

# Contents

	PAGE
About the Author	I-5
Preface to the First Edition	I-9
Preface to the Seventh Edition	I-11
Acknowledgement	I-13
How to use this workbook	I-15
Chapter-heads	I-17

## 1

### INTRODUCTION TO AUDIT OF FINANCIAL STATEMENTS

<b>1.1</b>	Regulatory Framework	1
1.1.1	Purpose of an Audit of Financial Statements	1
1.1.2	Overall Objectives of the Auditor	1
1.1.3	Key Terms	2
1.1.4	Inherent Limitations of an Audit	3
1.1.5	Timeliness of Financial Reporting and the balance between Benefit and Cost	4
1.1.6	Subsequent Discovery of Material Misstatement	4
<b>1.2</b>	Accounts and Balance Sheet of a Banking Company	5
1.2.1	Statutory Provisions in Banking Regulation Act, 1949	5
1.2.2	Audit of a Banking Company	6
1.2.3	Powers and Duties of an Auditor	6
<b>1.3</b>	Branch Audit of a Banking Company	6
1.3.1	Statutory Provisions in Companies Act, 2013	6
1.3.2	Auditor's Rights and Duties in Companies Act, 2013	7
1.3.3	Auditor's Obligations to Report Fraud	7
1.3.4	Enforcement Action Framework in respect of statutory auditors for the lapses in the statutory audit of commercial banks	8

	PAGE
<b>1.4</b> Audit Documentation: Requirements under ICAI Standards	9
<b>1.4.1</b> Audit Documentation	9
<b>1.4.2</b> Requirements under the Standard on Auditing (SA) 230 of ICAI	9
<b>1.4.3</b> Preservation of Audit Documentation	10

## 2

### **PRE-ACCEPTANCE PROCEDURES**

<b>2.1</b> Ascertaining the eligibility for accepting the position as statutory auditor	11
<b>2.2</b> Communicating with the Previous Auditor	12
<b>2.3</b> Accepting the offer	12
<b>2.3.1</b> Agreement on Audit Engagement Terms	13
<b>2.3.2</b> Issuing Audit Engagement Letter	13

## 3

### **POST-ACCEPTANCE PROCEDURES**

<b>3.1</b> Collecting Reference Information	16
<b>3.2</b> Getting Branch Prepared	16

## 4

### **PLANNING CONSIDERATIONS**

<b>4.1</b> Companies Act, 2013	18
<b>4.1.1</b> Seeking Information: Documenting the Information 'Sought' and 'Obtained'	18
<b>4.1.2</b> Fraud Considerations under section 143(12)	18
<b>4.2</b> RBI Regulations	19
<b>4.3</b> ICAI Standards on Auditing (SAs)	20
<b>4.3.1</b> SA 300 'Planning an Audit of Financial Statement'	20
<b>4.3.2</b> SA 315 'Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment'	21
<b>4.3.3</b> SA 250 'Consideration of Laws and Regulations in an Audit of Financial Statements': ICAI Guidance	22

	PAGE
4.3.4 SA 240 'Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements': ICAI Guidance	22
4.3.5 Window-dressing	24
4.4 Sampling Considerations (SA 530 Audit Sampling)	25
4.4.1 Brief Overview of Audit Sampling	25
4.4.2 Considerations for Sampling of Loans and Advances Accounts	26
4.5 Matters Normally Dealt with at Head Office	27

## 5

### **CBS ENVIRONMENT : USEFUL SYSTEM GENERATED REPORTS**

5.1 CBS Environment	28
5.1.1 Brief Introduction	28
5.1.2 CBS software used by Public Sector Commercial Banks	29
5.2 CBS reports generally available in finacle, B@NCS and flexcube	29
5.2.1 Finacle 10 reports	30
5.2.2 B@NCS and Flexcube Reports	34

## 6

### **OFFSITE PLANNING**

6.1 Knowing the Branch	38
6.2 Understanding the Accounting and Internal Control Systems	38
6.2.1 Collecting Information: A Questionnaire	38
6.3 Preliminary Analytical Reviews	39
6.3.1 Comparisons	40
6.3.2 Correlations	41
6.3.3 Collecting Information on Large/Irregular/Critical Advances	41

## 7

### **ONSITE PLANNING**

7.1 Applying professional skepticism: Considering Potential Frauds/ Management Override of Controls	42
7.1.1 Identifying Indications of Potential Window Dressing	42
7.1.2 Identifying Indications of Rushed Sanctions and Deposits	42

	PAGE
<b>7.1.3</b> Identifying Indications of Potential Ever-Greening of Weak Credit Facilities	43
<b>7.2</b> Using Internal Auditor's Work in Planning	44

## 8

### **PERFORMING PRELIMINARY (ROUTINE) AUDIT PROCEDURES**

<b>8.1</b> Routine Procedures for Audit of Financial Statements	46
<b>8.1.1</b> Verifying the Effect of Previous Year's Memorandum of Changes (MoCs)	46
<b>8.1.2</b> Verifying Routine Closing Activities of the Branch	47
<b>8.1.3</b> Comparing GL head balances/Balance Sheet items of Current Year with that of Previous Year: Consistency Check	48
<b>8.1.4</b> Balancing and Reconciliations	49
<b>8.1.5</b> Routine Verifications	50
<b>8.1.6</b> Routine Sample Vouching	51
<b>8.2</b> Preliminary Procedures for Audit of Adherence of Income Recognition, Asset Classification and Provisioning (IRACP) Norms	52
<b>8.2.1</b> Consistency Checks	52
<b>8.2.2</b> Reconciliation of NPA and Interest Not Collected (INC) Account	54

## 9

### **AUDIT OF NEW ADVANCES**

<b>9.1</b> Introduction	55
<b>9.2</b> Audit procedures	55
<b>9.2.1</b> Agricultural Advances	55
<b>9.2.2</b> Housing Loans	56
<b>9.2.3</b> MSME and Priority Sector Loans	59
<b>9.2.4</b> Digital Lending	65
<b>9.2.5</b> Multiple Banking Arrangements	66
<b>9.2.6</b> Consortium Arrangements	67
<b>9.2.7</b> Takeover Accounts	67
<b>9.2.8</b> Casual Facilities (TOD/DAUE/Excess/Ad hoc)	68

	PAGE
<b>9.2.9</b> Loan against Properties (Mortgage Loans)	70
<b>9.2.10</b> Vehicle loans	71
<b>9.2.11</b> Loan against Term - Deposits	71
<b>9.2.12</b> Loan against Gold/Silver Ornaments	72
<b>9.2.13</b> Loan against LIP/NSC/IVP etc.	73
<b>9.2.14</b> Loans to Directors and Staff Loans	74
<b>9.2.15</b> Bank Guarantees (BG)	75
<b>9.2.16</b> Guarantees Invoked and Payment of Guarantees	78
<b>9.2.17</b> Letters of Credit (LC)	79
<b>9.2.18</b> Bill Purchase/Discounting	80
<b>9.2.19</b> Negotiation/Discounting of Bills under Letter of Credit (LC)	83

## 10

### **AUDIT OF CREDIT MONITORING**

<b>10.1</b>	<b>RBI's Key Guidelines</b>	85
<b>10.1.1</b>	<b>Early Warning Signals (EWS) and Red Flagged Accounts (RFA)</b>	85
<b>10.1.2</b>	<b>Wilful Defaulters: Accountability of Promoters/ Directors/Auditors and Requirement of Additional Provisioning</b>	86
<b>10.1.3</b>	<b>Non-Co-operative Borrowers: Requirement of Additional Provisioning</b>	87
<b>10.1.4</b>	<b>Advances Related Frauds: Potential Frauds by Unscrupulous Borrowers</b>	88
<b>10.2</b>	<b>Audit procedures</b>	88
<b>10.2.1</b>	<b>Stock/Book - Debts Statements/Monthly Statement on Operating Data (MSOD) and Quarterly Monitoring Report (QMR)/Quarterly Performance Report (QPR)</b>	88
<b>10.2.2</b>	<b>Inspection of Securities Charged to the Bank</b>	91
<b>10.2.3</b>	<b>Excess/Temporary Over Limits (TOL)/Ad hoc</b>	92
<b>10.2.4</b>	<b>Supervision over Operations/Conduct of Account: Diversion/Siphoning of Funds</b>	92
<b>10.2.5</b>	<b>Early Warning Signals (EWS) and Red Flagged Accounts (RFA)</b>	95
<b>10.2.6</b>	<b>Wilful Default</b>	97
<b>10.2.7</b>	<b>Annual Reviews</b>	97

## **11**

### **AUDIT OF SPECIAL MENTION ACCOUNTS (SMA)**

<b>11.1</b>	Introduction	<i>104</i>
<b>11.1.1</b>	Special Mention Accounts (SMA)	<i>104</i>
<b>11.1.2</b>	Basis of Classification: Not only overdue position but Sign of Stress also	<i>104</i>
<b>11.1.3</b>	Classification of Special Mention Accounts (SMA) into sub-categories	<i>105</i>
<b>11.1.4</b>	Early Identification of and Reporting to CRILC and Penal Measures for non-adherence (Accelerated Provisioning)	<i>106</i>
<b>11.2</b>	Audit procedures	<i>106</i>

## **12**

### **AUDIT OF INCOME RECOGNITION AND ASSET CLASSIFICATION**

<b>12.1</b>	RBI's Key Guidelines	<i>110</i>
<b>12.1.1</b>	Brief Background	<i>110</i>
<b>12.1.2</b>	NPA Management - Requirement of Effective Mechanism and Granular Data	<i>110</i>
<b>12.1.3</b>	System - Driven Income Recognition, Asset Classification and Provisioning	<i>111</i>
<b>12.1.4</b>	Key Concepts	<i>112</i>
<b>12.1.5</b>	General Principles/Guidelines for Asset Classification	<i>114</i>
<b>12.1.6</b>	Asset classifications of Agricultural Advances: RBI's Key Guidelines	<i>116</i>
<b>12.1.7</b>	Income Recognition	<i>116</i>
<b>12.1.8</b>	Upgrading Loan Accounts Classified as NPAs	<i>117</i>
<b>12.2</b>	Audit Procedures	<i>117</i>
<b>12.2.1</b>	Cash Credit (Against Stocks/Book-Debts) and OD Limits	<i>118</i>
<b>12.2.2</b>	Term Loans (TL)	<i>123</i>
<b>12.2.3</b>	Bills Purchased/Discounted	<i>125</i>
<b>12.2.4</b>	Agricultural Advances	<i>126</i>
<b>12.2.5</b>	Advances against Term Deposits, NSCs, KVPs/IVPs etc.	<i>128</i>

	PAGE
<b>12.2.6</b> Credit Cards	129
<b>12.2.7</b> Upgrading of NPAs	129
<b>12.2.8</b> Asset Classification of MSMEs	131
<b>12.2.9</b> Special Considerations	134
<b>12.2.10</b> Income Recognition	136

## **13**

### **AUDIT OF PROVISIONING**

<b>13.1</b> RBI's Key Guidelines	139
<b>13.1.1</b> Provisions under Special Circumstances	139
<b>13.1.2</b> General Provisions on Standard Assets	140
<b>13.1.3</b> NPA Provisions and other Specific Provisions	140
<b>13.2</b> Audit Procedures	141
<b>13.2.1</b> General Procedures	141
<b>13.2.2</b> Verification of Provisions on NPAs	143
<b>13.2.3</b> Verification of Provisions on 'Standard' Advances	145

## **14**

### **AUDIT OF RESOLUTION OF STRESSED ASSETS**

<b>14.1</b> RBI Frameworks/Guidelines: Key Features	148
<b>14.1.1</b> Framework for Resolution of Stressed Assets	148
<b>14.1.2</b> Prudential Norms Applicable to 'Restructuring'	151
<b>14.1.3</b> Projects under Implementation	154
<b>14.1.4</b> Resolution Framework 2.0: Resolution of Covid-19 related stress of Micro, Small and Medium Enterprises	156
<b>14.1.5</b> Resolution Framework 2.0: Resolution of Covid-19 related stress of Individuals and Small Businesses	158
<b>14.1.6</b> Restructuring of loans in the event of Natural Calamity	160
<b>14.1.7</b> Restructuring of Education Loan Accounts	163
<b>14.2</b> Audit Procedures	163

	PAGE
<b>14.2.1</b> Restructuring under 'Framework for Resolution of Stressed Assets dated October 1, 2021'	163
<b>14.2.2</b> Restructuring of 'MSMEs' under Resolution Framework 2.0 dated 5 May, 2021	167
<b>14.2.3</b> Restructuring of 'Individuals and Small Businesses' under Resolution Framework 2.0 dated 5 May, 2021	168
<b>14.2.4</b> Restructuring on account of Natural Calamities	169
<b>14.2.5</b> Restructuring of Education Loan Accounts	171

## **15**

### **PERFORMING GENERAL LEDGER (GL) AND PROFIT & LOSS (PL) AUDIT PROCEDURES**

<b>15.1</b>	Legal/Regulatory Framework	172
<b>15.1.1</b>	Obligations under ICAI Standards on Auditing (SA)	172
<b>15.1.2</b>	Obligations under Companies Act, 2013	173
<b>15.2</b>	Audit Procedures for Balance Sheet items	173
<b>15.2.1</b>	Scrutiny of Transfer Journals	174
<b>15.2.2</b>	Scrutinizing Impersonal (Office) Ledger Accounts	175
<b>15.2.3</b>	Non-fund Based Business	178
<b>15.2.4</b>	Evaluating Indication of Potential Transactions in Excess of Powers : Lending and non-lending	178
<b>15.3</b>	Audit Procedures for Profit & Loss Account items	179
<b>15.3.1</b>	Scrutiny of Incomes and Expenses	179
<b>15.3.2</b>	Scrutiny of Provisions and Contingent Liabilities	181

## **16**

### **LONG FORM AUDIT REPORTING (LFAR) PROCEDURES**

<b>16.1</b>	LFAR Procedures	183
<b>16.2</b>	Ghosh & Jilani Committee Implementation	224
<b>16.3</b>	Ghosh Committee Recommendations : Evaluation of Implementation	226
<b>16.4</b>	Jilani Committee Recommendations : Evaluation of Implementation	237



**17****AUDIT OF CAPITAL ADEQUACY**

<b>17.1</b>	Regulatory Framework: Basel III Norms	240
<b>17.1.1</b>	Classification of Basel Customer Types	240
<b>17.1.2</b>	Basel Recognized Securities and Collaterals	241
<b>17.2</b>	Audit Procedures	242
<b>17.2.1</b>	Preliminary Procedures	242
<b>17.2.2</b>	Basel Asset Classes (Exposures) and Risk-Weights	244
<b>17.2.3</b>	Non-fund based Exposures	247
<b>17.2.4</b>	Un-availed Exposures	248
<b>17.2.5</b>	Corporate and Public Sector Enterprises (PSEs): Ratings and Updating thereof	248

**18****SPECIAL-PURPOSE CERTIFICATION**

<b>18.1</b>	Regulatory Framework/Requirements	249
<b>18.2</b>	Audit Procedures	252

**19****ISSUING INDEPENDENT BRANCH AUDITOR'S REPORT**

<b>19.1</b>	Legal/Regulatory Framework	254
<b>19.1.1</b>	Banking Regulation Act, 1949	254
<b>19.1.2</b>	Companies Act, 2013	254
<b>19.1.3</b>	RBI Regulations	257
<b>19.1.4</b>	Standards on Auditing (SA) 260 of ICAI: Communica- tion with those charged with Governance	257
<b>19.1.5</b>	Form of Opinion	257
<b>19.1.6</b>	Types of Modified Audit Reports	258
<b>19.1.7</b>	Form and Content of the auditor's report when the opinion is modified	259
<b>19.1.8</b>	Opinion Paragraph	260
<b>19.1.9</b>	Emphasis of Matter (EoM) Paragraph	263
<b>19.1.10</b>	Other Matter (OM) Paragraph	263

	PAGE
19.1.11 Communicating Key Audit Matters (KAM) paragraph SA 701	264
19.1.12 Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence due to a Management-Imposed Limitation after the Auditor has Accepted the Engagement	264
19.2 Writing the Audit Report	265
19.2.1 Reviewing the Audit Evidences gathered for Sufficiency and Appropriateness	265
19.2.2 Issuing the Appropriate Audit Report	266
19.2.3 Modifying the Audit Opinion and Issuing Qualified Opinion	266
19.2.4 Writing the 'Key Audit Matters (KAM)' Paragraph	267
19.2.5 Writing the 'Emphasis of Matter (EoM)' Paragraph and 'Other Matter (OM)' Paragraph	268
19.2.6 Writing Memorandum of Changes (MoCs)	268
19.2.7 Writing the Special Mention Account (SMA) MoCs	269
19.2.8 Writing Memorandum of Changes (MoCs): Few other Important Considerations	270

## APPENDIX A

SBA 1(1) : COMMUNICATION TO PREVIOUS AUDITOR	271
SBA 1(2) : LETTER OF REQUIREMENTS (LOR) SEEKING INFORMATION	272
SBA 1(3) : LETTER OF REQUIREMENTS (TO BRANCH OFFICE)	278
SBA 2(1) : BRANCH-PROFILE	280
SBA 2(2) : PRELIMINARY STUDY & EVALUATION OF ACCOUNTING AND INTERNAL CONTROL SYSTEMS	284
SBA 2(3) : QUARTERLY COST & YIELD VARIANCE ANALYSIS	291
SBA 2(4) : PRELIMINARY ANALYTICAL REVIEWS (AUDIT PLANNING LEVEL)	292
SBA 2(5) : COMPARISON OF NEAR QUARTER-END BUSINESS FIGURES	294
SBA 2(6) : ANALYSIS OF MOVEMENT IN ACCOUNTS RESTRUCTURED	295
SBA 2(7) : PRELIMINARY ANALYSIS OF MOVEMENT IN SMA	297
SBA 2(8) : MOVEMENT IN NPA, PROVISIONS AND IN INTEREST NOT COLLECTED (INC) ACCOUNT	298

	PAGE
<b>SBA 2(9)</b> : INFORMATION REQUIRED FOR LFAR PROCEDURES	300
<b>SBA 2(10)</b> : CBS SYSTEM GENERATED REPORTS REQUIRED (PRELIMINARY TENTATIVE LIST)	302
<b>SBA 2(11)</b> : FACT-SHEET FOR LARGE BORROWERS (TO BE OBTAINED FROM BRANCH MANAGEMENT)	305
<b>SBA 3(1)</b> : PHYSICAL VERIFICATION OF CASH	308
<b>SBA 3(2)</b> : ROUTINE VOUCHING : DEVIATIONS/IRREGULARITIES	310
<b>SBA 4(1)</b> : CHECKLIST FOR AUDIT OF RETAIL LOANS	312
<b>SBA 4(2)</b> : CHECKLIST FOR AUDIT OF AGRICULTURAL ADVANCES (KCC)	318
<b>SBA 4(3)</b> : CHECKLIST FOR AUDIT OF LIMITS REVIEWED/RENEWED	321
<b>SBA 4(4)</b> : CHECKLIST FOR AUDIT OF BANK GUARANTEES	325
<b>SBA 4(5)</b> : CHECKLIST FOR AUDIT OF LETTERS OF CREDIT (LC)	328
<b>SBA 4(6)</b> : CHECKLIST FOR OBTAINING INFORMATION ON SIGN OF STRESS	330
<b>SBA 4(7)</b> : CHECKLIST FOR REVIEW OF SUBMISSION OF RETURNS/ STATEMENTS	332
<b>SBA 4(8)</b> : TAX DEDUCTION AT SOURCE AND REMITTANCE	334

## APPENDIX B

<b>B1</b> : MINISTRY OF CORPORATE AFFAIRS NOTIFICATION DATED 14TH DECEMBER, 2015 G.S.R. 972(E)	336
<b>B2</b> : IMPLEMENTATION OF THE RECOMMENDATIONS OF THE COMMITTEE ON LEGAL ASPECTS OF BANK FRAUDS AND THE RECOMMENDATIONS OF THE HIGH LEVEL GROUP SET UP BY THE CENTRAL VIGILANCE COMMISSION (CVC)	338
<b>B3</b> : ENFORCEMENT ACTION FRAMEWORK IN RESPECT OF STATUTORY AUDITORS FOR LAPSES IN STATUTORY AUDIT OF COMMERCIAL BANKS	344
<b>B4</b> : ICAI ILLUSTRATIVE FORMAT OF CERTIFICATE W.R.T. COMPLIANCE/IMPLEMENTATION STATUS OF THE RECOMMENDATIONS OF THE GHOSH AND JILANI COMMITTEE	347
<b>B5</b> : EARLY WARNING SIGNALS (EWS)	348
<b>B6</b> : CHARGING OF INTEREST AT MONTHLY RATES : CONSOLIDATED INSTRUCTIONS	350
<b>B7</b> : ANNEX 2 OF RBI'S MASTER CIRCULAR DATED APRIL 1, 2022 ON IRACP : ACTIVITIES ELIGIBLE FOR CROP SEASON LINKED ASSET CLASSIFICATION NORMS	352

	PAGE
<b>B8</b> : KISAN CREDIT CARD SCHEME - ELIGIBILITY CRITERIA FOR FARMERS ENGAGED IN FISHERIES/AQUACULTURE	353
<b>B9</b> : MODIFIED INTEREST SUBVENTION SCHEME FOR SHORT TERM LOANS FOR AGRICULTURE AND ALLIED ACTIVITIES AVAILABLED THROUGH KISAN CREDIT CARD (KCC) DURING THE FINANCIAL YEARS 2022-23 AND 2023-24	354
<b>B10</b> : NEW DEFINITION OF MICRO, SMALL AND MEDIUM ENTERPRISES - CLARIFICATION	365