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Bank Audit-Ensuring Accuracy, Authenticity and Compliance

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ABSTRACT *Banking is trust-based relationship and the banking license from the regulator provides an assurance of trust to the public at large. To the banks, the banking license provides the privilege of accepting uncollateralized deposits from the public. However, the acts of stealth banking, negative option marketing, misleading advertisements, information gathering from customers for cross selling of products and services, and tie-up arrangements are inconsistent with the concept of a trust-based relationship. The lack of transparency, coupled with the difficulty of consumers in identifying key information from the large volume of material and communication in fine print, leads to an information asymmetry, which renders the banker-customer relationship one of unequals. Against this background, different aspects of Bank Audit Framework has been highlighted in this paper.*

BACKDROP

In this country, Banking is not a new occupation. We have a record of Banking which goes back at least 2,500 years, if not more. But in this long history of Banking till about 30 years back, Banking had very little to do with industry. Going through our ancient chronicles, whether the Arthashashtra or Buddhist Jatakas or the Jain chronicles, one does not see much connection between Banking and industry, though there are plenty of linkages between bankers and trade, between bankers and the state.

Commercial Banks, apart from providing a vital service, are business enterprises, and should, therefore conduct their affairs in such a manner as to conform to efficient business norms, both in collecting funds from different sources and the manner in which such funds are utilized. The sources and the uses of funds are deposits, borrowings, profits etc. which is in accounting terminology are liabilities. The avenues for utilizing these funds are loans and advances and investment in securities etc. The sources and the uses of funds need to be such as to keep the banks liquid and profitable.

In India nationalization of fourteen major banks in 1969 and six banks in 1980 changed basic nature and objective of the industry. It has no more kept itself restricted to accepting deposits and making loans based on principles of economic and financial viability of proposals. Since nationalization, the resources of banking industry are being utilized to meet socio-economic objectives also. In view of the changed situation the funds available with the profit centres have become meagre and costly. Thus, the bank have been confronted with a new challenges, they realize that the qualitative and quantitative dimensions of the new tasks have assumed unmanageable proportions and that they could not be met with existing ways and methods.

BANKING AND ECONOMIC DEVELOPMENT

Banking institutes have been playing a vital role in economic development of different countries in the world. An efficient and diversified banking system is a must for promoting savings and channelizing them into investment *(Ross 1997)* and help to achieve a faster rate of economic growth *(Dilip Chanda 2007)*. Thus, the good health of an economy is reflected in the good health of its banking system *(Robert G. et al. 1999)*. In a modern economy, banks are considered not only as the dealers in money but also the leaders of development. The banking sector is dominant in India as it accounts for more than half the assets of the financial sector. Section 5(1)(6) of the Banking Regulation Act defines "banking" as the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise. Section 5 (1)(C) defines "banking company" as any company which transact the business of banking in India. However, the acceptance of deposits by companies for the purpose of financing their own business is not regarded as "banking" within the meaning of the act. The essential characteristics of the banking business as defined in section 5(b) of the Banking Regulation Act are acceptance of deposits from the public; for the purpose of lending or investments; repayable on demand or otherwise and withdrawal by means of any instruments whether a cheque or otherwise.

VARIOUS ROLES OF BANKS

The role of banks in intermediation of financial needs of different classes of customers has undergone significant charges. For the sake of convenience, banks' various roles vis-à-vis their customers can be broadly categorized as

- Acceptors of deposits
- Credit providers
- Providers of payments and remittances services
- Providers of foreign exchange services
- Facilitators in circulation of currency notes/coins; and
- Providers of financial instruments.

COMMITTEE ON PROCEDURES AND PERFORMANCE AUDIT ON PUBLIC SERVICES

In the midterm review of the Monetary and Credit Policy 2003-2004, it was decided to review the level of public service provided by the Reserve Bank and banks, and to evolve appropriate incentives to facilitate change on an ongoing basis. Accordingly, the Committee on Procedures and Performance Audit on Public Services was set up. The Committee focused on the inadequacy in banking services available to common person and looked into the need to

- Benchmark the current level of service,
- Review the progress periodically,
- Enhance the timeliness and quality,
- Rationalize the processes taking into account technological developments, and

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- Suggest appropriate incentives to facilitate change on an ongoing basis.

Following the Committee's recommendations, various important customer service regulations were issued, notable among them being the guidelines on facilitating the payment to survivor/nominee of deceased depositor, simplifying the KYC requirements, collection of cheques and facilitating operations in bank accounts.

AUDIT- CONCEPTUAL FRAMEWORK

Bank Audit in banks traditionally implies transaction audit i.e. verification of accounts based on flow of accounting transactions over a specified period of time, generally a period of 12 months. Banking business has undergone complete transformation during last two decades. The bank branches are no longer there for intermediary role only to mobilize funds from "surplus clients" and deploying these funds with the "deficient clients" for their business purposes. Today most of the commercial banks have embraced multi faceted financial services business like investment banking, treasury functions, project consultancy services, executor-executrix business and insurance business etc.

CONDUCTANCE OF BANK AUDIT

The effective conduct of bank audit requires that a comprehensive audit programme be chalked out based on the size of the branch, volume of the transactions, status of computerization and the classification of the branch. The effective audit of banks require that the team members are familiar with the following:-

- Exact scope of work i.e. whether it is Concurrent Audit, Stock audit, Revenue Audit, Credit Risk Audit or any other assignment etc.
- RBI circulars relating to income recognition, asset classification and provisioning norms;
- Accounts closing instructions issued to the branches by the Head Office of the concerned bank;
- Guidelines issued to the auditors by the banks regarding certificates to be issued by them;
- The accounting system of the bank and the relevant internal controls;
- Salient features of Long Form Audit Report (LFAR);
- Audit procedure to be adopted;
- ICAI Guidance Note on bank audit;
- Various checklists for audit of different operations
- Understanding the business of the branch with specific reference to applicable laws like:
  - Banking Regulation Act, 1949;
  - Relevant State Co-operative Act;
  - Multi State Co-operative Act,2002;
  - Service Tax Provisions;
  - TDS Provisions under Income Tax Act;
  - Bank Cash Transaction Tax
  - Prevention of Money Laundering Act, 2002.

COVERAGE OF BANK AUDIT

The following areas are the critical areas in any bank audit:-

- Verification of Balance Sheet and Profit and Loss Accounts with main and subsidiary ledgers.
- Verification of all closing returns with the ledgers and registers.
- Review of inter-branch items and clearing differences.
- Verification of all large NPA advances and the provisioning thereof.
- Verification of all large advances granted during the year with specific reference to terms of sanction and documents.
- Balancing of books.
- PMRY loans granted during the year.

CONCURRENT AUDIT AS EFFECTIVE INTERNAL CONTROL

Concurrent audit is a systematic examination of financial transactions on a regular basis to ensure accuracy, authenticity and compliance with procedures and guidelines. It is an examination, which is contemporaneous with the occurrence of transaction or is carried out as near thereto as possible. The main focus of this audit is to ensure that transactions adhere to the system and laid down procedures. It serves the purpose of effective internal control as it reduces the time gap between occurrence of a transaction and its overview or checking. The concurrent audit is similar in nature to internal audit as both are generally initiated by the management itself. However, there is a basic difference between the two i.e. concurrent audit is regular audit of financial transaction whereas internal audit is a periodic audit.

Sound internal controls are essential to the prudent operation of banks and to promote stability in the financial system as a whole. Concurrent Audit ensures that adequate internal controls within banking organizations are supplemented by an effective internal audit function which independently evaluates the control systems within the organization. Concurrent Audit of Bank Branches involves checking of all aspects of banking and other operations on an ongoing daily basis to ensure that the Branch is adhering to the Bank's laid down system and procedures. The Concurrent Auditors are responsible to examine and comment on all the areas specified by the Bank/RBI from time to time in regard to concurrent audit of branches. A copy of guidelines on the manner of conduct of audit is also provided at the time of allotment of concurrent audit and form time to time thereafter. Therefore, it ensures that all errors and frauds, if any are generally detected immediately after their occurrence to control the damage, if any.

FUTURE OF PUBLIC SECTOR BANKS

Public Sector Banks (PSBs) now account for a little over 70 per cent of the commercial banks assets; the share of these banks could fall to say 60 per cent in the next decade. While the PSBs have responded well to the increasingly competitive environment, there are some issue which need early attention.

A number of committees have recommended that the government should give up majority ownership in these banks. This issue has been considered by governments of different hues but political economy considerations hold sway and the issue of giving up majority ownership by the government just does not arise. Since government financing has been provided on the basis of each bank's need, the banks grow at approximately the same pace and the public sector banking system veers to the lowest common multiple. Sooner or later all public sector banks will hit the 51 per cent government ownership rule. The government should not follow a passive policy of providing capital as asked for by all public sector banks. A viable strategy could be to selectively increase government capital only in the stronger PSBs. That way the stronger banks will grow faster and weaker banks will grow slower and thereby the overall public sector banking system would be stronger.

A whole gamut of issues will need attention in the next decade- loan processing, recoveries, customer service, and quality of staff, remuneration and overall governance. It is not reasonable to have one regulatory framework for PSBs and another for the rest of the system. Attention will need to be given to avoid regulatory capture by the PSBs to change the regulatory system to accommodate the PSBs.

INDIAN BANKING SECTOR : SHINING FACE

There have been many positive developments in the Indian banking sector during the last decade. Changes in policy and regulation brought about during this period have led to an overall improvement in the growth, asset quality and profitability of our banks, so that they now compare very favourably with other banks in the region. Banking index has grown at compounded annual rate of 51% since April 2001

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as compared to a 27% growth in the market index during this period. The capital to Risk Weighted Assets Ratio (CRAR) for all the scheduled commercial banks has increased to 13.2 per cent from 11.4 percent in 2001, which is more than the 8 per cent requirement specified under Basel frameworks, or the 9 per cent norm adopted by the RBI for an Indian Bank. Outstanding records of growth and innovation have been established by some banks. Even the public sector banks have stood up to the challenge posed by the new private banks, and have worked consciously upon improving their efficiency. The fact that Indian Banks have come out almost unscathed through the global downturn in a year that has seen the fall of several leading foreign banks, speaks volumes about their resilience.

CONCLUDING REMARKS

The Banking Structure is the core of the modern financial system. Their success notwithstanding, a lot more needs to be done to strengthen and streamline the sector so that it can respond to market realities and support the kind of growth to which India aspires. Bank penetration continues to be rather low in the country, despite expansion of services in rural areas. There are structural weaknesses in the system like restrictions on availability and deployment of capital, weak institutional support infrastructure, restrictive labour laws, ineffective regulations and governance issues. These need to be addressed urgently. Bank audit is the most important issue related to the growth and development of the banking sector in India, the challenges and opportunities that it faces today, and the way forward that policy makers and bank management need to take in order to strengthen the sector.

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