



AUDIT OF SPECIALIZED BRANCHES

SPECIALISED BRANCHES

1. RACPC

2. Service Branches: Clearing/ Digital Services/ Fixed Assets etc.

3. IFB

4. Stressed Assets / Recovery



RACPC IS RETAIL ASSETS CENTRAL PROCESSING CENTRE (INDIA):

1. Meaning

CPCs help banks to carry out all processing activities at one particular place while only front ending activities are carried out at the different branches of the bank. This results in better customer service and happy customers, and also provides the branch banking staff with a better chance for cross selling and up selling products. All the document intensive processes can be carried out in a CPC which in turn would result in leaner and thinner branches. Banks may have multiple CPCs (based upon the process and location).

2. Role of the Retail Assets Central Progressing Center (Products covered by Retail assets Central Processing Center:

- Housing loan.
- Car loan
- Education loan
- Mortgage loan
- Personal Loan



RACPC IS RETAIL ASSETS CENTRAL PROCESSING CENTRE (INDIA):

2. ACTIVITIES OF RACPC

1. Ensure maintenance, balancing and, reconciliation of various office Accounts as under:
 - RACPC Processing Charges Collection account
 - RACPC Advocates' Fees Collection account
 - RACPC Value's' Fees Collection account
 - RACPC Stamp Charges Collection account
 - RACPC Stamp account
2. Arrange for the availability of necessary resources and inputs for the RACPC after discussions with his sectional heads.
3. Check the important reports generated by the system and ensure that the laid down systems and procedures are followed in the best interest of the Bank



SERVICE BRANCHES: CLEARING (CTS)

○ Meaning

The Service Branch/ Clearing House primarily acts as an intermediary between branches and banks to ensure processing of negotiable instruments. Considering functions of this branch, the primary objective of the Auditor is to ensure that there are no long old outstanding open entries as well as unreconciled entries.

The Service Branch ensures that the duly balanced outward clearing batches are received from the various branches within the prescribed time schedule.

The Service branch is required to install devices/machines to detect the frauds. The auditor should verify whether such machines are being use extensively and whether they are in working condition etc.

ICFR testing in such branch is crucial as compared to financial statements of the branch.



SERVICE BRANCHES: CLEARING (CTS)

○ Inward Clearing

- The auditor is to check whether signature of the drawer of the cheque is being verified by the staff religiously or not as else there will be liability of the paying bank under all circumstances.
- If the encoded amount is more than the cheque amount and the cheque is passed through oversight, it will create contingent liability for the bank. The auditor is required to verify if any claims for refund of the amount excess debited are received from the customer, such claims to be verified and if necessary, provision for that to be made.

○ Outward Clearing

- Branch is required to verify if the cheque paper quality invariably.
- Branch is also required to verify if the signature of the drawer of the cheque is chemically altered.
- If the encoded amount is more than the cheque amount and the cheque is sent for collection and passed through oversight by the paying bank, it will create contingent liability for the bank. The auditor is to verify if any claims for refund of the amount excess credited are received from the other banks, such claims to be verified and if necessary, provision for that to be made



SERVICE BRANCHES: CLEARING (CTS)

Fraud Monitoring

- After centralizing the clearing transactions work, both inward and outward, at the service branch, perpetration of fraud in this area has increased. The service branch should initiate steps on ongoing basis to prevent frauds. All the staff at service branch to be involved in awareness programs and training programs to minimize frauds. They should be made aware about the frauds that took place in recent past in other banks to guard against its occurrence in the bank.
- The auditor should check that the cheque collection charges including speed clearing charges are not levied by banks if the collecting bank and the paying bank are located within the jurisdiction of the same CTS grid even though they are in different cities



SERVICE BRANCHES: DIGITAL SERVICES

○ Meaning

Digital Services include Credit Card / Debit Card/ ATM / UPI.

These branches are responsible for control over Physical maintenance of Blank Cards. They are also responsible for maintenance and recovery of ATM/ Digital Banking Clearing and reconciliations with all the vendors.

- Credit/ Debit Card:
 - The process of Card settlement
 - Vendor Control (SA 3402)
 - Reconciliation of balances with vendors
 - The process of periodic inspection
 - Control over issue of Cards
- ATM
 - Own/ White/ Brown – The Charges relating to each are different
 - Reconciliations
- UPI Transactions
 - Switch Reconciliation

ICFR testing in such branch is crucial as compared to financial statements of the branch.



SERVICE BRANCHES: FIXED ASSETS

Areas for checking	Audit Procedure
1. Properties under Dispute	<p>I) Check present status of the properties under dispute (both Owned and Leased).</p> <p>II) Check in detail the nature of dispute and assess how serious it is. If required provision should be made after discussion with the concerned person in charge.</p>
2. Capital work in progress	<p>I) Take a list of pending Capital work in progress (item wise)</p> <p>II) Check whether Assets are already put to use but still appearing in capital work in progress. This should attract provision of depreciation.</p> <p>III) Check for delays in capitalising and reasons thereof.</p>
3. Leasehold Premises	<p>I) Take a list of premises where lease has expired as on 31st March</p> <p>II) To review lease pending renewal as on the date of review</p>
4. Fixed Assets	<p>I) Check the Fixed Assets Register for the following points:-</p> <p>a) whether in correct format as per bank's policy</p> <p>b) Correctly filled up and uptodate.</p> <p>II) Check the sanction amount of the particular assets.</p> <p>III) Addition to Fixed Assets:-</p> <p>a) Check the purchase Bills/Contractor's Bills.</p> <p>b) Put to use Certificates.</p> <p>IV) Check the calculation of Depreciation with the rate of Depreciation as per Bank's Circular.</p> <p>V) Check the opening balance of Fixed Assets with Audited Accounts as on 31/03/2022.</p> <p>VI) Check the sale of Fixed Assets and the Corresponding Depreciation.</p> <p>VII) Check whether Bank policies followed for items Sold/ Scrapped.</p>



IFB :INDUSTRIAL FINANCE BRANCHES

1. Meaning

The industrial finance pertains to the financial system that provides financial resources for the conduct of industrial activities. The need is for different types of finance and an efficient financial system that adequately finances production and enhances industrial capacity.

Auditor has to verify all large advances, - i.e., more than 5% of aggregate outstanding branch advances or 2 crore whichever is lower.

2.Verification stages

A. Credit appraisal & sanction:

- Review of documents- Borrower's financials, Branch visit report, valuation report, Proforma invoice, bank credit appraisal report, Borrower & Guarantors net worth, Other banks confidential reports, ratio analysis
- Borrower' CIBIL report & past defaults of guarantors



IFB :INDUSTRIAL FINANCE BRANCHES

Auditor to verify:

- Sanction letter & compliance with all its terms -
- Violation of RBI prudential norms for individual & group borrowers
- Adverse comments on borrower in previous statutory audit, internal inspection or concurrent audit reports.

B. Disbursement ::

Borrower to execute- Demand promissory note, documents for hypothecation, pledge/ mortgage, letter of guarantee etc.

- All documents to be appropriately stamped.
- Other documents such as Title document for immovable properties, NOC for society.
- Properties given as security to be fully insured



INTERNAL/ OFFICE ACCOUNTS (RBI OBSERVATION)

It has, come to our notice that post-migration to Core Banking Solutions, some banks have resorted to certain undesirable practices in opening and operating internal accounts unauthorizedly for affording credits to certain borrowal accounts to prevent them from slipping into NPA. In almost all such cases, system-based identification of NPAs was bypassed in this manner. The entries were effected by officials at the branches or controlling offices and in many cases have not been pointed out by the internal inspection/ audit.

Further, in some banks, these internal accounts/branch GIs have been used for disbursing loan amount, parking Govt. funds, disguising customer's cash transactions, booking expenses such as telephone charges, ATM charges, service charge and interest reversals, etc. Similarly, there are instances of advances to customers/staff members have also been debited to such accounts.



IFB :INDUSTRIAL FINANCE BRANCHES

c. Review of operations::

Any transaction susceptible of fraud to be directly reported to the RBI by auditors

- Auditor to scrutinize bank statements, account transfers, cheque returns, withdrawals/deposits of cash, turnover in account, transfers to sister concerns (diversion of funds) etc.
- Auditor should compare movement of stock and book debts month-on-month with turnover in account. Compare it with audited/unaudited accounts. Book Debt statement should be certified by a CA on quarterly basis.
- Verify whether stock includes unpaid stock (sundry creditors), stock under LC, stock under Packing credit have been deducted from total stock considered for DP limit.
- In case of Advance against exports, bank to inform ECGC to cover said advance under the insurance scheme
- Compulsory for non-corporate entities having sanction limit above 10 lakhs to get their accounts audited.
- Balance in advance appearing in individual ledgers to be tallied with general ledger balance-unreconciled balances outstanding



SUPERVISORY POINT OF VIEW

Supervisory process has revealed that following aspects are generally misinterpreted that lead to Divergences

- Accounts closed to open new accounts to **camouflage rollover of accounts**- mainly in cases of STL which are not permitted beyond two times rollover
- Accounts which were already NPA but **camouflaged through ever greening** before the date of reference for restructuring
- Round tripping of funds from other banks
- Funds given to parent coming back to SPV to regularize the account
- Funds under devolved BG/LC not considered together with CC over-drawn
- Debt Service Reserve Account created from own disbursal and utilised to service interest/installment
- Enhancing FB limit repeatedly without assessment
- Change of DP multiple times in a month
- Converting NFB limit into FB limit without justification
- Sanction of ad-hoc limit to regularize an account
- Transfer of funds between intra-group companies



FRAUD CONCERNS

- SA 240- The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- Audit risk assessment & planning would be inconclusive in Banking without giving due weightages to Fraud reporting.
- RBI has specific directions and expectations with regard to fraud reporting.
- It is therefore integral part of the audit planning and developing audit procedures well ahead of time.
- Refer RBI circular in May 2015 on Framework for dealing with Loan Frauds advising the banks to Red flag the accounts based on early warning signals.



OBSERVATION ON FRAUDS

- About 90 percent of the frauds, in terms of the amount involved, are happening in the credit portfolio of the banks.
- During 2017-18, large value frauds involving Rs. 50 Cr and above constituted 80 percent of all frauds.
- Factors facilitating large value frauds are
 - Opening current account with banks outside consortium without the No Objection Certificate from lenders
 - Deficient and fraudulent services/certificates by Third Party Entities (TPEs)
 - Diversion of funds by the borrowers through various means including through associated/shell companies
 - Lapses in credit underwriting standards
 - Failing to identify the Early Warning Signals (EWS) of incipient frauds.



FRAUD CONCERNS BY REGULATOR

- **Delayed Recognition and Reporting of Frauds**
 - Advances related frauds often seasoned for 3 to 4 years as NPAs
 - Time between first bank and last bank in consortium reporting fraud
 - Ideally within six months from date first entity reports the account as fraud
 - Complicity of bank officials and third parties with the borrower
 - Reluctance to conduct the meeting of the lenders
- Delay in reporting in CRILC



FRAUD CONCERNS BY REGULATOR

- Delay in filing complaint with CBI/Police
- Very poor credit and fraud risk governance
- **Professional Service Providers**
 - Advocates, chartered accountants, valuers, independent engineers
 - Reporting and dissemination of names of such third party professionals by IBA

(RBI had advised IBA to put in place an enhanced web-enabled TPEs-reporting and disseminating system. IBA has implemented the same w.e.f. December 1, 2018).



FRAUD CONCERNS BY REGULATOR

- Opening of current accounts by banks outside the consortium without obtaining NOC and thus facilitating diversion of funds lent by consortium
- Deficiency in implementation of the Early Warning Signals (EWS) and Red Flagging of Accounts (RFA) Mechanism by banks
 - ❖ Banks have not adopted any or all of the indicative list of EWSs provided by RBI
 - ❖ Non-integration of the mechanism into banks' credit monitoring software
 - ❖ Not concluding investigation after RFA within the stipulated 6 month timeline
 - ❖ Inconclusive forensic audits due to non-cooperation by the borrowers
- Some banks in a consortium sell some accounts to ARCs just before their recognition as a fraud by the consortium.
- Slow progress in investigations and prosecution of fraudsters.



SOME EARLY WARNING SIGNALS (EWS)

- Critical issues highlighted in the stock audit report
- Poor disclosure of materially adverse information
- Frequent change in the scope of the project
- Liabilities appearing in ROC search report, not in annual report
- Not routing sales through consortium member bank
- LCs issued for related parties without underlying trade transaction
- Raid by Income tax /sales tax/ central excise duty officials
- Significant reduction in the stake of promoters or pledging of shares



IFB :INDUSTRIAL FINANCE BRANCHES

1. Any account in the branch having exposure (funded and non-funded) which is more than 2000 crores across banking sectors.
2. List of accounts against whom NCLT proceedings are initiated either by Bank, any other financial creditors, or the operational creditors.
3. List of accounts having exposure above 5 crores. Please look for the stock audit reports, and the Branch audit reports for any comment.
4. Obtain list of Red Flagged Accounts in the Branch.
5. Suspicious transactions reported under STR through branch



STRESSED ASSETS & RECOVERY

1. Meaning

Stressed accounts include accounts classified as SMA 1 or SMA 2 or projects where implementation is delayed. The banks monitor stressed accounts on daily basis.

- The IBC at present can only be triggered if there is a minimum default of Rs 1 lakh. This process can be triggered by way of filing an application before the National Company Law Tribunal (NCLT). The process can be initiated by two classes of creditors which would include financial creditors and operational creditors.
- Another important aspect that must be seen in respect of IBC is that at present only companies (both private and public limited) and Limited Liability Partnerships (LLP) can be considered as defaulting corporate debtors.
- Recovery department generally give details of upgraded accounts and also the contingent liability amounts that gets reported in the financial statements



Role of Statutory Auditor

- The auditor should review the updated policies of the bank framed for handling recoveries through this mechanism.
- The rationale for transfer of cases to either of the aforesaid legal mediums should be documented.
- Listing of cases pending in each of the forums and the updated status should be obtained. Automated MIS trackers to be in place to ensure adherence to timelines is scrupulously maintained.
- Review of these processes by an internal audit team should be done. Issues raised by audit, if any should be followed up for understanding the gaps and initiating remedial action.
- Empanelment process for enrolment of Advocates or other professionals should be examined.
- A key factor is to adhere to timelines stipulated in the policy. Delays, if any, in adhering to the timelines needs to be reviewed and set right.
- Auditors should review the operational procedures to ensure that necessary tracking and follow-up mechanism is in place and operating effectively.



THANK YOU

