that reprice in different time bands.

19.5 Profits and Profitability

Sustaining the profit momentum is beset with issues like progressive decline in interest spread, volatile business environment, fierce competitive pressures and the negative externalities. The ensuing banking order will presuppose a shift in focus from size related issues to concerns about profitability, profit monitoring and efficiency in operations. Various options to be explored in this regard include the following:

a) Prudent ALM and risk management system that are adequately responsive to environmental change.
b) Spread management through better cost discretion in resource mobilisation to counter the declining interest rate structure. Recourse to volume based business for offsetting margins.
c) Stress on better burden management as the burden will have better controllability.
d) Adequate emphasis on product innovation and marketing.
Asset - Liability Management ( ALM ) System

e) Forays into new sophisticated products like derivatives, swaps and options with adequate cushion against elements of risk.

f) Product-wise and business-line-wise profitability analysis.

g) Augmentation of fee-based income. Client centric focus on the product domain.

h) Greater application of technological advancements and the adoption of sophisticated products.

i) Strategic alliance with other banks/ non-banks for leveraging business.

j) Regular review of profitability and rationalisation of loss making branches.

k) Legal amendments like the Securitisation Bill requiring toning up recovery of impaired assets and profit volume.

19.6 Financial Reporting and Role of Auditors

Good financial reporting acts as a central pillar of market discipline. The Board has the responsibility to provide adequate information to the stakeholders. Particularly, when banking is becoming more complex and the investors are finding it difficult to understand the performance of banks and their risk profile, there is a clear need for better disclosures and more transparency. It is in this direction, the RBI has since standardized the reporting format, which will help the stakeholders to gain better understanding and the banks may internalize the same. The authenticity of the financial statements of the bank is certified by the auditors. It is, therefore, important that the auditors understand the ALM functioning and check the formats thoroughly before certifying.
Appendix I

Name of the bank:

Statement of Structural Liquidity as on …

Residual Maturity

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<th>(Amount ₹ Lakhs)</th>
<th>1-14 days</th>
<th>15-28 days</th>
<th>29 days – 3 months</th>
<th>Over 3 m. upto 6 m</th>
<th>Over 6 months-upto 1 yr.</th>
<th>Over 1 yr. Upto 3 yrs</th>
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## Asset - Liability Management (ALM) System

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</table>

### A. Total Outflows

**INFLOWS**

1. Cash

2. Balances with RBI

3. Balances with other banks
   - i. Current Account
   - ii. Money at Call and Short notice, Term deposits

4. Investments

5. Advances (Performing)
   - i. Bills purchased & Discounted
   - ii. CC/ OD/ Loans repayable on Demand
   - iii. Term loans

6. NPAs Advances & Investments)*

7. Fixed Assets

8. Other Assets
   - i. Inter Office Adjustments
   - ii. Leased assets
   - iii. Others

9. Interest
### Guidance Note on Audit of StCBs & DCCBs

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<tr>
<th>receivable</th>
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<td>10. Committed lines of Credit</td>
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<td>11. Others, specify</td>
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<td><strong>B. Total Inflows</strong></td>
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<td><strong>C. Mismatch B-A</strong></td>
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<td><strong>D. Cumulative Mismatch</strong></td>
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<td><strong>E. C as % of A</strong></td>
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*(Net of provisions, interest suspense and claims received from DICGC)*
## Interest Rate Sensitivity

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<th>Upto 1 month</th>
<th>1–3 months</th>
<th>Over 3 months</th>
<th>Over 6 months</th>
<th>Over 1 yr.</th>
<th>Over 3 yrs–upto 5 yrs</th>
<th>Over 5 yrs</th>
<th>Nonsensitive</th>
<th>Total</th>
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<td><strong>LIABILITIES</strong></td>
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<td>3. Deposits</td>
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<td>iv. Recurring deposit</td>
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<td>i. Call &amp; Short Notice</td>
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<td>5. Other Liabilities &amp; Provisions</td>
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<td>iii. Provisions*</td>
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* Excluding provisions for NPAs and Investments.
Guidance Note on Audit of StCBs & DCCBs

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Cash</th>
<th>Balances with RBI</th>
<th>Balances with other banks</th>
<th>Advances Performing</th>
<th>NPAs Advances &amp; Investments*</th>
<th>Fixed Assets</th>
<th>Other Assets</th>
<th>Interest receivable</th>
<th>Others (specify)</th>
<th>Total</th>
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|        |      |                  |                           |                    |                             |              |              |                   |                 |       |
|        |      |                  |                           |                    |                             |              |              |                   |                 |       |

**Notes:**
- *Amounts to be shown net of provisions, interest suspense and claims received from DICGC.
Asset - Liability Management (ALM) System

Appendix III

Name of the bank:

Statement of Short Term Dynamic Liquidity as on

(Amounts in lakhs of rupees)

<table>
<thead>
<tr>
<th>Out flows</th>
<th>1-14 days</th>
<th>15-28 days</th>
<th>29 days-3 months</th>
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<tbody>
<tr>
<td>1</td>
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<tr>
<td>A Total Outflows</td>
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<tr>
<td>B Total Inflows</td>
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</tbody>
</table>

Inflows

| 1 | Net Cash Position |
| 2 | Net Increase in Deposits (Less CRR obligations) |
| 3 | Interest on Investments |
| 4 | Inter Bank Claims |
| 5 | Refinance eligibility |
| 6 | Off Balance Sheet items (letters of credit, bank guarantees, etc.) |
| 7 | Others |

C Mismatch (B-A)

D Cumulative Mismatch

E C as % to A
The financial management process in banks involves simultaneously managing the different rates of return on the assets and the rate paid on money used to fund these assets. Hence, the management of spread, defined as the difference between the rate of return earned on the assets and the cost of liabilities is of critical importance to banks for achieving profitability objectives.

In view of the above convention, one of the major issues in the ALM problem at financial institutions is the problem of managing the spread income and controlling the risk associated with generating spread.

In addition, managing the spread and riskiness, the ALM function is more appropriately viewed as an integrated approach which requires simultaneous decisions about asset/liability mix and maturity structure.
Chapter 20
“Deposit” for DICGC Premium Calculation

20.1 Clarification of the term ‘Deposit’
Section 2(g) of the Deposit Insurance and Credit Guarantee Corporation Act, 1961, defines the term 'Deposit' as the aggregate of the unpaid balances due to a depositor in respect of all his accounts by whatever name called, with an insured bank and excludes certain categories of deposits from the purview of the Act. It follows that in order to be 'Deposit', the unpaid balances should be due to a depositor and should be in respect of accounts in his name or maintained by him.

20.2 Items which are to be included within the Category of 'Deposit' as defined in the Act
- Credit balances in cash credit accounts.
- Margins held against letters of credit, guarantees, bills purchased etc., if these amounts are held in an account of the depositor marking merely a lien or instructions as to disposal.
- Deposits held as security for advances or employees security deposits or staff cash security.
- Accrued interest on fixed and other term deposits.
- Mail and telegraphic transfers from one deposit account to another.
- Amount received for credit of deposit account but held in "Suspense" pending receipt of full particulars or compliance with some formalities.
- Overdue term deposits and unclaimed deposits/balances.
- Provident fund balances relating to the bank’s own staff.
- Deposits of local authorities and Quasi-Government bodies like Municipal Corporations, District Boards, Housing and Electricity Boards etc., which are separate legal entities.
- Deposits of Autonomous or Statutory Bodies, Government owned Corporations, Government Companies, Life Insurance Corporation, Industrial and State Financial Corporation etc.; security deposits and
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- Earnest money held in the name of Government departments on account of constituents which are payable to the constituents, if not claimed by Government.
- Deposits held in the individual names of Government and Embassy officials, Regimental Officers etc.
- Unpresented drafts and pay-orders held in the depositors’ accounts.
- Staff security deposits deposited in a scheduled bank as per provisions of Companies Act, 1956.
- Balances held in ‘Sundry Creditors’ for the purpose of credit to depositors’ accounts.
- Recurring deposits which have ceased to be deposits due to non-payment by clients, pending refund.
- Deposits of Non Resident Rupee Accounts.
- Provident fund balances relating to bank’s staff held by bank before they are transferred to Provident Fund Commissioner.
- Balances of Small Farmers Development Agency (SFDA), Fish Farmers Development Agency (FFDA), District Rural Development Agency (DRDA).
- Reserve fund of societies held with District/Central Co-operative Banks.
- Daily collections of ‘Pigmy Deposits’ credited to “Sundry Creditors” Account.
- Surplus credited to ‘Sundry Creditors’ Account after appropriating loan due from the proceeds of Term Deposits.
- Balances held in Foreign Currency Non-Resident (FCNR) Account.
- Amount representing pay orders/bankers cheques/demand drafts issued by closing of deposit accounts with or without reference to the depositor, but remaining unpaid.

20.3 Items which do not fall within the scope of the definition of ‘Deposit’ given in the Act

- Deposits received outside India.
- Money belonging to and deposits in the names of Foreign Government, Central Government, State Governments, Banking
Companies and Co-Operative Banks (Inter-bank deposits), Deposits of State Land Development Banks held with State Co-operative Banks.

- Outstanding Demand Drafts, pay orders and telegraphic remittances other than transfers from one deposit account to another.
- Proceeds of bills received for collection held in suspense pending remittance or compliance with certain formalities connected with the remittance.
- Amounts held in suspense for appropriation towards any amount due to the bank. When payment has been received in respect of an advance and the same is held in suspense on account of some dispute or compliance with certain formalities, such amount would not be deposit' as it is definitely meant to be appropriated towards the amount due.
- Collection account balance held for purposes of remittances.
- Taxes collected and held in suspense account for payment to competent authorities.
- Security Deposits (Earnest Money) held in the name of Government or banking company.
- Share call money, deposit for godown locks, staff guarantee fund, share suspense account.
- Margins held separately for the specific purpose of appropriation in a contingency.
Chapter 21
Suspicious Transactions and Counter Measures

21.1 Suspicious Transactions
a) As per Prevention of Money Laundering Rules, 2005 "suspicious transaction" means a transaction, even attempted, whether made in cash or otherwise, which, to a person acting in good faith:
   • gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime/ offence; or
   • appears to be made in circumstances of unusual or unjustified complexity; or
   • appears to have no economic rationale or bonafide purpose; or
   • gives rise to a reasonable ground of suspicion that it may involve financing of the activities relating to terrorism.

b) The said rules also define "transaction" to mean and include deposit, withdrawal, exchange or transfer of funds in whatever currency, whether in cash or by cheque, payment order or other instruments or by electronic or other non-physical means.

c) Banks are advised to develop suitable mechanism through appropriate policy framework for enhanced monitoring of accounts for quick identification of the suspicious transactions and making suitable reports to the Financial Intelligence Unit - India (FIU-IND), New Delhi on priority.

d) Whenever bank locates a suspicious transaction, the bank is required to file 'Suspicious Transaction Report' (STR) with FIU-IND, head-quartered at New Delhi. If a bank has not reported any transaction as 'suspicious transaction', but subsequently the investigating agency finds in their investigation that the transaction pertains to money laundering or terrorist financing, then the bank is answerable for not reporting the suspicious transaction.

21.2 KYC Norms
Banks are advised by RBI that all the existing customers' accounts be
complied with KYC norms in a time bound manner. Transactions in existing accounts should be continuously monitored. All the norms and procedures stated above apply to existing accounts also. Banks are required to ensure that term/recurring deposit accounts or accounts of similar nature are treated as new accounts at the time of renewal and subjected to revised KYC procedures. Where the bank is unable to apply appropriate KYC measures due to non-furnishing of information and/or non-co-operation by the customer, the bank may consider closing the account or terminating the banking business relationship after issuing due notice to the customer explaining the reasons for taking such a decision. Such decisions need to be taken at a reasonably senior level.

21.3 Combating Financing to Terrorism (CFT)

1. As and when lists of individuals and entities, approved by Security Council Committee established pursuant to various United Nations' Security Council Resolutions (UNSCRs), are received from Government of India, Reserve Bank of India circulates these to all banks and financial institutions. These lists give the details of individuals and entities involved in terrorist activities. Banks should ensure to update the consolidated list of individuals and entities as circulated by Reserve Bank of India. Further, banks are expected to update list of such individuals/entities from the United Nations website at http://www.un.org/sc/committees/1267/consolist.shtml. Banks are advised that before opening any new account, it should be ensured that the name/s of the proposed customer does not appear in the list. Further, banks are required to scan all existing accounts to ensure that no account is held by or linked to any of the entities or individuals included in the list. Banks are required to immediately intimate to RBI and FIU-IND full details of accounts bearing resemblance with any of the individuals/entities in the list.

2. KYC norms/AML standards/CFT measures have been prescribed to ensure that criminals are not allowed to misuse the banking channels. It would, therefore, be necessary that adequate screening mechanism is put in place by banks as an integral part even in their recruitment/hiring process of personnel.

3. With a view to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing, RBI has clarified that whenever there is suspicion of money laundering or terrorist financing or when other factors give rise to a belief that the customer does in fact, pose a low risk, banks should carry out full scale
Customer Due Diligence (CDD) before opening an account. Bank should not open an account (or should consider closing an existing account) when it is unable to apply appropriate CDD measures.

Various guidelines issued by RBI about KYC and AML are under Section 35A of the Banking Regulation Act, 1949 (AACS). Any contraventions thereof attract penalties under the relevant provisions of the said Act. Besides this, RBI and other regulators as defined in Prevention of Money Laundering Act Rules, 2005 may prescribe enhanced measures to verify the client’s identity taking into consideration type of client, business relationship or nature and value of transactions.

21.4 Monitoring of Transactions

For observance of effective KYC procedures, it is essential to monitor the transactions in the accounts on an ongoing manner. Banks can effectively control and reduce their risk only if they have an understanding of the normal and reasonable activity of the customer. It provides identifying transactions that fall outside the regular pattern of activity. However, the extent of monitoring will depend on the risk sensitivity of the account. Banks need to pay special attention to all complex, unusually large transactions and all unusual transaction patterns which have no apparent economic or visible lawful purpose. The bank may prescribe limits for a particular category of accounts and pay enhanced attention to the transactions which exceed these limit. Transactions that involve large amounts of cash inconsistent with the normal and expected activity of the customer should particularly attract the attention of the bank. Very high turnover in the account inconsistent with the size of the balance maintained may indicate that funds are being 'washed' through the account. High-risk accounts have to be subjected to higher monitoring. Every bank should set key indicators for such accounts, taking note of the social and economic background of the customer, such as the country of origin, sources of funds, the type of transactions involved and other risk factors. Banks should put in place a system of periodical review of risk categorization of accounts and the need for applying enhanced due diligence measures. Banks should ensure that a record of transactions in the accounts is preserved and maintained as required in terms of Section 12 of the Prevention of Money Laundering Act, 2002 and rules there under. It may also be ensured that transactions of suspicious nature and/or any other type of transactions are reported to the appropriate authorities. Banks should ensure that its branches continue to maintain proper record and reporting of all cash transactions (deposits and withdrawals) of Rs. 10 lakhs and above.
Suspicious Transactions and Counter Measures

The internal monitoring and also software system should have an inbuilt procedure for reporting of such transactions in prescribed formats. The Prevention of Money Laundering Act, 2002 has prescribed various periodical returns to be submitted by the banks to FIU - IND.

21.5 Risk Management

The Board of Directors of the bank should ensure that an effective KYC and Asset Liability Management (ALM) programme is put in place by establishing appropriate procedures. Effective implementation of KYC and ALM should be closely supervised by the Board of Directors. It should cover proper management oversight, systems and controls, segregation of duties, timely reporting to the respective authorities, remedial measures if any, adverse thing is noted, training and other related matter. Responsibility should be explicitly allocated within the bank for ensuring that the bank's policies and procedures are implemented effectively. Banks should, in consultation with their Boards, devise procedures for creating risk profiles of their existing and new customers and apply various Anti Money Laundering measures keeping in view the risks involved in transactions, accounts and other banking/business relationship.

Bank's internal audit and compliance functions should play an important role in evaluation and ensuring adherence to the KYC policies and procedures. A general rule, the compliance function should provide an independent evaluation of the bank's policies and procedures, including legal and regulatory requirements. Banks should ensure that their audit machinery is staffed adequately with officials who are well-versed in such policies, procedures and legal framework. Concurrent/Internal Auditors should specifically check the application of Know Your Customer (KYC) procedures and Anti-Money Laundering (AML) guidelines at the branches and specially comment on the lapses observed in this regard. The compliance in this regard should be put up before the Audit Committee of the Board on quarterly intervals. Banks must have an ongoing employee-training programme so that the members of the staff are adequately trained in KYC procedures and AML guidelines. Training input should contain different focuses for frontline staff, audit staff, compliance staff and staff dealing with new customers. It is crucial that all those concerned fully understand the rationale behind the KYC requirements and AML risks and implement policies of the bank consistently.

21.6 Politically Exposed Persons (PEPs)

Politically Exposed Persons are treated as high risk customers. In terms of RBI directives on the subject, for opening new account by PEP or in the
event of an existing customer or the beneficial owner of an existing account, subsequently becoming a PEP, banks should obtain an approval of senior management to continue the business relationship and subject to the ‘Customer Due Diligence’ (CDD) measures. For such accounts enhanced monitoring on an ongoing basis should be done. Accounts of customers who are close relatives of PEPs, and accounts of which PEP is the ultimate beneficial owner also attract the same precautions.

21.7 Accounts of Politically Exposed Persons (PEPs) Resident Outside India

Politically exposed persons are individuals who are or have been entrusted with prominent public functions in a foreign country, e.g. Heads of States or of Governments, Senior Politicians, Senior Government/Judicial/Military Officers, Senior Executives of State-owned Corporations, important Political Party’s Officials, etc. Banks should gather sufficient information on any person/customer of this category intending to establish a relationship and check all the information available on the person in the public domain. Banks should verify identity of the person and seek information about the sources of funds before accepting the PEP as a customer. The decision to open an account for PEP should be taken at a senior level which should be clearly spelt out in Customer Acceptance Policy. Banks should also subject such accounts to enhanced monitoring on an ongoing basis. The above norms may also be applied to the accounts of the family members or close relatives of PEPs.
22.1 Introduction

There may be many deficiencies, omissions pointed out by the auditors, internal auditors, discovered during inspections done by NABARD and the Registrar, etc. Many times they are neither complied with nor rectified. Moreover, the same mistakes are carried forward. To compel StCBs and DCCBs to comply with all the provisions of the law, NABARD issued a circular (dated 11th July, 2005 vide No. 155/DoS.23/2005) regarding the role of auditors in implementation of Prudential Norms for Income Recognition, Asset Classification and Provisioning.

22.2 Observations made by the Board of Supervision

The Board of Supervision (for StCBs, DCCBs and RRBs) had observed that there was an urgent need to ensure proper implementation of prudential norms by these banks without further delay and this can be addressed only through the statutory audit process. Accordingly, the statutory auditors are required to do the following:

- Ensure proper implementation of income recognition, assets classification and provisioning norms by the banks,
- Point out incorrect classification and shortfalls in provisioning,
- Prepare a divergence statement as regards the divergence in assessment of NPAs and provisioning done by the bank vis-à-vis what is actually required,
- Ensure that the banks rectify the deficiencies duly considering the divergence statements of the auditor/inspection report, and
- Ensure that deficiencies in this regard as pointed out by NABARD in the inspection report are corrected by the bank while preparing annual financial statements for the subsequent year.
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There is a great responsibility on the auditors to verify the accuracy before issuing the certificate regarding the assets classification and provisioning. If it is found that the auditors have issued certificate of accuracy without proper verification of asset classification and provisioning and/or fail to point out incorrect classification/shortfall in provisioning, the auditors will be asked to give explanation to the regulators as and when the same is found by the NABARD.
Chapter 23
Audit Observations – Reporting of Defects

During the course of audit, the auditors might notice several irregularities and/or defects which could be rectified during the course of audit or need to be reported to the management committee and/or general body for necessary resolution. Some of these defects may affect the financial statements requiring qualification of audit report by the auditors. The defects should be primarily categorized into:

23.1 Financial Irregularities
These defects could relate to any or all of the following or similar problems:

- expenditure exceeding the approved budgets limits;
- expenditure not covered by the budget;
- expenditure not in accordance with relevant provisions of the Societies Act;
- due procedures like quotations, comparative statements, purchase orders/work orders etc. not followed in incurring the expenditure;
- collections by PACS not properly deposited or accounted for;
- expenditure not supported by vouchers/supporting documents;
- income not recognised or recorded correctly in the books;
- retention of heavy cash balances without proper justification and/or withdrawal of heavy sums;
- irregular loan disbursements or loans not supported by required documents;
- irregular encashment of deposits;
- frauds and/or misappropriation of cash and other assets.

23.2 Accounting Irregularities
These defects could relate to any or all of the following problems:

- prescribed books of accounts not maintained;
- prescribed registers not maintained;
Guidance Note on Audit of StCBs & DCCBs

- incomplete/improper maintenance of books of accounts;
- vouchers, registers, ledgers not authorized/authenticated by the appropriate persons;
- wrong recording of expenditure/income; wrong postings; wrong classification of expenditure;
- inadequate provisioning or non provisioning for expenditure/liability;
- loans and advances not classified as per NABARD/RBI norms.

23.3 Administrative Irregularities

These are essentially compliance/organizational/management related defects such as:

- delegation of powers not accorded; where accorded not adhered to in the day to day functioning of the StCB/DCCB;
- general body meetings/management committee meetings not held or not held in time;
- elections not held as required under the provisions of the Societies Act;
- resolutions of general body/management committee not recorded properly;
- internal controls not implemented and/or where implemented, not effective or adequate considering the size and complexity of business;
- poor housekeeping (of accounting and other records);
- infringement of Bye-laws of the society;
- non compliance with defects as per previous audit reports;
- non adoption of accounts and audit reports.

The financial and administrative irregularities should necessarily be reported to the management committee for its information and resolution. Some of these defects which remain unresolved may have to be escalated to the Registrar of Co-operative Societies for regularization and/or for necessary ratification. Such defects should also be reported in the auditor’s report through a defect sheet.

The accounting defects should be corrected by the society during the course of audit and financial statements should be prepared after such correction.
Audit Observations – Reporting of Defects

However, unresolved accounting defects should be reported to the management committee and should be included in the auditor’s report.

Defects as pointed out should be supported by the audit evidence gathered during the course of audit. These should form part of audit working paper files. Defects may be communicated by any suitable mechanism such as half margin memos, other audit memos, etc. These half margin memos with clarification obtained shall be part of audit working paper files of the auditors.

A recommended schedule of audit defects/observations as included in model audit report is enclosed in Annexures to the Guidance Note.
Chapter 24
Attributes of a Audit Report

24.1 Attributes of a Audit Report

- Depiction of the true state of affairs of the bank/branch.
- Adequate and proper coverage of all the important aspects/observations in an in-depth manner.
- Presentation of defects to be made in such a manner as to indicate their magnitude.
- Clarity of expression, precise and to the point.
- Instances furnished should support the observation/defect adequately.
- Correctness of the facts and figures. No inconsistencies in the observations/defects.
- More focus on the systems and deficiencies thereof should be brought out clearly.
- Appropriate classification of defects and arrangement of the same in order of importance.
- Suggestions made should be appropriate and practicable.
- Non-compliance with legal requirements to be disclosed therein clearly.
- Proper headings and sub-headings to be given to the paragraphs.
- Grammatical and spelling mistakes to be avoided as they leave poor impression on the report.
- The contents of the audit report should be clear and specific so that a satisfactory compliance could be expected.
25.1 Audit Completion and Review

25.1.1 Objectives of Audit Completion Procedures

Audit completion procedures are required to be followed to ensure:

- that audit evidence as planned for has been obtained to support the audit opinion;
- working papers are completed to evidence that all workings and decisions taken have been documented;
- the audit defects/deficiencies are documented and discussed with StCBs and DCCBs management.

Audit completion procedures includes:

- applying analytical procedures based on the audited financial statements;
- review of events occurring after the year end (post balance sheet events);
- review of the presentation and disclosures in the financial statements to ensure that they comply with the Indian Accounting Standards issued by ICAI;
- consultation with external parties such as tax advisors, wherever necessary;
- review of the audit evidences obtained to frame an opinion;
- issuance of audit report based on financial statement and audit evidence.

25.1.2 Completion of Audit Areas

25.1.2.1 Lead and Supporting Schedules

- Cross reference should be made to all lead schedules and appropriate supporting schedules to the financial statements and the audit working papers;
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- Lead schedules for each audit area/work alongwith other documents supporting each lead schedule should show the audit objective, the work performed and the conclusions reached;
- Any adjustments made to the figures in the financial statements should also be reflected in relevant schedules.

25.1.2.2 Analytical Review

Summarize analytical review procedures and make notes to explain material changes and variations. This enables corroboration of conclusions formed during the audit and assist in arriving at the overall conclusion as to the reasonableness of the financial statements.

25.1.2.3 Audit Area Conclusions

- Draw a conclusion for each audit area and summarize key issues in each audit area;
- Ensure that audit has been done in accordance with the audit plan and programs and the audit procedures have been carried out as required and the overall audit strategy followed. Any deviations in the audit strategy and plan should be documented and evidenced by the initials of the senior most member of the audit team;
- Update all working papers to reflect all audit queries and the responses to queries raised by the audit reviewing seniors;
- Summarise all internal controls, other weaknesses and obtain necessary signatures of StCBs and DCCBs management team on the same;
- If any representation/explanation is required from the StCBs and DCCBs management obtain the same and file it in the audit working papers file.

25.1.2.4 Review of Accounting Policies & Procedures

Review the accounting policies as part of the substantive procedures adopted to ensure that the accounting policies are:
- acceptable;
- consistently applied; and
- appropriate to the nature of business of StCB and DCCB.
Auditor Completion

Review should also ensure that:

- the additions and cross-casts are correct;
- the comparative figures agree with the previous year’s financial statements;
- the audit opinion is supported by the audit evidence on the file;
- there are no errors of fact and there are no omissions;
- the financial statements comply with legal requirements and its applicable financial reporting framework; and
- the pending audit compliances relating to previous years have been properly rectified/addressed to by the StCBs and DCCBs management.

25.1.2.5 Review of Audit Files

The audit files should be reviewed by the senior most auditor as well as signing partner. Generally, the review should focus on the following:

- maintenance of audit files as well as to the audit opinion expressed in the light of audit defects observed;
- working papers for their completeness and adequacy to support the audit opinion;
- whether the sample sizes are adequate and appropriate and the method of sample selection is properly documented;
- conduct of audit in accordance with the audit plan and strategy, modified as necessary during the course of the audit;
- working papers provide appropriate and adequate audit evidence to support conclusions reached; and
- identification of areas of weakness in internal controls for StCB and DCCB.

The review of audit files should be evidenced by signatures on the working papers and notes of the reviewer/s.

25.1.3 Discussion with StCBs and DCCBs Management

Upon completion of the audit and review of the audit files by the senior most member of the audit team and preparation of the “Schedule of Defects” (refer Model Audit Report enclosed in the Annexure to the Guidance Note), these
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observations should be discussed with the CEO/Managing Director of the StCB and DCCB and where necessary, with the Board of Directors for necessary clarifications and resolutions.

The process of communication and discussion with StCBs and DCCBs management should happen:

- during the course of audit by the field auditors through half margin memorandum/others acceptable communication modes to elicit replies/responses to the audit observations and defects; and
- upon the closure of the audit and before formalizing the audit opinion and audit report.

At the time of audit closure and discussion with the management of StCBs and DCCBs one of the senior auditors not involved in the field audit should be present along with the audit team. These discussions should ensure that the irregularities/defects that remain unresolved during the course of audit are taken to the notice of the Secretary/President in order to resolve as many defects as possible prior to the issue of audit report.

If the audit defects were serious in nature such as frauds or embezzlement etc., these should be communicated to the StCB and DCCB, the Registrar and NABARD, as the administrative authority for necessary action. All such defects must be disclosed in the audit report either as “disclosures” or by “qualification” of the audit report depending upon the impact such defects may have on the financial statements subjected to audit.

25.1.4 Audit Opinion

Upon conclusion of audit closure meetings with the management of StCB and DCCB, the auditors should form an audit opinion based on the review of the financial statements and the audit evidence.

Before issuing the final audit report, a draft audit report based on such opinion shall be made and issued to the StCB and DCCB. To this audit report the financial statements together with notes and schedules that were subjected to audit should be annexed.
26.1 Audit Report

The auditor’s report on financial statements is a report issued as a result of an audit performed by the auditor/s on the financial statements of StCBs and DCCBs. The auditor’s report expresses a clear written opinion on the financial statements based on conclusions drawn from the audit evidence gathered by the auditors during the process of audit.

Auditor’s report should be addressed to the members of the StCBs and DCCBs and/or the authority appointing the auditors. The report should identify the financial statements subjected to audit and must clearly state that the preparation of those financial statements is the responsibility of the management of StCBs and DCCBs and auditor only expresses an opinion. It should identify the scope, particularly where such scope is determined by a Statute and include a statement that the audit was performed to obtain reasonable assurance that the financial statements are free of material misstatements. It should indicate the financial reporting framework and express a clear opinion as to whether the financial statements present a true and fair view and comply with the statutory requirements.

When the auditor concludes that the financial statements give a true and a fair view, an unqualified opinion should be expressed. However, if the circumstances warrant, the auditor should qualify the report clearly stating in the body of the report the nature of defect/deficiency due to which the report has been qualified. Examples for such qualified opinions are: (i) limitations on the scope, (ii) disagreement with the management on the nature and type of accounting policies followed, (iii) non adherence with the accounting standards, if applicable, (iv) inadequate disclosures, (v) wrong accounting leading to distortion of financial statements, etc.

The balance sheet as on 31st March and the profit & loss account for the year ended on that date which were subjected to audit should be appended to the auditor’s report and properly signed by the auditors along with the audit report. In addition, the schedules to the Balance Sheet, P&L Account and notes on accounts annexed to the financial statements shall also be signed by the auditors along with the management of StCBs and DCCBs.
26.2 Annual Report of the Management

Generally, an auditor’s report is confined to the expression of an opinion on the financial statements. The Co-operative Societies Act in some states seeks a narrative report in addition to a normal auditors’ report. This narrative report is akin in several ways to the “Annual Report” published by Corporates. However, preparation of this report should be the responsibility of the management of StCBs and DCCBs and auditors should only state their agreement to the facts and opinions stated in such report.
Chapter 27
Audit Documentation

27.1 Audit Working Papers and Audit Documentation

Audit working papers need to be maintained to document matters which are important in providing evidence that the audit was carried out in accordance with the generally accepted audit standards and practices. Audit working papers aid in planning and performance of audit and facilitate supervision and review of the audit work and provide evidence of the audit work performed. These working papers should be preserved for such period of time that is prescribed by the Act or if there are no regulatory prescriptions, for such time as is required to meet the professional requirements of record retention.

27.2 Form and Content of Audit Working Papers

Audit working papers normally record the audit plan, the nature and extent of the auditing procedures performed, and the conclusions drawn from the evidence obtained.

The form and content of working papers are normally determined by the following factors:

- Nature and complexity of StCBs and DCCBs business;
- Condition of records at StCBs and DCCBs and the controls therein on which auditors place their reliance;
- Direction, supervision and review of work performed by audit assistants/junior auditors;
- Form and content of auditor’s report.
- Standardized working papers like checklists, specimen letters, questionnaires etc.
- Lead schedules, groupings and schedules prepared by StCBs and DCCBs.
27.3 The SA 230 (Standard on Auditing) issued by the ICAI deals with the auditors’ responsibility to prepare audit documentation for an audit of financial statements. It is to be adopted as necessary in the circumstances when applied to audit of financial statements. Applicable laws or regulations may establish additional documentation requirements. Various issues covered by SA 230 are as follows:

27.3.1 Definitions

(a) **Audit documentation** – The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “work papers” are also sometimes used).

(b) **Audit file** – One or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

(c) **Experienced auditor** – An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:

   (i) Audit processes;
   (ii) SAs and applicable legal and regulatory requirements;
   (iii) The business environment in which the entity operates; and
   (iv) Auditing and financial reporting issues relevant to the entity’s industry.

27.3.2 Nature and Purposes of Audit Documentation

- Audit documentation that meets the requirements of the SA 230 (Revised) and the specific documentation requirements of other relevant SAs provides:
  - Evidence of the auditor’s basis for a conclusion about the achievement of the overall objective of the auditor; and
  - Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

- Audit documentation serves a number of additional purposes, including the following:
  - Assisting the engagement team to plan and perform the audit.
Audit Documentation

- Assisting members of the engagement team responsible to direct and supervise the audit work and to discharge their review responsibilities properly.
- 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 quality control reviews and inspections in accordance with SQC 1.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

27.3.3 Requirements

The auditor shall prepare audit documentation of audit procedures performed and audit evidence obtained on a timely basis:

A. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:
   (a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;
   (b) The results of the audit procedures performed, and the audit evidence obtained; and
   (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

B. In documenting, the nature, timing and extent of audit procedures performed, the auditor shall record:
   (a) The identifying characteristics of the specific items or matters tested;
   (b) Who performed the audit work and the date on which such work was completed; and
   (c) Who reviewed the audit work performed and the date and extent of such review.

   - The auditor shall document discussions of significant matters with management, those charged with
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governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

- If the auditor identified information that is inconsistent with the auditor’s final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

- Departure from a relevant requirement If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement in a SA, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure.

- Matters arising after the date of the auditors’ report
  - If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor’s report, the auditor shall document:
    - The circumstances encountered;
    - The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor’s report; and
    - When and by whom the resulting changes to audit documentation were made and reviewed.

(iv) Assembly of the final audit file

- The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor’s report.

- After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

- In circumstances other than those envisaged in paragraph 13 where the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor
shall, regardless of the nature of the modifications or additions, document:

(a) The specific reasons for making them; and

(b) When and by whom they were made and reviewed.
28.1 Background

In the course of audit of a bank or a branch of a bank, the auditor may come across matters, which though not directly relevant or material for the purpose of his main audit report are nevertheless considered important enough to be communicated to the bank management. In such circumstances, the auditor in addition to submitting his main report in accordance with the requirement of the applicable laws may also submit a separate report to the management. Such a report is usually termed as a Long Form Audit Report (LFAR).

In the year 1985, Reserve Bank of India (RBI) advised the Public Sector Banks to obtain LFAR from the auditors. The report is not a substitute for the statutory report and is not deemed to be a part of the said report. However since the operations and audits of a bank are mainly based on the effectiveness of its internal controls, this report serves this purpose to a great extent for bringing to the notice of the management, the lacunae, shortcomings and failures in respect of compliance or adherence to the internal control measures adopted by the banks.

The main report is to be submitted as per the requirements of Banking Regulation Act, 1949. LFAR is a separate report to be submitted to the management (Format of LFAR for StCB and DCCB is decided by NABARD). It is a detailed questionnaire prepared by Reserve Bank of India (RBI) and has been in use since the year 1985. The same was revised in the year 1992-93 and the latest format has been revised in the year 2003. The new format was made effective w.e.f. 31st March, 2003.

There are no legal bindings on the LFAR and it is only a management report. However a lot of importance is given to the LFAR by the management of banks and RBI. The replies do prepared would reveal some facts which may be required to be looked into by the management for improving the working of the bank. It is advisable to discuss the contents of the LFAR with the branch head and get his responses before finalizing the same.

In the preparation of the LFAR, the auditor should call for and look into the previous reports to ascertain whether in respect of the accounts for the year under audit, there are any matters, which deserve the attention of the management particularly as regards adverse comments of a material nature in which remedial action was warranted.
The auditor should also seek written representation from the management regarding any change in CIS (Computer Information System) that have taken place during the year.

The LFAR cannot in any way be a substitute for the main report. The main report is a self-contained document and should not make any reference to the LFAR. However, matters in the main report may be elaborated in the LFAR.

In designing the audit programme, the auditor should take into consideration, the requirement of the relevant questionnaire and should accordingly plan the audit work so as to cover the LFAR expeditiously to the extent practicable. The work relating to preparation of LFAR should be carried out simultaneously with that of main report. This would enable the auditor to appreciate and consider effect of various matters to be reported in his LFAR on his main audit report. As far as possible both the reports should be submitted simultaneously. However, the submission of the report should not be delayed merely because the LFAR is pending for completion.

LFAR in respect of bank branches are prepared in such a manner so as to enable the expeditious completion and submission of the LFAR by the statutory auditors. It would also be desirable that the branch auditors familiarise themselves with the questionnaire applicable to the statutory auditors. In response to a question, the statutory auditor has to take into account the comments made on those matters by the branch auditor in their LFAR. He should use his judgment to determine whether or not comments/observations made in the branch LFAR is material enough to be incorporated in his own report.

Some of the matters dealt within the LFAR need compilation of detailed information/statements. It should be recognized that the responsibility for such compilation is that of the bank/branch concerned.

Where any of the comments made by the auditor in the LFAR is adverse, he should consider whether a qualification in the main report is necessary. Situation where relevant instances are giving rise to their reservations/adverse remarks should be given. Reasons for the same must also be given.

**28.2 Long Form Audit Report (LFAR)**

LFAR is a questionnaire, which asks specific questions for which replies should be specific. The auditor should not shirk his responsibility of
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answering any questions by remaining silent. At the same time he should not answer facts for which replies were never sought. What is important is a thorough reading and understanding of the questions and a specific, clear and unambiguous reply to the question. Key is to ensure correct presentation so as to state facts which have been verified.

Further, there is no need to take/accept more responsibility and liability. It is well understood that in the limited time, auditor can only do a macro level scrutiny on a random check basis prioritizing risks involved.

While compelling the LFAR there are certain Auditing Standards, which the auditor should be aware of.

Format of LFAR applicable to StCB and DCCB is given in the NABARD circular dated 30th June, 2008 vide circular number 106/Dos-19/2008/ Ref. No. NB.DOS.POL/1309/J.1/2008-09. (Given in the Annexures to the Guidance Note)

28.3 Coverage and Content of LFAR

I. Capital

- Share capital from member societies, individuals and Government and share holding of Government in the total capital; change of position from the previous year.
- System followed for share-linking to borrowings by member societies/borrowers.
- Arrears in collection of share capital from affiliated institutions/individuals.
- Net-worth as percentage to total assets, Capital to Risk weighted Assets Ratio (CRAR) and computation thereof.

II. Assets

A. ADVANCES

1. Credit Appraisal
   - Loan policy, new schemes introduced.
   - System of appraisal of loan/credit proposals and its adequacy thereof.
   - Over extended position and adequacy of security obtained.
2. **Sanctioning/Disbursement**
   - System of receipt and disposal of loan applications.
   - Delegation of powers/authority at various levels.
   - Adherence to authorized limits.
   - Allowing of drawals during unrenewed period.
   - Whether funds are disbursed under sanctioned limits after complying with terms and conditions of sanction
   - Exposure limits to individuals.
   - Sectors and exposure to outside co-operative fold, etc.
   - Review of advances including enhancement of limits and renewal of loan facilities.
   - Irregularities found in sanctioning and disbursement.

3. **Documentation**
   - System of ensuring that documents are executed as per the terms of sanction.
   - Defects in documentation and suggestions to avoid such defects.
   - System of documentation in respect of joint/consortium advances.
   - Renewal of documents/time-barred documents.
   - Acknowledgement of debts.
   - Custody of documents and system of keeping the same.
   - Maintenance of document register.

4. **Review/Monitoring/Supervision**
   - Periodic balance confirmation.
   - Receipt of regular information, stock/book debt statements, Balance Sheet, etc.
   - System of scrutiny of the above information and follow-up by the bank to ensure compliance with credit discipline.
   - System of periodic physical verification or inspection of stocks, equipments, machineries and other securities.
   - Insurance cover for stocks and its adequacy-timely renewal of policies.
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- Inspection reports of bank officials and follow-up thereon.
- Overall monitoring of advances through maturity/age/industry-wise analysis.
- Computation of Demand and Collection Balance (DCB) as on 30th June every year as per guidelines of NABARD.

5. Large Advances
- Adverse features in respect of large advances considered significant and requiring management's attention.
- Compliance with exposure norms relating to advances as per the exposure norms stipulated by NABARD/RBI/provisions of Co-operative Societies Act.
- Review of the large advances by the Board of Directors and follow up action taken

6. Foreign Exchange Bills
- Foreign bills negotiated under letters of credit.
- Including pre and post shipment credit.
- Whether the debits and credits are permissible under the rules, whether inward/outward remittances have been properly accounted for, adherence to the guidelines issued by the RBI regarding the above operations, violations of FEMA, if any.

7. Coverage of Crop Loans under Crop Insurance
The following need to be examined:
(i) Whether all the loanee farmers and crops have been covered as per the guidelines of Agricultural Insurance Company of India (AICI).
(ii) Whether premium is remitted to the insurance company in time.
(iii) Amount of claims preferred.
(iv) Amount of claims settled by AICI
   (a) Of (iii) above, those pending adjustment at the bank level.
   (b) How much is adjusted to the loan accounts.

8. Imbalances
- No. of PACS with imbalances.
- Imbalance in principal account and interest account of the DCCBs.
Long Form Audit Report

- Percentage of imbalances to total loans & advances outstanding.
- Reasons for the same and likely impact on the bank.
- Steps taken by the bank to reduce imbalances.

B. INVESTMENTS

- System of assessing surplus funds, purchase and sale of investments, delegation of powers, reporting systems, etc. Whether investments have been earmarked towards reserve funds.
- System relating to Subsidiary General Ledger (SGL), Bankers Receipts (BRs), control over SGL/BRs outstanding at the year end and their subsequent clearance; reconciliation of the balances of SGL transfer forms as per bank’s books should be checked.
- Purchase and sale of Government securities, etc. should be subjected to audit and the results of their audit also covering delay in collection of interest on investments, profit and loss incurred in trading Government securities
- Placing related information before the Board of Directors.
- Audit of the treasury operations should include:
  - Adherence to the aggregate upper contract limit of 5% of total transactions (both purchase and sales) for each of the approved brokers entered into by the bank during a year. Whether part of the business is transacted through only one or a few brokers, the extent and modalities. The limit should cover both the business initiated by the bank and the business offered/brought to the bank by broker. Besides, whether the business put through any individual broker or brokers in excess of the limit of 5% of total transactions entered into by the bank during the year with the reasons therefor, covered in the half-yearly review to the Board of Directors.
  - Controls over investments, including periodic physical verification/reconciliation of investments with Demat accounts, books/records.
  - Checking of the periodical collection of interest on investments.
  - Valuation methods and changes in mode of valuation of securities compared to previous year; shortfall and provision therefor as per extant guidelines of RBI/NABARD. Whether amortization of premium is done properly.
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- Whether provisions of the /State Co-operative Societies Act/Rules/Bye-laws as also investment policy/guidelines of RBI/NABARD are followed for investment in SLR/Non-SLR investments and other related aspects.

C. OTHER ASSETS
- Comment on the status of ‘other assets’ including depreciation policy and their valuation and provision made therefor.
- Whether the bank retained non-banking assets beyond the specified/extended period, and reasons therefor.

D. NON-FUND BUSINESS
Policy, procedure, income, service charges covering lockers, safe deposit vaults, Letter of Credit (LCs), Guarantees issued etc, and violations, if any with reference to guidelines issued by NABARD/RBI on the subject.

E. APPLICATION OF PRUDENTIAL NORMS
Verify the adoption/application of Income Recognition, Assets Classification and Provisioning norms by Co-operative banks as per the guidelines issued by RBI/NABARD from time to time.

The auditors must also issue a certificate to the effect that the implementation of the prudential norms is satisfactory or otherwise and, the shortcomings, if any, should be duly listed out.

The auditors are required to specifically comment on the following:

(i) Income Recognition
   (a) Whether the bank recognized income as per instructions in vogue.
   (b) The total amount of income derecognised (cumulative).
   (c) The amount of derecognised income recovered during the year.
   (d) The procedure followed by the bank for accounting derecognised income.

(ii) Assets Classification: The following may be examined and commented upon:
- Whether the norms for assets classification in respect of all assets and the provisioning norms have been complied with by the Co-operative banks? If not, the divergence observed in classification and the extent of provisions required.
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- Extent of NPAs, amount required to be provided for and the amount actually provided for by the Co-operative banks.
- Movement of NPAs.
- Effectiveness of the system for compiling data relating to the impaired advances, system for charging of interest and making provision to unrealized interest taken to P & L A/c, ascertaining the realisable value of securities and the possible realisation from guarantors; assessment of the efficacy of rehabilitation programmes, provisions/write-offs and appropriateness of authority thereto, recovery procedure, including that relating to suit-filed and decree accounts.
- NPA management strategy of the bank.

III. Management Appraisal

Functioning of Elected Board, Composition, Committees, their oversight, corporate governance, regularity in conduct of meetings, issues discussed in the meetings, defaulting directors, if any, violations of Bye-laws by the directors, disqualification of directors, etc. In case, administrator is in-charge of the bank, comments may be made on the performance of the administrator.

- Competence of CEO in managing the bank and in implementation of policies in conformity with the guidelines issued by GoI/RBI/NABARD.
- Competence of second line management, specific job chart, recruitment policy, training and HRD plans, rotation of staff, accountability, etc.

IV. Earning Appraisal

Analysis of variations in major items of income and expenditure compared to previous year, with important ratios.

- Losses arising due to mismanagement.
- Funds flow statement as on balance sheet date vis-a-vis the previous year.
- Effect of any change in the accounting policies on profit/ loss for the year.
- Carry out test check of application of interest rates on various advances/borrowings as also on deposits and comment on revenue loss, if any incurred by Co-operative banks due to inappropriate application of prescribed interest rates.
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- Whether overdue interest is taken to P & L A/c and if so, whether corresponding provision is made. Bank must mention the extent of overdue interest out of the interest receivable.
- Whether the bank has written back excess provision, if any, to P&L account.
- Whether the bank has made adequate provision for impaired credits and erosion in other assets and liabilities.
- Whether allocation of net profit is done as per the provisions of B.R Act/ State Co-operative Societies Act/bye-laws and whether prior permission was obtained for withdrawal of any amount from reserves.
- Whether the bank earned operating profit and the extent the operating profit covers provision required to be made.
- Whether the bank earned net profit and if not reasons for the same. Where the net profit, if any is made after making full provision and whether the bank is in a position to contribute to reserves and declare dividends.
- Any system for revenue audit to find income leakages.
- Comment on the system of Transfer Price Mechanism.

V. Liquidity Management

1. Cash

Examine and comment on the system of monitoring of cash at branches and its management, fixation of retention limits at branches and their compliance/violations, insurance cover and adequacy including for cash-in-transit, system and procedure followed for physical custody of cash, etc.

2. Statutory Liquidity Ratio (SLR) /Cash Reserve Ratio (CRR) Requirements - System of Ensuring Compliance

- System of compiling and monitoring Demand and Time Liability (DTL) position.
- Records maintained for the above purpose.
- System of ensuring compliance, defaults paid, if any and review of the position by CEO/Board.
- Violations, if any in the maintenance of CRR/SLR, details thereof and reasons for the same.
3. **Repayment of Borrowings**
Comment on ‘Maximum Borrowing Power’, various types of borrowings availed, high cost borrowings, if any approving authority for borrowings; whether the bank had defaulted in repayment in respect of borrowings made, number of occasions, reasons therefore, maintenance of Due Date Register.

4. **Deposits**
Comment on as to whether bank has laid down norms/guidelines for conduct and operation of inoperative accounts and violations, if any; over-drawal, if any and allowing draws against unrealized cheques; delay in paying matured deposits; obtaining necessary declarations wherever required; comments on adherence to KYC norms.

- Whether there were any unusual large movements in aggregate deposits held by HO/branch at the year-end and window-dressing.
- Whether the bank has correctly assessed the deposits for coverage under insurance (DICGCI) and whether premium is worked out correctly and remitted the same timely.
- Comment on composition and the growth of deposits and the extent of low cost deposits; new deposit schemes.
- Opening and operation of FCNR and other non-resident accounts, whether the debits and credits are permissible under the rules, whether inward/outward remittance have been properly accounted for, ensure adherence to the guidelines issued by the RBI regarding the above operations, violations of FEMA, if any. Irregularities if any, in repayment of deposits
- Whether the bank reported the information as per Anti-Money Laundering (AML) guidelines.

VI. **Systems and Controls**

1. Written guidelines/instructions on loans and advances covering appraisal, issue of sanction letters, follow up, etc.

2. Accounting policies – their conformity with Accounting Standards; time taken to finalise accounts; any major observations on branch returns and process of their consolidation in final statements of accounts.

3. Compliance to disclosure norms.

   - System of monitoring the position of balancing of General Ledger and
Guidance Note on Audit of StCBs & DCCBs

- other books /including reconciliation of control and subsidiary records, whether the bank or auditor has finalised the accounts.

- Balancing of drafts payable, DD paid without advice, bills payable, periodical Physical verification of security forms (cheque books, FDRs, DD, MT, etc.) and follow up action.

5. **Inter–branch Reconciliation**
   - Comments on the system/procedure and records maintained.
   - Procedure followed for remittance of funds, TT discounting, etc.
   - Test checks for any unusual entries put through inter – branch/head office accounts.
   - Position of outstanding entries; system for locating long outstanding items of high value. Steps taken or to be taken for bringing the reconciliation up-to-date.

6. **Inter bank accounts Reconciliation**

Balances with other banks (including Apex Bank) – observations – on outstanding items in reconciliation statements. Provision required for long pending unreconciled portion.

7. **Suspense Accounts, Sundry Deposits, Etc.**
   - System for clearance of items debited/ credited to these accounts.
   - Test check for any unusual entries under these heads.
   - Long pendency in these accounts, reasons therefor; provision required if, any.

8. **Long pending items in balance sheet and their position**

A list of long pending items in balance sheet may be examined and the measures taken by the bank for squaring off the same.

9. **Branch Inspections**
   - System of branch inspections: frequency; scope/coverage of inspection; system of internal audit, concurrent audit/ revenue audit and reporting. Arrears, if any in inspections/audit to be mentioned.
   - System of follow-up of these reports; position of compliance.
   - Supervision and monitoring the functioning of DCCBs (in case of apex banks).
Long Form Audit Report

10. **Management Information System (MIS)**
   - The efficacy of MIS maintained by the bank.
   - Comment on regularity of receipt of internal returns.
   - Comment on content and regularity of submission of various statutory returns including Off-Site Surveillance System (OSS) returns and other external returns.

11. **Fraud prevention, Monitoring and Control**
   - Observations on major frauds, misappropriations, embezzlements, etc discovered during the year under audit covering modus operandi, action taken, recovery efforts, etc.
   - Monitoring, review, incidence of thefts, robberies, dacoits. Reporting of frauds to NABARD, provision required, if any.
   - Preventive measures to avoid recurrence of frauds, etc.

12. **Risk Management Systems**
   - Comment on risk profile of the bank viz. liquidity risk, credit risk, exposure risk, interest rate risk and operational risk faced by bank supported by ratio analysis.
   - Comment on systems and procedures for identifying, managing and mitigating risks and also default monitoring mechanism.

13. **Asset Liability Management (ALM) System**
   Comment on the ALM mechanism put in place by the bank. Comment on the functioning of ALCO Committee.
   - Comment on the gaps/mismatches, analysis and generation of reports.

14. **Vigilance Arrangements**
   - Implementation of Vigilance guidelines and systems as per guidelines of NABARD-Working of Vigilance Cell.
   - Irregularities/inadequacies in the vigilance arrangements.

**VII. Compliance**

**Functioning of Audit Committee of Board** - System for taking timely follow-up action on the observations and suggestions made in the inspection reports of NABARD, statutory auditors and those submitted by the Internal Inspection Department, Vigilance Cell and internal auditors; including
Guidance Note on Audit of StCBs & DCCBs

concurrent auditor, timeliness and effectiveness of timely follow-up action on guidelines, circulars, etc. issued by NABARD/RBI; overseeing and providing direction as also discharge of other duties/ responsibilities of the Committee may be commented upon.

Comment on compliance with important provisions of the B.R. Act’1949, (AACS), B.R Act’ 1934 and provisions of State Co-operative Societies Act and bye-laws.

Compliance to IT Act and other laws in force.

VIII. Audit of Computerised Operations

All co-operative banks having fully/partially-computerised operations should ensure to comply with the following norms and auditors may comment on the same.

- Availability of competent personnel, segregation of duties of programmer and persons operating the system, existence of physical, logical and procedural access to system; standards for quality assurance and periodically testing and checking them; formal declaration of system development methodology.

- Programming and documentation standards to be followed by the bank, in the absence of which quality of system maintenance/improvement might suffer, contingency plans/procedures in case of failure of system/disaster management system, manual of instructions for their inspectors/auditors and its periodical updation.

- If services of outside computer agencies are engaged whether "clause of visitorial rights” in the contract, has been incorporated so as to have the right to inspect the process of application and also ensure the security of the data/inputs is ensured while entrusted to such outside agencies.

- Auditors may also comment on (wherever applicable) automation and computerization process and policy for the same. Progress made during the year under review, critical area of operations not covered by automation, number of branches covered by computerization and extent of computerization, volume of business computerized, suggestion, if any.

- Arrangements for system/IT audit.

- Issues connected with maintenance of ATMs-cash replenishment, security and monitoring etc.
Comment on working of various technology driven products and services e.g. smart cards, credit cards, if any.

IX. Preparation/Implementation of DAP & MoU Executed and Revival Package, etc.

Performance under the Development Action Plan and MoU executed, system of monitoring the achievements, etc.

Implementation of Revival Package-utilisation of amounts received under the GoI package and adherence to various guidelines issued by NABARD in this regard.

Verify implementation of schemes like Interest Subvention, Debt Waiver & Relief etc., and whether benefits have been extended to borrowers.

Any other matter/adverse developments in the functioning of the banks, which, the auditor considers significant, should be brought to the notice of management.
29.1 Norms for Classification

Norms for audit classification of SICB & DCCB have been specified by NABARD, vide circular no. 106/DoS-19/2008 dated 30th June 2008 (which also specifies format of LFAR).

The Audit Classification Model and related scaling pattern are based on following broad parameters:

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Maximum Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Capital Adequacy</td>
<td>15</td>
</tr>
<tr>
<td>2. Asset Quality</td>
<td>15</td>
</tr>
<tr>
<td>3. Management</td>
<td>10</td>
</tr>
<tr>
<td>4. Earnings</td>
<td>08</td>
</tr>
<tr>
<td>5. Liquidity</td>
<td>20</td>
</tr>
<tr>
<td>6. System &amp; Controls</td>
<td>20</td>
</tr>
<tr>
<td>7. Compliance</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total Marks</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The model is based on CAMELS rating, which is used by regulatory authorities for commercial banks. Different sub-parameters have been identified in each of above parameters.

For example, capital adequacy has 2 sub-parameters namely:

i. Net worth as a percentage of total assets
ii. Capital to Risk Weighted Assets Ratio

Based on the scale for any sub-parameter, marks shall be allotted for each item. For example, marks shall be allotted to “Net worth as a percentage of total assets” as under:

<table>
<thead>
<tr>
<th>Sub-parameter</th>
<th>Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net worth as a percentage of total assets</td>
<td></td>
</tr>
<tr>
<td>Greater than 5%</td>
<td>10</td>
</tr>
<tr>
<td>Greater than 4% but up to 5%</td>
<td>8</td>
</tr>
<tr>
<td>Greater than 2% but up to 4%</td>
<td>5</td>
</tr>
<tr>
<td>Greater than 0.25% but up to 2%</td>
<td>3</td>
</tr>
<tr>
<td>Less than 0.25%</td>
<td>0</td>
</tr>
</tbody>
</table>
Audit Classification

The auditor shall be required to calculate the respective ratios, to facilitate allotment of marks.

While calculating ratios for financial parameters (like net profit after making full provisions required to be made), qualifications given by the auditors in the audit report, which have an impact on the net profit should be appropriately considered.

For instance: If the auditors have given a qualification in audit report, on non-provision or inadequate provision of certain expenses such as gratuity to employees, the amount of such non-provision or inadequate provision, shall be reduced from the amount of net profit, as per the published Profit & Loss Account.

The marks obtained by a bank against the above respective parameters would indicate level of performance of the bank in respective area.

Based on total marks obtained for all 7 parameters, audit classification shall be awarded to the bank on the scale of “A” to “D” indicating decreasing order of performance/increasing order of supervisory concern as under:

<table>
<thead>
<tr>
<th>Marks obtained</th>
<th>Audit Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>75 and above</td>
<td>A</td>
</tr>
<tr>
<td>60 and above but less than 75</td>
<td>B</td>
</tr>
<tr>
<td>40 and above but less than 60</td>
<td>C</td>
</tr>
<tr>
<td>Below 40</td>
<td>D</td>
</tr>
</tbody>
</table>

29.2 Important Aspects

The audit classification as per above parameters and scaling pattern is subject to the following factors, while allotting the final audit classification:

i. Banks not complying with Section 11(1) of the B.R.Act, 1949 (AACS) should be placed in “D” class, irrespective of the marks secured.
   - Section 11(1) of the Act specifies requirement as to minimum paid up capital and reserves.

ii. Banks which do not comply with section 22(3)(b) of the B.R.Act, 1949 (AACS) should not be awarded “A” class, irrespective of the marks secured.
   - Section 22(3)(b) of the Act specifies licensing requirements for the banks.
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iii. If the bank’s NPAs show an increasing trend and has incurred loss for the year under audit, no marks should be awarded for management parameter.

29.3 Parameters of Classification

Auditors have to give marks on following parameters while conducting audit exercise:

29.3.1 Capital Adequacy (Total Marks : 15)

i) Net worth as percentage to total assets

“Capital” indicates as a shock absorber or buffer in the times of crisis. Further adequate capital adequacy also boosts confidence of the depositors. It is therefore to be ensured as to whether the bank is augmenting its share capital by linking the same to the borrowers of bank. The networth which comprises capital plus free reserves should also be positive and it should be at least above 5% of total asset. Any erosion in networth will have bearing in reduction of marks in this category.

ii) Capital to Risk Weighted Assets (CRAR)

Ideally capital to risk asset ratio should be 9% or more and the bank should chalk out strategies to achieve this level. Since DCCBs are having their branch network only in particular District and also in view of the fact that such banks are financing loans mainly for on-lending purpose, they are having limited canvass to strengthen their capital base. Taking into consideration all such aspects, suitable care has been taken and CRAR in the range of 5% to 8% is rated as satisfactory performance. Any impairment in this regard will have impact in reduction in marks as stipulated in sub parameters.

29.3.2 Asset Quality (Total Marks : 15)

- Ascertain gross level of NPAs as a percentage to gross advances. The more is the percentage, lesser are the marks to be allotted.
- Examine demonstrated ability of the bank in reduction of NPAs by way of cash recovery, upgradation, arresting slippages etc.
- Whether provisions made in respect of NPAs are adequate as stipulated by NABARD or is there any understatement of provision.
- Whether IRAC norms are followed in letter and spirit.
- Whether impairment in the value of securities in advances account have been properly assessed.
29.3.3 Management (Total Marks : 10)

Degree of efficiency in respect of the management to be assessed with reference to leadership, top management, second line management, training requirements, recruitment policy, rotation of staff etc.

It is expected that the bank should constitute various committees such as Audit Committee, Investment Committee, Asset - Liability Management Committee, Recovery Committee etc., and their meetings are held periodically. Apart from this, meetings of Board of Directors should be held periodically and various issues are discussed in depth. Minutes of such meetings should be perused by auditors. It is pertinent to note that if increasing trend in NPAs is noticed, no marks should be allotted under management parameter.

Decision taken at Board level, policies decided in the Board meeting should be implemented by the top management such as Chief Executive Officer/General Manager and there should not be any laxity in this regard. The other tiers in the organisation should also be well groomed so that effective control and management of the policies of the Government, RBI, NABARD and also policies of the StCBs or DCCBs itself can be implemented in a smooth way.

29.3.4 Earnings (Total Marks : 8)

Profit is essence of business and as such concentration on strengthening bottom line hardly need any emphasis. Net interest margin ratio, non-interest income to non-interest expenses ratio, retained earnings to net profit etc., are to be carefully examined. Operating profit should be adequate to cover the various provisions required to be made. Net profit should be adequate for building up reserve apart from declaring dividend.

29.3.5 Liquidity and Funds Management (Total Marks: 20)

Factors to be considered under this parameter consist of:

- There should not be any default in maintenance of CRR/SLR.
- Installments in respect of borrowings should be timely repaid and there should not be any defaults.
- Cash being non-earning asset its management should be done properly. Maintenance of excess cash is drag in the profit. More thrust should be given to mobilise Current and Saving Account (CASA) deposits.
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- Various policies in respect of investment management, cash management, liquidity management, deposit development etc., should be documented and periodically reviewed.
- DICGC insurance cover should be availed at all times. There should not be any default in payment of premium.

29.3.6 Systems and Control (Total Marks: 20)

- Whether bank has put in place system of internal inspection, internal audit system, concurrent audit system. How effectively all these aspects are implemented.
- Whether loan policy in connection with pre disbursement, disbursement and post disbursement is prepared. Whether the same is reviewed/updated on periodical basis.
- Whether delay is observed in compiling and finalising Annual Closing Financial Statement.
- Housekeeping by way of balancing of books, reconciliation etc., should be well within control.
- Various risk matrix should be properly studied from the view point of risk management and proper system and procedure should be implemented to averse the risk.
- Efforts put in by the bank towards computerisation to be examined. The level of computerisation at the branches to be seen.

29.3.7 Compliance (Total Marks: 12)

- Whether compliance of audit report is undertaken timely and reviewed by the board within three months of the audit report. Irregularities pointed out in the audit report to be dealt with conclusively. Any delay in attending to audit report and its subsequent review by the Board should be noted and marks to be allotted as per sub parameter.
- As far as NABARD inspection report is concerned the same should be complied with within three months from the date of issue. The requirement about core compliance within 45 days should be adhered to. If any delay in this regard is observed marks to be allotted under this sub parameter to be reduced proportionately.
- MIS should be reviewed. How effectively internal as well as external
returns are submitted with specific reference to Off-Site Surveillance (OSS) and other statutory returns.

- Position of achievements of targets under MOU should be seen. Based on percentage of achievement marks to be allotted.

### 29.4 Communication

Auditors are required to communicate audit classification, along with working of marks to NABARD’s Regional Office.
Annexure 1
Draft Engagement Letter to be sent to the Appointing Authority of the Bank

The following letter is for use as a guide and will need to be varied according to individual requirements and circumstances relevant to the engagement.

To
___________ Bank
___________ Zone/ Region

Dear Sirs:

Re.: Engagement Letter

As you are aware, we have been appointed as _______Auditors to audit and report on the accounts of your ________ for the year ________.

We have accepted the appointment and confirm that the audit shall be carried out in accordance with the applicable legal provisions and the regulatory requirements, besides the applicable authoritative pronouncements of the Institute of Chartered Accountants of India with the objective of expressing an opinion on the Branch financial statements. For this purpose, we will perform sufficient tests to obtain reasonable assurance as to whether the information contained in the accounting records and other source data is reliable and sufficient as the basis of the preparation of the financial statements and whether the information is properly presented in the said statements.

We will conduct our audit in accordance with the auditing standards generally accepted in India and with the requirements of the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934 and the guidelines issued under the said Statutes from time to time. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

However, having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any
accounting and internal control system, there is an unavoidable risk that even some material misstatements of financial statements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.

In addition to our report on the financial statements, we expect to provide you with a separate letter concerning any material weaknesses in accounting and internal control systems which might come to our notice in the form of a Long Form Audit Report.

The responsibility for preparation of financial statements on a going concern basis is that of management. Management is also responsible for selection and consistent application of appropriate accounting policies, including implementation of applicable accounting standards along with proper explanation relating to any material departures from those accounting standards. The management is also responsible for making judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the entity at the end of the financial year and of the profit or loss of the entity for that period.

Responsibility of management also includes maintenance of adequate accounting records and internal controls for safeguarding of the assets of the branch and for the preventing and detecting fraud or other irregularities. As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

We also wish to invite your attention that our audit process is subject to 'Peer Review' under the Chartered Accountants Act, 1949. The reviewer may examine our working papers during the course of the peer review.

We look forward to full cooperation with your staff and we trust that they will make available to us whatever records; documentation and other information are requested in connection with our audit.

Please note that we shall commence the audit of your branch on __________ and we plan to complete the audit within __________.

We shall appreciate your full co-operation in all the matters discussed above.

For ABC & Co
Chartered Accountants

Dated at: __________
The _____ day of _____, ______

____________________
Partner
Annexure 2
Format of Balance Sheet and Profit & Loss Account

The Third Schedule to the Banking Regulation Act, 1949
(See Section 29)
FORM A
Form of Balance Sheet
Balance Sheet of _________ (here enter name of the bank) as on 31st March - (Year)
(000's omitted)

<table>
<thead>
<tr>
<th>Capital &amp; Liabilities</th>
<th>Schedule</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves &amp; Surplus</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other liabilities and provisions</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th>Schedule</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Balances with Reserve Bank of India</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balances with banks and money at call and short notice</td>
<td>7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances</td>
<td>9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Assets</td>
<td>11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contingent Liabilities</td>
<td>12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bills for Collection</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Schedule 1
**Capital**

<table>
<thead>
<tr>
<th></th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. For Nationalised Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital (Fully owned by Central Government)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>II. For Banks Incorporated Outside India</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head.) Amount of deposit kept with RBI under section 11 (2) of the Banking Regulation Act, 1949</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>I. For Other Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Authorised Capital (........shares of Rs....each)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issued Capital (......shares of Rs.....each)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subscribed Capital (......shares of Rs......each)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Called-up Capital (........shares of Rs... each)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Calls unpaid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add: Forfeited shares</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Schedule 2
Reserves & Surplus

<table>
<thead>
<tr>
<th></th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. <strong>Statutory Reserves</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening Balances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deductions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II. <strong>Capital Reserves</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening Balances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deductions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III. <strong>Share Premium</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening Balances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deductions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV. <strong>Revenue and Other Reserves</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening Balances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deductions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>V. <strong>Balance in Profit and Loss Account</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (I, II, III, IV and V)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Schedule 3
Deposits

<table>
<thead>
<tr>
<th></th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. I. <strong>Demand Deposits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) From banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) From others</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II. <strong>Savings Bank Deposits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>III. <strong>Term Deposits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) From banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) From others</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (I, II and III)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Annexures

B. (i) Deposits of branches in India
(ii) Deposits of branches outside India
Total

Schedule 4
Borrowings

<table>
<thead>
<tr>
<th>I. Borrowings in India</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Reserve Bank of India</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Other banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Other institutions and agencies</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

II Borrowings outside India

<table>
<thead>
<tr>
<th>Total (I &amp; II)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Secured borrowings included in I &amp; II above - Rs.</td>
<td></td>
</tr>
</tbody>
</table>

Schedule 5
Other Liabilities and Provisions

<table>
<thead>
<tr>
<th>(i) Bills payable</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(ii) Inter-office adjustments (net)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Interest accrued</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Others (including provisions)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Total | |
|-------| |
## Guidance Note on Audit of StCBs & DCCBs

### Schedule 6
**Cash and Balances with Reserve Bank of India**

<table>
<thead>
<tr>
<th></th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Cash in hand</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(including foreign currency notes)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>II. Balances with Reserve Bank of India</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) in Current Account</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) in Other Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (I &amp; II)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Schedule 7
**Balances with Banks and Money at Call & Short Notice**

<table>
<thead>
<tr>
<th></th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous Year)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. In India</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) Balances with banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) in current accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) in other deposit accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Money at call and short notice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) with banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) with other institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total (i &amp; ii)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>II. Outside India</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) in current accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) in other deposit accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Money at call and short notice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grand Total (I&amp;II)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Schedule 8

**Investments**

<table>
<thead>
<tr>
<th>I. Investments in India in</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Government securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Other approved securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Shares</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Debentures and bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(v) Subsidiaries and/or joint ventures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vi) Others (to be specified)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>II. Investments Outside India in</th>
<th>As on 31.3_ (current year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Government securities (including local authorities)</td>
<td></td>
</tr>
<tr>
<td>(ii) Subsidiaries and/or joint ventures abroad</td>
<td></td>
</tr>
<tr>
<td>(iii) Other investments (to be specified)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
</tr>
<tr>
<td>Grand Total (I &amp; II)</td>
<td></td>
</tr>
</tbody>
</table>

### Schedule 9

**Advances**

<table>
<thead>
<tr>
<th>A.</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Bills purchased and discounted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) Cash credits, overdrafts and loans repayable on demand</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Term loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B.</th>
<th>As on 31.3_ (current year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Secured by tangible assets</td>
<td></td>
</tr>
<tr>
<td>(ii) Covered by bank/Government guarantees</td>
<td></td>
</tr>
<tr>
<td>(iii) Unsecured</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
</tr>
</tbody>
</table>
**Guidance Note on Audit of StCBs & DCCBs**

<table>
<thead>
<tr>
<th>C.</th>
<th>I. Advances in India</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(i) Priority sectors</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Public sector</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(iii) Banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(iv) Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>II.</th>
<th>Advances outside India</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(i) Due from banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Due from others</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) Bills purchased and discounted</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) Syndicated loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(c) Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

|   | Grand Total (C.I. & C.II) |   |   |

**Schedule 10**

**Fixed Assets**

<table>
<thead>
<tr>
<th></th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I.</td>
<td><strong>Premises</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>At cost as on 31st March of the preceding year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Additions during the year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Deductions during the year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Depreciation to date</td>
<td></td>
</tr>
<tr>
<td>II.</td>
<td><strong>Other Fixed Assets</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(including furniture and fixtures)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>At cost as on 31st March of the preceding year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Additions during the year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Deductions during the year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Depreciation to date</td>
<td></td>
</tr>
<tr>
<td>Total (I &amp; II)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Schedule 11
**Other Assets**

<table>
<thead>
<tr>
<th>I.</th>
<th>Inter-office adjustments (net)</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>II.</td>
<td>Interest accrued</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III.</td>
<td>Tax paid in advance/tax deducted at source</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV.</td>
<td>Stationery and stamps</td>
<td></td>
<td></td>
</tr>
<tr>
<td>V.</td>
<td>Non-banking assets acquired in satisfaction of claims</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VI.</td>
<td>Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* In case there is any unadjusted balance of loss the same may be shown under this item with appropriate footnote.

### Schedule 12
**Contingent Liabilities**

<table>
<thead>
<tr>
<th>I.</th>
<th>Claims against the bank not acknowledged as debt</th>
<th>As on 31.3_ (current year)</th>
<th>As on 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>II.</td>
<td>Liability for partly paid investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III.</td>
<td>Liability on account of outstanding forward exchange contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV.</td>
<td>Guarantees given on behalf of constituents (a) In India (b) Outside India</td>
<td></td>
<td></td>
</tr>
<tr>
<td>V.</td>
<td>Acceptances, endorsements and other Obligations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VI.</td>
<td>Other items for which the bank is contingently liable</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# Guidance Note on Audit of StCBs & DCCBs

**Form 'B'**

**Form of Profit & Loss Account**

for the year ended 31st March____  
(000’s omitted)

<table>
<thead>
<tr>
<th>Schedule</th>
<th>Year ended 31.3__ (current year)</th>
<th>Year ended 31.3__ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest earned</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>Other income</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>II. Expenditure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expended</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Operating expenses</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>Provisions and contingencies</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>III. Profit/Loss</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net profit/loss (-) for the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit/loss (-) brought forward</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>IV. Appropriations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer to statutory reserves</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer to other reserves</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer to Government/ Proposed dividend</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance carried over to balance-sheet</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Schedule 13
#### Interest Earned

<table>
<thead>
<tr>
<th></th>
<th>Year ended 31.3_ (current year)</th>
<th>Year ended 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Interest/discount on advances/bills</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II. Income on investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III. Interest on balances with Reserve Bank of India and other inter-bank funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV. Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Schedule 14
#### Other Income

<table>
<thead>
<tr>
<th></th>
<th>Year ended 31.3_ (current year)</th>
<th>Year ended 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Commission, exchange and brokerage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II. Profit on sale of investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Loss on sale of investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III. Profit on revaluation of investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Loss on revaluation of investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV. Profit on sale of land, buildings and other assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Loss on sale of land, buildings and other assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>V. Profit on exchange transactions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Loss on exchange transactions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VI. Income earned by way of dividends etc. from subsidiaries, companies and/or joint ventures abroad/in India</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VII. Miscellaneous income</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Under items II to V, loss figures may be shown in brackets.
## Guidance Note on Audit of StCBs & DCCBs

### Schedule 15
**Interest Expended**

<table>
<thead>
<tr>
<th></th>
<th>Year ended 31.3_ (current year)</th>
<th>Year ended 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Interest on deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II. Interest on Reserve Bank of India/interbank borrowings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III. Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Schedule 16
**Operating Expenses**

<table>
<thead>
<tr>
<th></th>
<th>Year ended 31.3_ (current year)</th>
<th>Year ended 31.3_ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Payments to and provisions for employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>II Rent, taxes and lighting</td>
<td></td>
<td></td>
</tr>
<tr>
<td>III Printing and stationery</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV Advertisement and publicity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>V Depreciation on bank's property</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VI Directors' fees, allowances and expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VII Auditors' fees and expenses (including branch auditors' fees and expenses)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VIII Law charges</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IX Postage, telegrams, telephones, etc.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>X Repairs and maintenance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>XI Insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>XII Other expenditure</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Annexures

Annexure 3

Model Audit Report

STATUTORY AUDITORS REPORT FORMAT

(Under Section 31 of the Banking Regulation Act, 1949 (as applicable))

We have audited the attached Balance Sheet of ___________________, as at 31st March, 2XXX and the Profit and Loss Account for the year ended on that date, incorporating the returns of Branches and Head Office. These financial statements are the responsibility of the Bank’s management. Our responsibility is to express an opinion on these Financial Statements based on our audit.

We have conducted our audit in accordance with Auditing Standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates by the Management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

On the basis of audit procedure indicated above and as required by Section 31 of the Banking Regulation Act, 1949 (as applicable to State and District Central Co-Operative Banks) we report that:-

a) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit and have found them to be satisfactory.

b) The transactions of the bank which have come to our notice have been within the competence of the bank.

c) In our opinion, proper books of account as required by Law have been kept by the bank so far, as appears from our examination of those books and proper returns adequate for the purpose of our audit have been received from the branches of the bank.

d) The Balance Sheet and Profit & Loss Account dealt with by this report are in agreement with the books of account and are drawn up in conformity with the law.

e) Certain items of Income & Expenditure as stated in the para 'III (ii)' of the significant accounting policies are accounted on cash basis as
Guidance Note on Audit of StCBs & DCCBs

against accrual basis specified under Accounting Standard – 9 on
‘Revenue Recognition’ issued by ‘The Institute of Chartered
accountants of India’.

In our opinion and to the best of our information and according to the
explanation given to us, the said Accounts Subject to para ‘e’ above and
subject to Significant Accounting Policies and Notes on Accounts forming
part of accounts and our comments and observations contained in Audit
Memorandum, in conformity with the accounting principles generally
accepted in India, give a true and fair view:-

i) In the cases of the Balance Sheet of the state of affairs of the bank
as at 31st March, 2XXX and

ii) In the cases of the Profit & Loss Account of the profit of the bank for
the year ended 31st March, 2XXX.

For XYZ & Co.
Chartered Accountants

Partner

Place:

Date:
Annexure 4
Asset Classification and Provisioning
Statement as on the date of Audit

(For the year ended 31st March ______)

A. Loans and Advances

(Rs. in lakhs)

<table>
<thead>
<tr>
<th>CATEGORY OF CREDIT FACILITY</th>
<th>ST SAO</th>
<th>ST OSAO</th>
<th>CC &amp; OD</th>
<th>Bills</th>
<th>Term Loans</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Amount Outstanding</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>II. Asset Classification</td>
<td></td>
<td></td>
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<tr>
<td>1. Standard</td>
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<tr>
<td>(a) Agriculture &amp; SME</td>
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<tr>
<td>(b) Others</td>
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<tr>
<td>2. Sub standard</td>
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<td>3. Doubtful</td>
<td></td>
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<tr>
<td>(i) Secured loans</td>
<td></td>
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<tr>
<td>(a) D1</td>
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<tr>
<td>(b) D2</td>
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<tr>
<td>(c) D3</td>
<td></td>
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<tr>
<td>(ii) Unsecured loans</td>
<td></td>
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<tr>
<td>4. Loss assets</td>
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</tr>
<tr>
<td>5. Total NPA (2+3+4)</td>
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</tr>
<tr>
<td>III. Provisioning required</td>
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<tr>
<td>1. Standard assets</td>
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<tr>
<td>(a) Agriculture &amp; SME</td>
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<tr>
<td>(b) Others</td>
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</tr>
</tbody>
</table>
### Guidance Note on Audit of StCBs & DCCBs

2. Sub-standard assets

3. Doubtful assets
   (i) Secured portion
      a) D1
      b) D2
      c) D3
   (ii) Unsecured loan

4. Loss assets

<table>
<thead>
<tr>
<th>IV. Total provision required to be made</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1+2+3+4)</td>
</tr>
<tr>
<td>(a) Bank's assessment</td>
</tr>
<tr>
<td>(b) Auditor's assessment</td>
</tr>
</tbody>
</table>

| V. Provision actually made (excluding Standard Asset Provision) |

| VI. Difference (IV-V) |

| B. Income Recognition |

| (i) Total interest/dividend on loans and advances and investments taken to P & L A/c |

| (ii) Of item (i) above, interest accrued but not due |

| (iii) Of item (i) above, overdue interest accrued and not realised. |

| (iv) Other income taken to P & L |

| 296 |
Annexures

<table>
<thead>
<tr>
<th>Account but not realised.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(v) Provision required to be made for overdue interest and other income taken to P &amp; L Account</td>
<td></td>
</tr>
<tr>
<td>(vi) Provision for overdue interest and other income actually made.</td>
<td></td>
</tr>
</tbody>
</table>

C. Other Assets/ Liabilities

(Rs. in Lakhs)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Depreciation on investments</td>
<td>Required</td>
</tr>
<tr>
<td>(a) Govt. securities/ bonds, etc.</td>
<td></td>
</tr>
<tr>
<td>(b) Share in other co-operative institutions</td>
<td></td>
</tr>
<tr>
<td>(c) Other investments - shares, etc.</td>
<td></td>
</tr>
<tr>
<td>(d) Repo sold</td>
<td></td>
</tr>
<tr>
<td>Total of (i)</td>
<td></td>
</tr>
<tr>
<td>(ii) Frauds, embezzlements, etc.</td>
<td></td>
</tr>
<tr>
<td>(iii) PF, Gratuity, etc.</td>
<td></td>
</tr>
<tr>
<td>(iv) Other liabilities like rent, rates, taxes, etc.</td>
<td></td>
</tr>
<tr>
<td>(v) Contingent/ off-balance sheet exposures</td>
<td></td>
</tr>
<tr>
<td>(vi) Interest on deposits and borrowings outstanding as liability</td>
<td></td>
</tr>
<tr>
<td>(vii) Depreciation on other assets like land, building, furniture, fixtures, etc.</td>
<td></td>
</tr>
<tr>
<td>Grand total</td>
<td></td>
</tr>
<tr>
<td>(i) Total provision required to be made in Balance Sheet</td>
<td></td>
</tr>
<tr>
<td>(ii) Actually made</td>
<td></td>
</tr>
<tr>
<td>(iii) Deficit (-)/ Surplus (+)</td>
<td></td>
</tr>
</tbody>
</table>
Annexure 5
Format of Significant Accounting Policies
and Notes on Accounts

NOTES FORMING PART OF THE BALANCE SHEET AS AT 31ST MARCH
_______ AND PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED
MARCH _______

<table>
<thead>
<tr>
<th>A)</th>
<th>SIGNIFICANT ACCOUNTING POLICIES :</th>
</tr>
</thead>
<tbody>
<tr>
<td>1)</td>
<td>ACCOUNTING CONVENTION :</td>
</tr>
<tr>
<td></td>
<td>The financial statements are prepared and presented under the historical cost convention on going concern basis following the accrual concept of accounting, unless otherwise stated. The financial statements comply with generally accepted accounting principles, statutory requirements prescribed under the Banking Regulation Act, 1949, circulars and guidelines issued by the Reserve Bank of India (RBI) from time to time, Accounting Standards (AS) issued by the Institute of Chartered Accountants of India (ICAI) and current practices prevailing within the banking industry in India.</td>
</tr>
<tr>
<td>2)</td>
<td>USE OF ESTIMATES :</td>
</tr>
<tr>
<td></td>
<td>The preparation of the financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from those estimates. Management believes that the estimates used in the preparation of the financial statements are prudent and reasonable.</td>
</tr>
<tr>
<td>3)</td>
<td>INVESTMENTS :</td>
</tr>
<tr>
<td></td>
<td>(a) Classification :</td>
</tr>
<tr>
<td></td>
<td>For the purpose of disclosure in the Balance Sheet, Investments are classified under four groups as required under RBI guidelines – Government Securities, Other Approved Securities, Shares with Co-operative Institutions and Other Investments.</td>
</tr>
<tr>
<td></td>
<td>(b) Valuation:</td>
</tr>
<tr>
<td></td>
<td>i. Investments are carried at their acquisition cost.</td>
</tr>
</tbody>
</table>
ii. Any premium on acquisition of investment is mortised over the balance period to maturity.

iii. Interest accrued up to the date of acquisition of securities (i.e. broken period interest) is excluded from the acquisition cost and debited to interest on investments income.

iv. Brokerage, Commission, CCIL charges etc. pertaining to investments paid at the time of acquisition are charged as expenditure.

v. Upfront incentives received on subscription to securities are recognized as income.

vi. Diminution other than temporary, if any, in the value of other investments is provided for by debiting Profit & Loss Account reducing the value of Investments. Diminution, if any, in the value of Government Securities & other approved securities is not accounted for.

vii. Units of mutual funds are valued at the lower of cost and net asset value provided by the respective mutual funds.

viii. Appreciation in the value of investments except to the extent of cost price, where there has been a diminution earlier, is not accounted for.

(c) Profit/Loss on Sale:

i. Profit in respect of investments sold is included in profit & loss account as profit on sale of investments.

ii. Loss, if any, on sale of investments is charged to profit & loss account as loss on sale of investments.

4) ADVANCES:

(a) Advances are classified into Standard, Sub-Standard, Doubtful and Loss Assets and provisions are made in accordance with the prudential norm prescribed by RBI. In addition, general provisions on standard assets are made at _____% of the outstanding amount on a portfolio basis except in the case of direct advance to agricultural and SME sector which are at ____%.

(b) The overdue interest in respect of non-performing advances is derecognized and is provided separately under “Overdue Interest Reserve” as per the directives issued by RBI/NABARD.

5) FIXED ASSETS & DEPRECIATION:

(a) Fixed assets are carried at historical cost less accumulated
Depreciation. Cost includes incidental expenses incurred on acquisition of assets.

(b) Depreciation on Fixed Assets purchased during the year is charged for the full year if the asset is purchased on or before 30th September, otherwise it is charged at 50% of the normal rate. No depreciation is charged on fixed assets sold during the year.

(c) Depreciation on Furniture & Fixture, Plant & Machinery, Building and Books & Periodicals are provided as per W.D.V. method. Whereas, depreciation on Computers and Motor Cars/Vehicles is provided as per Straight line method. Depreciation on Fixed Assets are provided at the following rates:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Furniture &amp; Fixture</td>
<td></td>
</tr>
<tr>
<td>b. Plant &amp; Machinery</td>
<td></td>
</tr>
<tr>
<td>c. Building</td>
<td></td>
</tr>
<tr>
<td>d. Books and Periodicals</td>
<td></td>
</tr>
<tr>
<td>e. Motor cars/ Vehicle</td>
<td></td>
</tr>
<tr>
<td>f. Computers</td>
<td></td>
</tr>
</tbody>
</table>

(d) Capital work-in-progress are stated at cost incurred during construction, installation etc. relating to assets in progress.

6) RECOGNITION OF INCOME/EXPENDITURE:

(a) Items of Income & Expenditure are recognized on an accrual basis except for leave encashment, gratuity & other retirement benefits which are being accounted for on cash basis.

(b) Income from non-performing assets are recognized to the extent realized, as per the directives issued by RBI.

(c) Interest on Government Securities, Debentures and other fixed income securities are recognized on accrual basis. Income on discounted instruments is recognized over the tenor of the instrument.

(d) Dividend income is accounted on accrual basis when the right to receive payment is established.

7) EMPLOYEE BENEFITS:

(a) The bank contributes to Provident Fund which is administered by a duly constituted and approved independent trust.
<table>
<thead>
<tr>
<th>Annexures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution to Provident Fund is accounted on accrual basis with corresponding contribution to recognized fund.</td>
</tr>
<tr>
<td>(b) Bank’s contributions to Pension Fund are accounted for on the basis of contribution to the Fund.</td>
</tr>
<tr>
<td>(c) The bank contributes to Approved Gratuity Scheme administered by independent trustees and the bank’s contribution to the scheme as well as the amount of gratuity paid to employees in excess of the amount receivable from LIC as per the scheme are accounted for as gratuity expenses.</td>
</tr>
<tr>
<td>(d) Leave encashment paid to employees as per bank’s policy are accounted for on cash basis.</td>
</tr>
<tr>
<td>(e) No actuarial valuation of the liability towards employee benefits such as Gratuity, Leave Encashment, Staff Pension etc. are done.</td>
</tr>
</tbody>
</table>

8) **PROVISIONS:**

A provision is recognized when the bank has a present obligation as a result of past event where it is probable that an outflow of resources will be required to settle the obligation, in respect of which a reliable estimate can be made. Provisions are not discounted to its present value and are determined based on best estimate required to settle the obligation at the balance sheet date. These are reviewed at each balance sheet date and adjusted to reflect the current best estimates.

9) **TAXATION:**

Tax expenses comprise of Income Tax. Income Tax is provided for in accordance with the applicable provisions of the Income Tax Act, 1961 and Rules framed there under.

10) **CONTINGENT LIABILITIES AND ASSETS:**

Contingent Liabilities are not recognised as expenditure. These are, however, disclosed by way of Notes.

A disclosure of contingent liability is made when there is :

i. A possible obligation arising from a past event, the existence of which will be confirmed by occurrence or non-occurrence of one or more uncertain future events not within the control of the bank; or

ii. A present obligation arising from a past event which is not recognized as it is not probable that an outflow of resources will be required to settle the obligation or a reliable estimate of the amount of the obligation cannot be made.

Contingent assets are not recognized in the financial statements.
Guidance Note on Audit of StCBs & DCCBs

11) EARNING PER SHARE:

Earning per share (EPS) reported is computed by dividing net profit after tax by the weighted average number of equity shares outstanding for the year.

B. NOTES ON ACCOUNTS:

1) Share Suspense of_______ relates to partial amounts collected against Share Capital due to increase in the nominal value of each share from____ to____ or for other reasons.

2) Borrowings from other sources represent the borrowing made from National Schedule Tribe Finance & Development Corporation and National Handicapped Finance and Development Corporation.

3) Provision for Non Performing Assets of_______ includes provision of_______ made for debit balances in Deposit accounts.

4) Earmarked Investments represent amount invested with SBI Life Insurance Company Ltd. to meet future Leave Encashment payment obligations.

5) Out of total Advances of_______ Lacs, total NPA is/_______ Lacs consisting of Short Term, Medium Term & Long Term NPA of_______ Lacs,_______ Lacs &_______ Lacs respectively.

6) Gross NPA of the bank has gone down from____ % to____%. However, Net NPA has gone up from____ % to____ % of total advances and total NPA has increased by____ % from____ lakhs to____ lakhs.

7) As per the guidelines of RBI, provision on standard assets is required to be made at____ % of the outstanding amount on a portfolio basis except in the case of direct advance to agricultural and SME sector which should be provided for at____%. No additional provision has been made during the year, as the accumulated provision as at 31st March,____ exceeds the provision required to made as per above guidelines.

8) Amounts “considered to be bad and doubtful of recovery” (as shown in the Schedule____ “Advances” of the Balance Sheet) reflects the total amount of loss assets and doubtful assets as per prudential norms issued by RBI.

9) Income Tax Suspense of_______ includes_______ relating to Financial Year_______ and/_______ relating to the financial year_______.
10) Gratuity expenditure includes ____ crores paid to________ Co-Operative Bank Employees’ Group Gratuity Scheme.

11) Insurance expenditure includes Deposit Insurance Premium of ₹ ________ paid to Deposit Insurance & Credit Guarantee Corporation.

12) Provident Fund Trust loss amounting to/________ reflects loss incurred by independent Provident Fund Trust which has been borne by the bank. Loss has been incurred by the trust due to excess provision of interest payable over the income earned by the trust.

13) Loss on Impairment of Fixed Assets amounting to/_______ represents depletion in value of Fixed Assets of Secretariat Branch.

14) Prior Period Expenses aggregating to रु ________ (₹ __________ relating to Professional Fees and ₹ __________ relating to Rates & Taxes) have been debited to the Profit & Loss A/c during the year.

15) During the year RBI has not imposed any penalty/fine on the bank. However, Income Tax Department has imposed penalty of ________ during the year.

16) The bank has Contingent liabilities of ________ relating to Suspended Staff as on 31.03._____.

17) The bank is a Co-operative Society, registered under the Co-operative Society Act, 1949 and there are no related parties requiring a disclosure under Accounting standard - 18 issued by the Institute of Chartered Accountants of India, other than one Key Managerial Personnel, viz __________, Chief Executive Officer of the Bank. However, in terms of RBI circular dated 29.03.03, he being single party coming under the category, no further details need to be disclosed.

18) Calculation of Basic E.P.S. & Diluted E.P.S.

<table>
<thead>
<tr>
<th>PARTICULARS</th>
<th>As on 31.03._ (current year)</th>
<th>As on 31.03._ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Net Profit after tax (₹)</td>
<td></td>
<td></td>
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<tr>
<td>b) Weighted Average number of Equity Shares</td>
<td></td>
<td></td>
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<tr>
<td>c) Earning Per Share (a/b)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

19) Following additional disclosures are made:

(₹ in Lakhs)
### Guidance Note on Audit of StCBs & DCCBs

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Particulars</th>
<th>As on 31.03.__ (current year)</th>
<th>As on 31.03._ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A Capital to Risk Assets Ratio (CRAR)</td>
<td></td>
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<tr>
<td></td>
<td>(i) Total Capital Funds</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>(ii) Risk Weighted Assets</td>
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<td></td>
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<tr>
<td></td>
<td>(iii) CRAR</td>
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<tr>
<td></td>
<td>B Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) Book Value</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Face Value</td>
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<td></td>
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<td></td>
<td>(iii) Market Value</td>
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<tr>
<td></td>
<td>C Advances against</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>(i) Real Estate</td>
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<tr>
<td></td>
<td>(ii) Construction business</td>
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<td></td>
<td>(iii) Housing</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>D Advances against shares &amp; debentures</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>E Advances to directors, their relatives, companies/firms in which they are interested:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) Fund based</td>
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<tr>
<td></td>
<td>(ii) Non-Fund based</td>
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<td></td>
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<tr>
<td></td>
<td>F Average cost of deposits</td>
<td></td>
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<tr>
<td></td>
<td>G NPAs</td>
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<tr>
<td></td>
<td>(i) Gross NPAs</td>
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</tr>
<tr>
<td></td>
<td>(ii) Net NPAs</td>
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<tr>
<td></td>
<td>H Movement in NPAs</td>
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</tr>
<tr>
<td></td>
<td>(i) Gross NPAs</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Opening Balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Add : Additions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less : Reduction during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Closing Balances</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Net NPAs</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Opening Balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Add : Addition during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less : Reduction during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Closing Balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>I Profitability : (Annualized basis)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Annexures

(i) Interest income as a percentage of working funds
(ii) Non-interest income as a percentage of working funds
(iii) Operating profit as a percentage of working funds
(iv) Return on average Assets
(v) Business (Deposits + Advances) per employee
(vi) Operating profit per employee

J Provisions made towards
(i) NPAs
(ii) Depreciation in investments towards revaluation

K Movement in Provisions
(i) Towards NPAs
   Opening Balance
   Add : Additions during the year
   Less : Reduction during the year
   Closing Balance
(ii) Towards Standard Assets
   Opening Balance
   Add : Additions during the year
   Less : Reduction during the year
   Closing Balance

L (i) In connection with Repo/ Reverse Repo transactions (० in Lakhs)

<table>
<thead>
<tr>
<th>No.</th>
<th>Particulars</th>
<th>Minimum outstanding during the year</th>
<th>Maximum outstanding during the year</th>
<th>Daily average outstanding during the year</th>
<th>As on 31.03.____</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Security sold under repos</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Guidance Note on Audit of StCBs & DCCBs

2. Securities purchased under reverse repos

*(Figures in brackets represent previous year’s figures.*

(ii) Issuer composition of Non-SLR Investments

<table>
<thead>
<tr>
<th>No.</th>
<th>Issuer</th>
<th>Amount (in Lakhs)</th>
<th>Extent of private placement</th>
<th>Extent of ‘below investment grade’ Securities</th>
<th>Extent of ‘unrated’ securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>P S Us (NABARD/IDBI)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>FIs (IFCI)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Public Sector Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Mutual Funds</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Others – (SBI Life Insurance, HDFC Bank/ ICICI Bank)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*(Figures in brackets represent previous year’s figures.*

(iii) Non – Performing Non - SLR Investments:

(₹ in Lakhs)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>As on 31.03._ (current year)</th>
<th>As on 31.03._ (previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add: Addition during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Reductions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total provisions held</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Annexures

20) Previous year’s figures are regrouped or rearranged, wherever necessary to conform to the layout of the accounts of the current year.

FOR XYZ & ASSOCIATES
CHARTERED ACCOUNTANTS

PLACE : _______________
DATE : _______________

(CA. ABC)

PARTNER
MRN. ______
FRN. ______
Annexure 6
LFAR (Long Form Audit Report) Format

The following paragraphs list the matters, which the branch auditors of banks are expected to comment upon in their LFAR. The list is illustrative and not exhaustive.

I. Assets

1. Cash

Cash balances at branches and whether the same exceeded the limits fixed by H.O significantly. Does the branch hold adequate insurance cover for cash and cash in transit.

Is cash maintained in effective joint custody of two or more officials, as per instructions of the Head Office? Have the authorised officials of the bank checked the cash balances at the branch at periodic intervals.

2. Balances with Banks

a) Were balance confirmation certificates obtained in respect of outstanding balances as at the year-end and whether the aforesaid balances have been reconciled? If not, the nature and extent of differences be reported.

b) Observations on the reconciliation statements may be reported in the following manner.

   i) Cash transactions remaining unresponded (give details);
   
   ii) Revenue items requiring adjustment/write-off (give details);
   
   iii) Old outstanding balances remaining unexplained/unadjusted for over one year (give year-wise details).

   c) In case, any item deserves special attention of the management, the same may be reported.

3. Investments

Has the branch kept money at call and short notice or purchased/sold investments during the year? If so, whether instructions/guidelines, if any, laid down by Head Office/Controlling Authority have been complied with? Whether the securities held in the books of the branch are physically held by it.
Annexures

4. Advances

(The answers to the following questions may be based on the auditor's examination of all large advances and a test check of other advances. In respect of large advances, all cases of major adverse features, deficiencies, etc., should be reported. In respect of other advances, the auditor may comment upon the relevant aspects generally, along with instances of situations giving rise to his reservations or adverse remarks. For purposes of the above, large advances are those in respect of which the outstanding is in excess of 1% of the aggregate advances of the branch or Rs. 1 lakh, whichever is less).

a) Credit Appraisal

(i) Whether in any cases the branch has not obtained loan applications in appropriate forms prescribed by the Head office during the year.

(ii) Has the branch complied with the procedures/instructions of Head Office regarding preparation of proposals for grant/ renewal of advances, enhancement of limits, etc.

(iii) What are the major shortcomings in credit appraisals.

b) Sanctioning/Disbursement

i) Any cases of credit facilities having been sanctioned beyond the delegated authority or limit of the branch? Are such cases reported to higher authorities.

ii) Whether disbursements made under credit limits without complying with the terms and conditions of the sanction.

c) Documentation

i. Whether credit facilities were released by the branch without execution of all the necessary documents? If so, give details of such cases.

ii. Whether deficiencies in documentation, value of security and inspection thereof or any other adverse features such as frequent/ unauthorized overdrawing beyond limits, inadequate insurance coverage, non-registration of charge, etc. were noticed.

d) Review/Monitoring/Supervision

(i) Whether the branch followed the procedure laid down by the Head Office for periodic review of advances including periodic balance confirmation/acknowledgement of debts.
Guidance Note on Audit of StCBs & DCCBs

(ii) Method of charging interest in respect of agricultural advances—whether interest is capitalised and if so, at what periodicity.

(iii) Are the stock/book debt statements and other periodic operational data and financial statements, etc., received regularly from the borrowers and duly scrutinized? Is suitable action taken on the basis of such scrutiny in appropriate cases.

(iv) Indicate the cases of advances to non-corporate entities with limits beyond Rs.10 lakh where the Reserve Bank of India guidelines with regard to compulsory audit have not been complied with.

(v) Has the inspection or physical verification of security charged to the Bank been carried out by the branch as per the procedure laid down by the Head office? Whether securities and documents have been received and properly charged/registered.

(vi) Has the branch identified and classified advances into Standard/Sub-standard/Doubtful/Loss Assets in line with the norms prescribed by RBI/NABARD? (The auditor may refer to the relevant Head Office instructions for identification of nonperforming assets and classification of advances).

If disagreed with the branch classification, give details of such advances with reasons.

(vii) Whether cases where the Board or Controlling Authority has authorised legal action for recovery of advances or discontinuance of application of interest on doubtful advances or recalling of advances but no such action was taken by the branch were noticed.

(viii) Have all irregular, sticky/sick advances been reported to the Controlling Authority promptly? Also state whether any rehabilitation programme in respect of such advances has been undertaken, and if so, the status of such programme.

(ix) Are appropriate claims for insurance and subsidies, if any, duly lodged and settled? If not, indicate the number of cases and the amounts involved. Also check whether the branch has credited the amounts to the concerned.

(x) Check whether the letters of credit issued by the branch are within the delegated power and whether they are for genuine trade transactions.
(xi) Check the bank guarantees issued, whether the same have been properly recorded in the register of the bank. Whether they have been promptly renewed on the due dates.

(xii) List the major deficiencies in credit supervision.

5. Other Assets

a) Stationery and Stamps

Does the system of the bank ensure adequate internal control over issue and custody of stationery comprising of security items (Term Deposit Receipts, Drafts, Pay Orders, Cheque Books, Traveller’s Cheques, Gift Cheques, etc.).

b) Suspense Accounts/Sundry Assets and Other Items

(i) Does the system of the bank ensure expeditious clearance of items debited to Suspense Account? Details of old outstanding entries and the reasons for delay in adjusting the entries may be ascertained.

(ii) Does the scrutiny of the accounts under various sub-heads reveal balances; which are not recoverable in the opinion of auditor and would require a provision/write-off? If so, give details thereof.

(iii) Does your test check indicate any unusual items in these accounts? If so, report their nature and the amounts involved.

II. Liabilities

1. Deposits

i) Check the transactions about deposits received and repaid.

ii) Percentage check of interest paid on deposits, including calculation of interest on large deposits. Also check the deposits made by PACS and calculation of interest thereon.

iii) Whether the procedures connected with the opening of new accounts have been followed as per RBI instructions.

2. Bills Payable, Sundry Deposits, etc.

(i) The number of items and the aggregate amount of old outstanding items pending for three years or more may be obtained and reported under appropriate heads. Does the scrutiny of the accounts under various sub-heads reveal old balances? If so, give details thereof.

(ii) Does test check indicate any unusual items in these accounts? If so, report their nature and the amounts involved.
Guidance Note on Audit of StCBs & DCCBs

(iii) Check cheques returned/bills returned register and look into reasons for return of those instruments. Checking of inward and outward remittances (DDs. MTs and TTs).

iv) Verify cheques purchased/discounted beyond the sanctioned limit on a sample basis.

III. Foreign Exchange Transactions

Foreign bills negotiated under Letters of Credit (LCs), Foreign Currency Non-Residential Account (FCNR) and other non-resident accounts, whether the debits and credits are permissible under the rules, whether inward/outward remittance have been properly accounted for. Ensure adherence to the guidelines issued by RBI regarding the above operations, statements to be submitted, etc.

IV. Profit and Loss Account

i. Has the test-checking of interest revealed excess/short credit of material amount? If so, give details thereof.

ii. Has the branch complied with the Income Recognition norms prescribed by RBI? (The auditor may refer to the Head Office instructions regarding charging of interest on non-performing assets).

iii. Has the test check of interest on deposits revealed any material discrepancies.

iv. Are there any divergent trends in major items of income and expenditure, which are not satisfactorily explained by the branch? If so, the same may be reported. For this purpose, an appropriate statement may be obtained from the branch manager explaining the divergent trends in major items of income and expenditure.

v. Indicate the effect of changes, if any, in accounting policies on the items of income and expenditure. (The auditor may refer to the instructions of the Head Office regarding changes in accounting policies).

V. Internal Controls

1. Books and Records

a) Does general scrutiny of the books of accounts indicate whether the same have been properly maintained, with balances duly inked out and authenticated by the authorized signatories.
b) Indicate the position relating to balancing of the books examined—
maintenance and balancing of accounts, ledgers and registers
including Clean Cash and General Ledger.

2. Reconciliation of Control and Subsidiary Records

Have the figures of the control and subsidiary records been reconciled as at
the year–end. If not, the last date up to which such figures have been
reconciled should be given under the respective heads, preferably in the
following proforma:

Head of Account Balance as at 31.3…. (specify date)
Reconciled upto
As per General Ledger
As per Subsidiary Ledger

3. Inter-branch Accounts

a) Indicate the date up to which reconciliation in various accounts
pertaining to inter branch transactions (e.g. Demand Drafts paid/
payable) is available with the branch. A year-wise break-up of
outstanding entries in the inter–branch accounts, together with a
statement of the reason for their remaining outstanding and the steps
being taken by the management in respect thereof, should be
obtained from the management and reported in the following format:

<table>
<thead>
<tr>
<th>Year</th>
<th>No.</th>
<th>Debits Amount (Rs.)</th>
<th>Credits Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of entries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of entries</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Statement of reasons: Statement of steps being taken by the
management:

b) Does your test check indicate any unusual entries put through inter-
branch/ Head Office accounts? If so, report their nature and the
amounts involved.

c) Are long outstanding items of high value identified regularly and
action taken thereon.
Guidance Note on Audit of StCBs & DCCBs

d) Reconciliation of entries outstanding in the inter-branch and inter-
bank accounts, Suspense Accounts, Sundry Deposits Account, Drafts
Accounts, etc.

4. Frauds
Furnish particulars of frauds discovered during the year under audit at the
branch, modus operandi together with your suggestions, if any, to minimise
their recurrence.

5. Previous Inspection/Audit Reports
In framing the audit report, whether the major adverse comments arising out
of the latest reports of the previous auditors, concurrent auditors or internal
auditors/inspections, or in inspection report of NABARD have been
considered? State various adverse features persisting in the branch though
brought out in these audit/inspection reports.

VI. Miscellaneous

a) Does the examination of the accounts indicate possible window
dressing.

b) Comment on clearing operations.

c) Details of off-balance sheet transactions and whether they are
properly followed by all branches. Also comment on non-fund based
business undertaken by branch.

d) Supervision arrangement- extent of supervision of PACS by the
branch.

e) Are there any other matters, which could be brought to the notice of
the management or the central statutory auditors.

f) Auditors may themselves identify problem areas at branch level/bank
and offer their suggestions to overcome them.
### Annexure 7

**Audit Classification Scale for StCBs and DCCBs**

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Parameter</th>
<th>Existing Classification Scale for StCBs &amp; DCCBs</th>
<th>Audit Classification Scale for StCBs &amp; DCCBs</th>
<th>Revision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Capital Adequacy</td>
<td>15 (i)10</td>
<td>15 (i)10</td>
<td>No change</td>
</tr>
<tr>
<td></td>
<td>(i) Networth as percentage to total assets</td>
<td>10</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt;5%</td>
<td>8</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt; 4% to 5%</td>
<td>5</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt; 2% to 4%</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt; 0,25% to 2%</td>
<td>Nil</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less than 0.25%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Capital to Risk-weighted Assets</td>
<td>(ii) 5</td>
<td>(ii) 5</td>
<td>No change</td>
</tr>
<tr>
<td></td>
<td>8% and above</td>
<td>5</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5% to &lt; 8%</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2% to &lt;5%</td>
<td>2</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less than 2%, but positive</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Negative</td>
<td>Nil</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Asset Quality</td>
<td>15 (i)10</td>
<td>15 (i)10</td>
<td>No change</td>
</tr>
<tr>
<td></td>
<td>(i) Level of NPA (Gross NPA as % to total loans &amp; advances outstanding)</td>
<td>10</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Upto 5%</td>
<td>8</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt;5% to 10%</td>
<td>6</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt; 10% to 15%</td>
<td>4</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt; 15% to 20%</td>
<td>Nil</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td></td>
<td>&gt; 20%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Percentage of provisions made to provisions required to be made</td>
<td>(ii) 5</td>
<td>(ii) 5</td>
<td>No change</td>
</tr>
<tr>
<td>Percentage</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>------------</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>100%</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>76% to 99%</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>51% to 75%</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>25% to 50%</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Less than 25%</td>
<td>5</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Section</th>
<th>Marks to be awarded depending on the degree of efficiency under each</th>
<th>(i)</th>
<th>(ii)</th>
<th>(iii)</th>
<th>No change</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Management</td>
<td>10</td>
<td>10</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) Leadership</td>
<td>(i) 2</td>
<td>(i) 2</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Elected Board, Committees including Audit Committee, in position and work like professionals for development of the bank. Regular holding of meetings and reviews of issues like deposit mobilisation recovery performance, investments, audit report, NABARD, Inspection Report and review of compliance, etc. by the Board. If the elected Board does not exist the auditor will have to assess the performance of the administrator.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Top Management</td>
<td>(ii) 1</td>
<td>(ii) 1</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CEO/GM in place and well versed with the working of the bank.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Efficient and effective to implement the policies of the bank which are in conformity with the guidelines of GoI/RBI/NABARD.</td>
<td>(iii) 2</td>
<td>(iii) 2</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(iii) 2nd Line of Management</td>
<td>(iii) 2</td>
<td>(iii) 2</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. Exists well groomed team with succession planning</td>
<td>a.2</td>
<td>a.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annexures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-----------</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>b. One or two groomed but inadequate succession planning</strong></td>
<td>b.1</td>
<td>b.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(iv) Organisation and Job Descriptions</strong></td>
<td>(iv) 1</td>
<td>(iv) 1</td>
<td>No change</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full marks if training policy/plan with definite scientific training requirement and long term strategies.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(v) Recruitment Policy</strong></td>
<td>(v) 1</td>
<td>(v) 1</td>
<td>No change</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Well defined policy with no violation in implementation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(vi) Training</strong></td>
<td>(vi) 2</td>
<td>(vi) 2</td>
<td>No change</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full marks if training policy/plan with definite scientific training requirement and long term strategies (Else 1.5 or 1 or 0.5 or nil at the discretion of the auditor)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(vii) Rotation of Staff</strong></td>
<td>(vii) 1</td>
<td>(vii) 1</td>
<td>No change</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Periodical rotation of job is done for all staff as per policy.</td>
<td>a. 1</td>
<td>a. 1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Periodical rotation of job is done for a few staff members but without any policy</td>
<td>b. 0.5</td>
<td>b. 0.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Ad hoc/No rotation</td>
<td>c. Nil</td>
<td>c. Nil</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Earnings</strong></td>
<td>10</td>
<td>10</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(i) Operating Profit</strong> (Interest income on loans &amp; advances and investments + other operating income) minus (interest expenses on deposits and borrowings+ staff cost + other operating cost like rent, postage &amp; stationery etc.)</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. If operating profit is more than the provisions required to be made.</td>
<td>a.5</td>
<td>a.5</td>
<td>a. 4</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Guidance Note on Audit of StCBs & DCCBs

<table>
<thead>
<tr>
<th>b. If operating profit cover only 75% of the provisions required to be made</th>
<th>b. 4</th>
<th>b. 4</th>
<th>b. 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>c. If operating profit cover only 50% of the provisions required to be made</td>
<td>c. 3</td>
<td>c. 3</td>
<td>c. 2</td>
</tr>
<tr>
<td>d. If operating profit cover only 40% of the provisions required to be made</td>
<td>d. 2</td>
<td>d. 2</td>
<td>d. 1</td>
</tr>
<tr>
<td>e. If operating profit cover less than 40% of the provisions required to be made</td>
<td>e. 1</td>
<td>e. 1</td>
<td>e. 0</td>
</tr>
</tbody>
</table>

**(ii) Net Profit** (Operating profit + other income like sale of assets, transfer from reserves etc), minus (other costs, provisions, taxes etc.)

<table>
<thead>
<tr>
<th>a. If net profit is earned after making full provision required to be made and contributed to various reserves as per Bye-laws and surplus available for dividend</th>
<th>(ii) 5</th>
<th>(ii) 5</th>
<th>(ii) 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. Net profit but not adequate to declare dividend</td>
<td>a. 5</td>
<td>a. 5</td>
<td>a. 4</td>
</tr>
<tr>
<td>c. Net profit but not adequate to contribute to reserves</td>
<td>b. 3</td>
<td>b. 3</td>
<td>b. 2</td>
</tr>
</tbody>
</table>

### Liquidity and Funds Management

**(i) Maintenance of CRR/SLR**

<table>
<thead>
<tr>
<th>a. No violation of CRR/SLR</th>
<th>(i) 5</th>
<th>(i) 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. No CRR violation but violated SLR not more than 3 occasions</td>
<td>a. 5</td>
<td>a. 5</td>
</tr>
<tr>
<td>c. No CRR violation but violated SLR on more than 3 occasions</td>
<td>b. 4</td>
<td>b. 4</td>
</tr>
<tr>
<td>d. CRR violated on more than 2 occasions but no SLR violations</td>
<td>c. 2</td>
<td>c. 2</td>
</tr>
<tr>
<td>e. Violated both CRR/SLR</td>
<td>d. 1</td>
<td>d. 1</td>
</tr>
<tr>
<td>e. Nil</td>
<td>e. Nil</td>
<td>No change</td>
</tr>
</tbody>
</table>
### Annexures

<table>
<thead>
<tr>
<th>Annexure</th>
<th>(ii) Timely Repayment of Borrowings</th>
<th>(iii) Cash Management</th>
<th>(iv) Investment Management</th>
<th>(v) Deposit Mobilisation</th>
<th>(vi) Deposit Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. No default</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b. Single default</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c. Defaulted twice</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>d. Defaulted more than twice</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. 5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b. 4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c. 3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>d. Nil</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. 5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b. 4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c. 3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>d. Nil</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) 5</td>
<td>(iii) 2</td>
<td>(iv) 3</td>
<td>(v) 3</td>
<td>(vi) 2</td>
</tr>
<tr>
<td></td>
<td>No change</td>
<td>No change</td>
<td>No change</td>
<td>No change</td>
<td>No change</td>
</tr>
</tbody>
</table>
b. Assessable deposits not properly worked out, but no delay in payment of premium.  
   c. Assessable deposits not properly worked out and also delayed the payment of premium (delay in respect of one half year).  
   d. Not paid premium for two half year (on date of audit).

<table>
<thead>
<tr>
<th>b.</th>
<th>c.</th>
<th>d.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.5</td>
<td>Nil</td>
</tr>
</tbody>
</table>

6 Systems & Control  
(i) Internal Inspection and Internal Audit  
<table>
<thead>
<tr>
<th>a.</th>
<th>b.</th>
<th>c.</th>
<th>d.</th>
<th>e.</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>Nil</td>
</tr>
</tbody>
</table>

(ii) Loans and Advances Policies  
<table>
<thead>
<tr>
<th>a.</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
</tr>
</tbody>
</table>

No change
follow-up done and sanction letter issued indicating terms and conditions.

| b. Sanction is in order no post sanction follow-up. | b. 3 | b. 3 |
| c. Sanction is in order no post sanction follow-up and sanction letter also not noticed. | c. 2 | c. 2 |
| d. Sanction letter issued but no pre-sanction appraisal and post sanction follow-up | d. 1 | d. 1 |
| e. If none and merely allowed drawals | e. Nil | e. Nil |

(iii) Accounting Procedure

| a. Accounts finalised and financial statements prepared without waiting for audit within three months from the date of balance sheet | (iii) 2 | (iii) 2 |
| b. Accounts finalised and financial statements prepared without waiting for audit within four months from the date of balance sheet. | b. 1.5 | b 1.5 |
| c. Accounts finalised and financial statements prepared without waiting for audit within six months from the date of the balance sheet. | c. 1 | c. 1 |
| d. Accounts finalised with the help of auditors within six months from the date of balance sheet. | d 0.5 | d. 0.5 |
| e. Accounts finalised with the help of auditors and delay was more than six months from the date of balance sheet. | e. Nil | e. Nil |

No change
No change within 2 months
No change within 3 months
No change within 4 months
No change
No change
### Guidance Note on Audit of StCBs & DCCBs

#### (iv) House Keeping
- **a.** All books balanced with the general ledger including bank reconciliation and Debit/Credit summation done, etc., without any delay (or delay of less than one month).
- **b.** — Do — within two months delay.
- **c.** Some of the books not balanced and bank reconciliation not done though accounts were closed.
- **d.** Books not balanced and waited for auditors to do the job.

<table>
<thead>
<tr>
<th>(iv)</th>
<th>2</th>
<th>a. 2</th>
<th>b. 1</th>
<th>c. 0.5</th>
<th>d. Nil</th>
<th>No change</th>
</tr>
</thead>
</table>

#### (v) Risk Management Systems
Proper system and procedures followed to cover all risks viz., Liquidity Risk, Credit Risk, Exposure Risk, Interest Rate Risk and Operational Risk. Auditors may use discretion on the basis of exposure of the bank to various risks and efficacy of risk management system.

<table>
<thead>
<tr>
<th>(v)</th>
<th>3</th>
<th>(v) 3</th>
<th>No change</th>
</tr>
</thead>
</table>

#### (vi) Computerisation
- **a.** All branches and head office
- **b.** 75% of branches and head office
- **c.** 50% of branches and head office
- **d.** 25% of branches and head office
- **e.** Less than 25%

<table>
<thead>
<tr>
<th>(vi)</th>
<th>4</th>
<th>a. 4</th>
<th>b. 3</th>
<th>c. 2</th>
<th>d. 1</th>
<th>e. Nil</th>
<th>No change</th>
</tr>
</thead>
</table>

#### Compliance
- **7.** 10
- **(i) Minimum Involvement (MI)**

<table>
<thead>
<tr>
<th>(i)</th>
<th>2</th>
<th>(i) 2</th>
<th>Deleted in view of</th>
</tr>
</thead>
</table>

322
<table>
<thead>
<tr>
<th>Annexures</th>
<th>change in Refinance policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Complied with the MI requirement in full.</td>
<td>a. 2</td>
</tr>
<tr>
<td>b. 80% but less than 100% of MI met.</td>
<td>b. 1.5</td>
</tr>
<tr>
<td>c. 71% but less than 80%.</td>
<td>c. 1</td>
</tr>
<tr>
<td>d. 61% but less than 70%.</td>
<td>d. 0.5</td>
</tr>
<tr>
<td>e. Less than 60%.</td>
<td>e. Nil</td>
</tr>
</tbody>
</table>

(ii) Compliance on Audit Report

<table>
<thead>
<tr>
<th>(ii)</th>
<th>(ii) 3</th>
<th>(ii) 3</th>
<th>(ii) 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Fully complied and reviewed by the Board within three months from the date of issue.</td>
<td>a. 3</td>
<td>a. 3</td>
<td>a. 5</td>
</tr>
<tr>
<td>b. ~ Do ~ after three months but less than six months.</td>
<td>b. 2</td>
<td>b. 2</td>
<td>b. 4</td>
</tr>
<tr>
<td>c. Partial compliance within three months.</td>
<td>c. 1</td>
<td>c. 1</td>
<td>c. 2</td>
</tr>
<tr>
<td>d. ~ Do ~ after three months but less than six months.</td>
<td>d. 0.5</td>
<td>d. 0.5</td>
<td>d. 1</td>
</tr>
<tr>
<td>e. No compliance or delayed by more than six months.</td>
<td>e. Nil</td>
<td>e. Nil</td>
<td>e. Nil</td>
</tr>
</tbody>
</table>

(iii) Compliance on NABARD Inspection Report

<table>
<thead>
<tr>
<th>(iii)</th>
<th>(iii) 2</th>
<th>(iii) 2</th>
<th>(iii) 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. All compliance given within three months from the date of issue.</td>
<td>a. 2</td>
<td>a. 2</td>
<td>a. 4</td>
</tr>
<tr>
<td>b. Only core compliance given within 45 days and other compliance delayed.</td>
<td>b. 1.5</td>
<td>b. 1.5</td>
<td>b. 3</td>
</tr>
<tr>
<td>c. Both core and general compliance delayed but delay of less than one month in both cases.</td>
<td>c. 1</td>
<td>c. 1</td>
<td>c. 2</td>
</tr>
<tr>
<td>d. Of core and general compliance, one of them delayed by more than 1 month.</td>
<td>d. 0.5</td>
<td>d. 0.5</td>
<td>d. 1</td>
</tr>
</tbody>
</table>
## Guidance Note on Audit of StCBs & DCCBs

<table>
<thead>
<tr>
<th>(iv) Internal Returns</th>
<th>(iv) 1</th>
<th>(iv) 1</th>
<th>(iv) 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Returns</td>
<td>(iv)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discretion to be used</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>by auditors on the</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>basis of regularity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>in receipt of all</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>returns.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(v) External Returns</th>
<th>(v) 1</th>
<th>(v) 1</th>
<th>(v) 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>External Returns</td>
<td>(v)</td>
<td>(v)</td>
<td>(v)</td>
</tr>
<tr>
<td>Discretion to be used</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>by auditors on the</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>basis of timeliness</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>and regularity in</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>submission of all</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>returns including OSS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>and other statutory</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>returns.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(vi) Implementation of DAP/MoU</th>
<th>(vi) 1</th>
<th>(vi) 1</th>
<th>No change</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) All targets fully achieved</td>
<td>(i) 1</td>
<td>(i) 1</td>
<td></td>
</tr>
<tr>
<td>(b) Upto 90% of targets</td>
<td>(ii) 0.75</td>
<td>(ii) 0.75</td>
<td></td>
</tr>
<tr>
<td>achieved</td>
<td>(iii) 0.50</td>
<td>(iii) 0.50</td>
<td></td>
</tr>
<tr>
<td>(c) Upto 80%</td>
<td>(iv) 0.25</td>
<td>(iv) 0.25</td>
<td></td>
</tr>
<tr>
<td>(d) Upto 70%</td>
<td>(v) Nil</td>
<td>(v) Nil</td>
<td></td>
</tr>
<tr>
<td>(e) Less than 70%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total</th>
<th>100</th>
<th>100</th>
<th>100</th>
</tr>
</thead>
</table>

**Notes:**

1. On the basis of the marks secured, banks may be awarded Audit Classification as under:

<table>
<thead>
<tr>
<th>Marks obtained</th>
<th>Audit Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>75 and above</td>
<td>A</td>
</tr>
<tr>
<td>60 and above but less than 75</td>
<td>B</td>
</tr>
<tr>
<td>40 and above but less than 60</td>
<td>C</td>
</tr>
<tr>
<td>Below 40</td>
<td>D</td>
</tr>
</tbody>
</table>

2. Banks not complying with Section 11(1) of the B. R. Act, 1949 (AACS) should invariably be placed in “D” class irrespective of the marks secured.

3. Banks which do not comply with Section 22(3)(b) of the B.R. Act, 1949 (AACS) should not be awarded “A” class irrespective of the marks secured.
4. If the bank's NPA shows an increasing trend and it has incurred loss for the year in question, no marks should be awarded for the management parameter.

**SUMMARY OF MARKS**

<table>
<thead>
<tr>
<th>Sr No.</th>
<th>Parameter</th>
<th>Existing Marks</th>
<th>Revised Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Capital Adequacy</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>2</td>
<td>Asset Quality</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>3</td>
<td>Management</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>Earnings</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>5</td>
<td>Liquidity</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>6</td>
<td>Systems and Control</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>7</td>
<td>Compliance</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
March ____, ______

The Branch Manager

___________ Bank

___________ Branch

Dear Sir:

Sub.: Statutory Audit of your branch for the year _______.

As you are aware, we have been appointed as the Statutory Auditor to report on the accounts of your Branch for the year _______.

In order to enable us to finalise the audit programme and furnish our report on the audit of the accounts for the year ______ of your branch, may we request you to keep the following information/ clarification ready and make the same available to our audit team at the earliest:

1. Latest Reports

The following latest reports on the accounts of your Bank, and compliance by the Bank on the observations contained therein may be kept ready for our perusal:

- Latest RBI Inspection Report;
- Internal/ Concurrent Audit Reports;
- Head Office Inspection Reports;
- Internal Inspection Reports;
- Revenue Audit Report (if any);
- Income and Expenditure Control Report (if any);
Annexures

- Report on any other Inspection/ Audit that may have been conducted during the course of the year relevant to the financial year ______.

2. Circulars in Connection with Accounts

Please let us have a copy of the Head Office circulars/ instructions in connection with the closing of your accounts for the year, to the extent not communicated to us or incorporated in our letter of appointment.

3. Accounting Policies

Kindly confirm whether, as compared to the earlier year, there are any changes in the accounting policies during the year under audit.

If so, please let us have a list and a copy of the accounting policy/ies amended by the bank during the year covered by the current audit and compute the financial effect thereof to enable us to verify the same.

4. Balancing of Books

Kindly confirm the present status of balancing of the subsidiary records with the relevant control accounts. In case of differences between balances in the control and subsidiary records, please give the details thereof and let us know the efforts being made to reconcile/ balance the same. This information may be given head–wise for the relevant control accounts, indicating the date when the balances were last tallied.

5. Deposits

a. Please let us have the Interest rate structure, applicable for the current year, for all the types of deposits accepted by the branch.

b. Kindly confirm the transferred Overdue/Matured Term Deposits to Current Account Deposit. If not, details/particulars of credit balances comprising Overdue/ Matured Term Deposits as at the year–end which continue to be shown as Term Deposit, particularly where the branch does not have any instructions/ communication for renewal of such deposits from the account holder and amount of provision of interest made on such overdue/matured term deposits, should be separately marked out and be kept ready for our reference/ verification.

6. Advances

a. Kindly confirm whether in respect of the advances against tangible securities, the branch holds evidence of existence and latest market value of the relevant securities as at the year–end.
b. Kindly inform the year–end status of the accounts, particularly those which have been adversely commented upon in the latest reports of RBI/ Internal Auditors/ Concurrent Auditors/ Statutory Auditors, etc on the branch as also accounts in respect of which provisions have been made/ recommended as at the previous year–end.

Information in relation to such advances accounts where provision computed/ recommended may please be prepared indicating:

i. Name of the borrower

ii. Type of facility

iii. Total amount outstanding as at the year–end (both for principal and interest) specifying the date upto which interest has been levied and recovered

iv. Particulars of securities and value on the basis of latest report/ statement

v. Nature of default and action taken

vi. Brief history and present status of the advance

vii. Provision already made/recommended

viii. NPA since when (please specify the date)

* Corresponding figures for the previous year–end may please be given

c. Kindly confirm whether the borrowers’ account have been categorised according to the norms applicable for the year into Standard, Sub–standard, Doubtful or Loss assets, with special emphasis on Non–Performing Assets (NPA) and whether such classification has also been made applicable by the branch to advances with balances of less than Rs. 25,000 each.

Kindly confirm whether you have examined the accounts and applied the norms borrower–wise and not account–wise for categorising the accounts. Please let us have the particulars of provisions computed/ recommended in respect of the above during the financial year under audit.

d. A list of all advances accounts which have been identified as bad/ doubtful accounts and where pending formal sanction of the higher authorities, the relevant amount have not been re–classified/ re–categorised in the book of the Branch for provision/ write off. This covers all account identified by the Branch or internal/ external
annexures

auditor or by RBI inspectors but the amount has not been written–off wholly or partly In case the bank has recommended action against the borrowers or for initiating legal or other coercive action for recovery of dues, a list of such borrowers' accounts may be furnished to us.

e. Please let us have a list of borrowers’ accounts where classification made as at the end of the previous year has been changed to a better classification stating reasons for the same.

f. Kindly also confirm whether any income has been adjusted/ recorded to revenue, contrary to the norms of income recognition notified by circulars issued by the Reserve Bank of India in this regard; and particularly where the chances of recovery/ realisablity of the income are remote.

Kindly also confirm whether any income has been recorded on Non–Performing Accounts other than on actual realization.

7. Outstanding in Suspense/ Sundry Account

Kindly let us have a year–wise/ entry–wise break up of amounts outstanding in Suspense/ Sundry accounts as on 31st March. Kindly explain the nature of the amounts in brief. Supporting evidences relating to the existence of such amounts in the aforesaid accounts may be kept ready at the branch for verification. Reasons for non–adjustment of items included in these may be made known.

8. Inter–branch/ Office Accounts/ Head Office Account

a. Please let us have a statement of entries (head–wise) which originated prior to the year–end at other branches, but were responded during the period after 31st March at the branch.

b. Date–wise details of debits in various sub–heads relating to Inter–branch transactions and reasons for outstanding amounts particularly those, which are over 30 days as at the Balance Sheet date.

9. Contingent Liabilities

a. Kindly confirm whether other than for advances, there are any matters involving the Bank in any claims in litigation, arbitration or other disputes in which there may be some financial implications, including for staff claim, municipal taxes, local levies etc If so, these
Guidance Note on Audit of StCBs & DCCBs

may be listed for our verification, and you may confirm whether you have included these as contingent liabilities.

b. Kindly confirm whether guarantees are being disclosed net of margins, or otherwise as at the year-end, and whether the expired guarantee where the claim year has also expired, continue to be disclosed in the Branch return. Please confirm specifically.

10. Interest Provision

a. Kindly confirm whether interest provision has been made on deposits, etc. in accordance with the latest instruction of the RBI/interest rate structure of the bank. A copy of such instructions/rate structure may be made available for our scrutiny.

b. Kindly confirm whether any amount recorded as income upto the year-end, which remains unrecovered or not realisable, has been reversed from any of the income heads or has been debited to any expenditure head during the financial year. If so, please let us have details to enable us to verify the same.

c. Kindly confirm the accounting treatment as regards reversal, if any of interest/other income recorded upto the previous year-end; and the amount reversed during the year under audit i.e. income of earlier years derecognised during the year.

11. Investment/ Stationery

For Investment held by the branch:

a. These may be produced for physical verification and/or evidence of holding the same should be made available.

b. Stock of unused security paper stationery/numbered forms like B/Rs, SGL forms, etc may please be produced for physical verification.

c. It may be confirmed whether income accrued/collected has been accounted as per the laid down procedure.

d. It may be confirmed whether Investment Valuation has been done as per the extant RBI guidelines.

12. Long Form Audit Report – Branch response to the Questionnaire

In connection with the Long Form Audit Report, please let us have complete information as regards each item in the questionnaire, to enable us to verify the same for the purpose of our audit.
13. **Tax Audit in terms of Section 44AB of the Income–tax Act, 1961**

Please let us have the information required for the tax audit under section 44AB of the Income Tax Act, 1961 to enable us to verify the same for the purpose of our report thereon.

14. **Other Certification**

Please furnish us the duly authenticated information as regards other matters, which as per the letter of appointment require certification.

15. **Bank Reconciliation & Confirmations**

Please let us have the duly reconciled statements for all Bank Accounts with other Bank. A copy of the year–end balance confirmation statements should also be called for and kept ready for our review.

16. **Books of Accounts and Records**

Kindly keep ready all the books of accounts and other records like vouchers, documents, Fixed Assets Register, etc. for our verification.

We shall appreciate your kind co–operation in the matter.

Thanking you,

Yours truly,

For ABC & Co
Chartered Accountants

____________________
Partner

Date :
Place :