Bank Audit under CBS Environment (Focus areas: Issues in NPA identification, Revenue Leakage, Forex Transactions & Office Accounts) Hosted by Gandhidham Branch of WIRC of ICAI 11th March, 2017 Presented by CA. Kuntal P. Shah, Ahmedabad

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Some News Headlines

DNLIVE » DUGINESS

Feb 19, 2014 at 10:10pm

United Bank blames Infosys software for wrong NPA entries

UBI takes a U-turns, says no Issues with Finacle's NPA tool Somasroy Chakraborty/Kolkata 21 Feb 14 | 12:26 AM

If RBI inspectors are able to identify these divergences (Asset Quality) in the limited time-frame that they are on-site, why the banks' auditors are not able to do so... Is it a question of efficiency of the auditors or is there a much deeper issue - something to do with the transparency of the process itself?," - (Mr. S S Mundra, RBI Deputy Governor while addressing ACB of ICICI Bank 16th January, 2015) Source: Business Standard

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Package Provider Finacle Infosys FLEXCUBE Oracle Financial Services Software, (By iflex) TCS BaNCS Tata Consultancy Services (TCS) Alnova Financial Solutions Accenture / Alnova SAP Banking Services SAP AG CA. Kuntal Shah, Ahmedabad 4

* Parameters affecting NPA identification * Identification of Revenue Leakage * Foreign Exchange Transactions * Office Accounts * Audit activity through CBS – LFAR & Tax Audit Requirements

In terms of directives issued by Ministry of Finance and Reserve Bank of India, it is mandatory for banks to identify the bad loans through CBS / Systems instead of conventional methods. CBS like other software work on GIGO principle. Master Data play an important role in correct identification of Bad Loans.

Parameters affecting NPA identification

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1. Discrepancies in setting up the EMI / Installments:

Auditors' primary checks:

- Whether EMI / installment is correctly setup.
- Whether EMI / installment amount is matching with the Sanctioned Terms.
- Whether periodicity of Installment is correctly classified as per Sanctioned Terms?

System support:

> Finacle:

- ACI -> Option "E" Repayment details

➤ BaNCS:

- DL/TL Accounts & Services → Enquiries → Account
- Deposit / CC / OD Accounts & Services → Enquiries → Deposit / CC / OD Account

(Short & Long Inquiry options are available under both menu.)

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Parameters affecting NPA identification

2. Multiple sets of EMI / Installments:

Auditors' primary checks:

- For case of Multiple sets of EMI e.g. For 1-5 years EMI of Rs. 7,000 and after 5 years Rs. 7,500

 Whether sets of EMI are properly entered?

 Is there any substantial difference between 1st set of EMI and 2nd or other sets (e.g. 1st set Rs. 5,000 and 2nd Rs. 1,00,000) which cast doubt on debt serviceability?

System support:

> Finacle:

- ACI -> Option "E" Repayment details

> BaNCS:

- DITL Accounts & Services → Enquiries → Account

 Deposit / CC / OD Accounts & Services → Enquiries → Deposit / CC / OD Account

(Short & Long Inquiry options are available under both menu.)

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Parameters affecting NPA identification

System determined Asset Classification vis a vis User defined Asset Classification:

Auditors' primary checks:

- CBS contain two sets of parameters. At first instance CBS identify the account based on set parameters under Asset Classification types
- User is generally given the option to differ and select / amend the
- This feature gives rise to numerous question on functioning of CBS.
- At times it is possible that the classification by CBS may be incorrect due to errors in certain Master Data. However, such accounts require detailed scrutiny.

System support:

> Finacle:

- ACM / ACI Option Y Asset Classification Inquiry
- A report containing accounts wherein there is difference between Asset Classification by System and by user should be requested for. Accounts listed in the said report should be thoroughly verified.

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* 4. Manipulation in SL / DP:

Auditors' primary checks:

- Changes in SL / DP should be cross checked with Sanctioned Letter.
- Whether any change in Limit is supported by necessary documentation?

System support:

> Finacle:

- ACLHM - Account Limit History Maintenance

> BaNCS:

- Tailormade report on Changes in Account Limits

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Parameters affecting NPA identification

* 5. Incorrect moratorium period:

Auditors' primary checks:

- > Based on moratorium period CBS will identify the Loan Installment and will track repayment.
- > In case the moratorium period / installment start date is erroneously updated system will not show correct result.

System support:

> Finacle:

- ACI - Option "E" - Repayment Details

➤ BaNCS:

- Account Master details (Long Inquiry)

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Parameters affecting NPA identification

6. Rephasement without reporting it as reschedule:

- Auditors' primary checks:
 - At times it is observed that the Loan Account Installments are rephased / recalibrated without reporting the same as Re-Schedule.
 - Verify whether any change in Repayment instruction is made through System. Compare the said accounts with list of Restructured Accounts.

System support:

- > Finacle:
 - ACI Option "E" Repayment Details

➤ BaNCS:

- Account Master details (Long Inquiry)
- Report containing details of all the cases wherein EMI / Installment is changed should be sought

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* 7. Installment Start Date is Future Date:

Auditors' primary checks:

- Check whether Installment Start Date entered as per sanctioned term.
- In case of future date system will not identify installment and any repayment received will be shown as "Overflow".

System support:

> Finacle:

- ACI - Option "E" - Repayment Details

> BaNCS:

- Account Master details (Long Inquiry)

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Parameters affecting NPA identification

* 8. Interest Demand date (Future Date):

Auditors' primary checks:

- Check whether Interest Start Date entered is as per Sanctioned Term.
- In case of future date as Interest Demand Date system will not accrue interest and any repayment received will be shown as "Overflow".

System support:

> Finacle:

- ACI - Option "E" - Repayment Details

➤ BaNCS:

- Account Master details (Long Inquiry)

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Parameters affecting NPA identification

* 9. Fictitious credit through Office Account / Inter-branch Account:

Auditors' primary checks:

- > Are there any quarter / year end credits cited in the account?
- Check the source of Credit Entries.
- > Review transactions in Office Accounts / Inter Branch Accounts.

System support:

> Finacle:

- ACLI (Use CTRL + E to Explore the Tran)
- Review of Office Account Ledgers

> BaNCS:

- Deposit / CC / OD Accounts & Services → Enquiries → Transaction
- DL/TL Accounts & Services → Enquiries → Transaction

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* 10. Round tripping from internal accounts:

- Auditors' primary checks:
 - Close scrutiny of transaction and review of chain / series of transaction for accounts with deficiency is required.
 - It is used to generate / misguide the system on Credit Turnover aspect.

System support:

- > Finacle:
 - ACLI (Use CTRL + E to Explore the Tran)
 - Do not rely wholly on "ATOR" / "CUTI" / "ACTI" results

> BaNCS:

- Deposit / CC / OD Accounts & Services → Enquiries → Transaction
- DL/TL Accounts & Services → Enquiries → Transaction

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Parameters affecting NPA identification

* 11. Temporary Overdrafts:

- Auditors' primary checks:
 - At times it is observed that in order to bring the overdrawn limit to base level additional facility through TOD is sanctioned
 - > It is not permitted as per IRAC guidelines.

System support:

- > Finacle:
 - ACLI Option "O"
 - TODRP TOD Register Printing

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Parameters affecting NPA identification

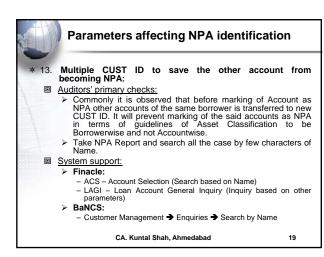
- 12. Devolved bills parked in Office Accounts and not in limit account:
 - Auditors' primary checks:
 - Devolved Bills under LCs are required to be debited to the Limit Accounts only. Assessment of Asset Classification will be based on composite overdrawn portion Limit + LC Devolved amount (if any on devolvement)
 - At times it is observed that the amount of devolvement of LC backed bills are parked in Office Accounts to suppress total exposure on borrower.

System support:

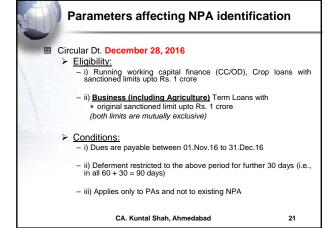
- > Finacle:
 - BI & FBI With Bill Status as "K" using Status Date Filter

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Parameters affecting NPA identification * 14. Deferment for NPA classification (Demonetization): © Circular Dt. November 21, 2016 Eligibility: - i) Running working capital finance (CC/OD), Crop loans with sanctioned limits upto Rs. 1 crore - ii) Term Loans with original sanctioned limit upto Rs. 1 crore - iii) Loans to NBFC / Housing Finance Companies, PACs - iv) Loans by State Co-op. Bank to DCCBs Conditions: - i) Dues are payable between 01.Nov.16 to 31.Dec.16 - ii) Deferment restricted to the above period for further 60 days - iii) Applies only to PAs and not to existing NPAs CA. Kuntal Shah, Ahmedabad



Parameters affecting NPA identification Auditors' primary checks: Installments getting due during Nov. 2016 and Dec. 2016 will have immunity under this circulars. Check how the system configuration is handled for such cases? Is it manual? Whether Repayment Date is extended by 2 months in CBS? If so there is a possibility of extending entire loan tenure by 2 months (Not in line with Circular) System support: Finacle: ACI - Option "E" - Repayment Details BaNCS: - Account Master details (Long Inquiry)

* Parameters affecting NPA identification * Identification of Revenue Leakage * Foreign Exchange Transactions * Office Accounts * Audit activity through CBS – LFAR & Tax Audit Requirements

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* Primary revenue for Banks is Interest on Loans and Advances. * Charging of Interest is completely automated. However, the processing is based on certain important parameters. * System parameters / fields which affect the Interest Computation should be thoroughly verified. * Let us discuss few event / scenario wherein there is possibility of non application / incorrect application of Interest.

Identification of Revenue Leakage Various Interest Parameters Interest Table > Debit Interest Rate & Credit Interest Rate - Interest Version - Currency - Limit Level Interest > Penal Interest Interest Rate (Static & Based on Ref. Rate) Customer Preferential (Dr. Interest) [(+)ve / (-) ve rate] □ Customer Preferential (Cr. Interest) [(+)ve / (-) ve rate] Important Commands – Finacle: INTCI, AINTRPT, INTPRF, INTTM TCS Bancs: i) OD/CC Accounts -> Interest Rate History ii) DL / TL -> Interest Rate History CA. Kuntal Shah, Ahmedabad 25 Identification of Revenue Leakage Few reasons for Non Application / wrong application of Interest by Interest pegging in Advance Accounts set as "Y". (If "Y" is selected, system will charge interest at the rate prevailing at the time of Account Opening. For the cases of Fixed Rate Loans Pegging Flag will be "Y") Future Date is updated in Interest Demand Date Interest on Principal / Payment of Interest Flag is set as "N" Effective Rate of Interest is updated as "0" Account Open and Installment Start Dates are identical. CA. Kuntal Shah, Ahmedabad 26 Identification of Revenue Leakage [Cont ...] Account Open and Interest Demand Dates are identical. Interest Table Code "Zero" is selected Interest Demand Date is Past Date Interest Demand Frequency is Blank.

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Audit of Foreign Exchange Transactions

- * Liberalization Opening of New areas for Inbound and Outbound Investment
- * Ease of Doing Business Relaxation in certain Forex Transaction procedure / mode of compliance
- * Enhanced vigilance required for
 - Money Laundering in garb of genuine Foreign Exchange Transaction
 - Misuse of Advances secured against Export Bills
 - Genuineness of Export Documents

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Audit of Foreign Exchange Transactions

LFAR: For Branches dealing in Foreign Exchange Transactions

- Material adverse points pointed out in the Audit Reports which continue to persist in relation to NRE/ NRO/ NRNR/ FCNR-B/ EEFC/ RFC?
- Whether the Branch has followed the instructions and guidelines of the controlling authorities of the bank with regard to the following in relation to the foreign exchange. If not, state the irregularities: Deposits, Advances, Export Bills, Bills for collection, Dealing Room operations, Any other area
- Nostro Account Management

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Audit of Foreign Exchange Transactions

- * Bills / Cheques on Collection Balancing and reconciliation with GL Balance (Contingent Liab.)
 - Bill Balancing Report (Finacle: BR, BRCR, FBBR)
 - GL Balance Respective Cont. Liab. Account
 - LFAR Reporting: Liab.3
- * Bills / Cheques purchased / Discounted Balancing and reconciliation with GL
 - Bill Balancing Report (Finacle: BRBPR, FBBR)
 - Aggregation of accounts under BD / BP Scheme Codes

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Audit of Foreign Exchange Transactions

- * Packing Credit (Pre & Post Shipment In INR or FCY)
 - Adjustment through Export Bills / EEFC Balance
 - Review of Transactions for adjustment of balance through other than above mode
 - Max Tenor (Pre Shipment): 360 Days
 - Max Tenor (Post Shipment): 365 from Shipment Date
 - Rate of Interest if not adjusted within 360 days Clean OD Rate with Penal Interest from <u>ab initio</u>
 - Monitoring of End use of Fund
 - Running Account Facility and Monitoring of adjustment within 360 Days

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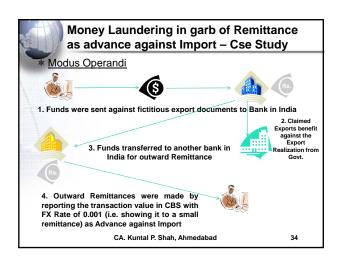
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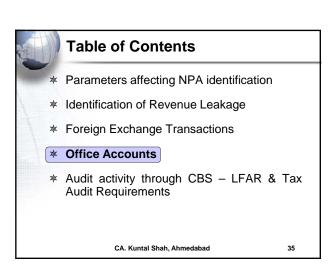


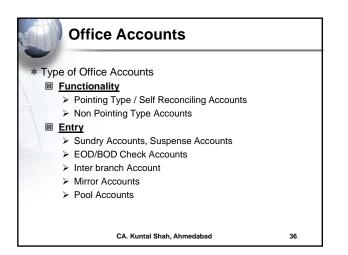
Audit of Foreign Exchange Transactions

- * Devolvement of Import Bills under LC
 - © Check the Reg. Type and Sub Type of Import Bills under LC
 - Use Menu Option FBI (in Finacle) to search Bills under Import LC Delinked (Status Code "K" with Status Date Filter)
 - Separate Account opened (if any) for Devolved Bills
 - Bill devolved but not crystallized in CBS
 - Crystallization of Devolved Bill through Office Account.

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Important Points in Office Accounts Review * Cash Payment from Office Accounts * TOD through Office Accounts * Parking of Cash Difference in Office Accounts * Clearing / Remittance differences through Office Accounts * Rotation of entries in Office Accounts CA. Kuntal Shah, Ahmedabad 37

Important Points in Office Accounts Review

- * Correctness in mapping of reversal transaction to originating transaction
- * Value Dated Transactions
- * Round Tripping
- * Advance paid for Fixed Assets not capitalized
- * Income realized not credited to Revenue Account
- * LFAR: Point No. Assets.6.b., Liab.2.a.

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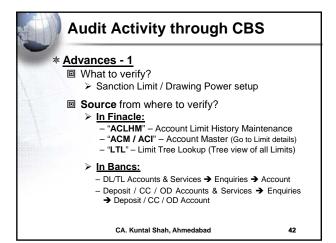
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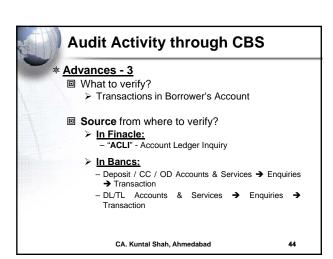
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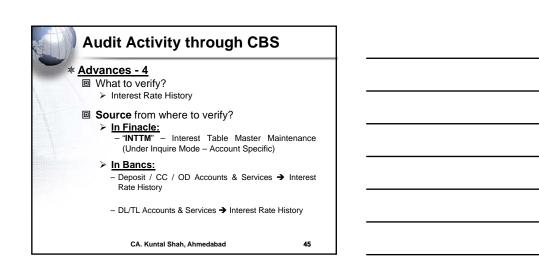
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Audit Activity through CBS * Cash What to verify? Cash Balance as on 31st March Cash Balance as on the date of verification Cash Balances reported in Friday Statement Source from where to verify? In Finacle: "ACLI" - Account Ledger Inquiry (Vault A/c and Teller Accounts) In Bancs: Reports → Cash Related → View Cash Summary (Click on Fetch) Branch Reports → Cash Officer's Jotting Book Report Report Reports → Printing Reports → Cashier / Teller Cash Report

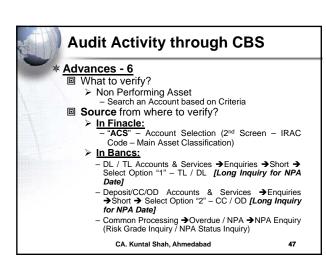
Audit Activity through CBS
* Balances with RBI / SBI / Other Banks
What to verify?
Balance as on Date
Transactions in Mirror Accounts
 Reconciliation Statement (Generally outside of CBS)
Source from where to verify?
> In Finacle:
- "ACLI" - Account Ledger Inquiry
➤ In Bancs:
 → Branch Accounting (BGL) → Enquire → Transaction

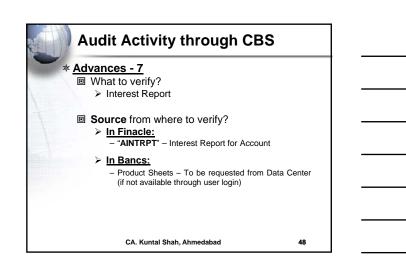




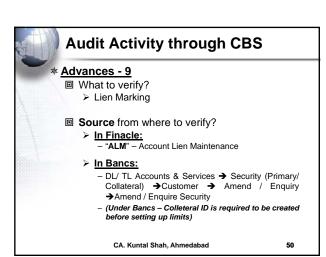


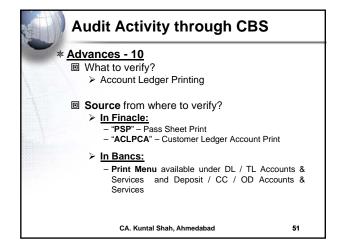
Audit Activity through CBS * Advances - 5 ■ What to verify? Conduct of Account and Credit Turnover - Turnover of CC Account based on Borrower's Business profile In case of Loan accounts ACTUAL recovery of Installments and Interest Source from where to verify? In Finacle: - "ATOR" - Account Turnover Report - "ACTI" - Account Turnover Inquiry - "CUTI" - Customer Level Turnover Inquiry In Bancs: - DL/TL Accounts & Services → Enquiries → Long - Deposit/CC/OD Accounts & Services → Enquiries Long CA. Kuntal Shah, Ahmedabad



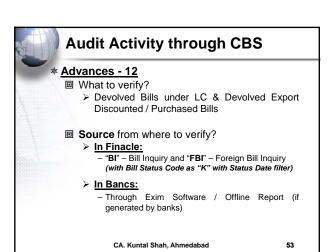


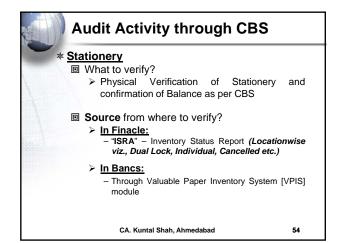
Audit Activity through CBS * Advances - 8 ■ What to verify? > Primary & Collateral Security Maintenance ■ Source from where to verify? > In Finacle: - "SRM" – Security Register Maintenance > In Bancs: - DL/ TL Accounts & Services → Security (Primary/Collateral) → Customer → Amend / Enquiry → Amend / Enquire Security CA. Kuntal Shah, Ahmedabad 49





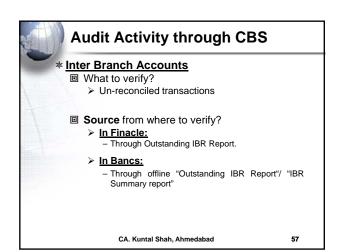
Audit Activity through CBS * Advances - 11 What to verify? Non Fund based Facility (LC, BG) Source from where to verify? In Finacle: - "GI" - Guarantee Inquiry - "DCQRY" - Documentary Credit Query In Bancs: - Through Exim Software / Offline Report (if generated by banks)





Audit Activity through CBS * Suspense / Sundry Assets Accounts, Bills payable, Sundry Deposits etc. - 1 What to verify? Outstanding entries for reporting Entries outstanding – Whether any provisioning is required? Source from where to verify? In Finacle: "IOT" – Inquire on Transaction (As on date Inquiry) "MSGOIRP" – Outstanding Items Report In Bancs: Through offline reports viz. "Audit BGL accounts age wise break up" and "GL-Outstanding-Accnts" report. CA. Kuntal Shah. Ahmedabad

* Suspense / Sundry Assets Accounts, Bills payable, Sundry Deposits etc. - 2 What to verify? Printing of Office Accounts Source from where to verify? In Finacle: - "ACLPOA" — Account Ledger printing Office Account In Bancs: Facility of printing of BGL (Branch General Ledgers) is not available under user login. It needs to be requested from Data Center. CA. Kuntal Shah, Ahmedabad 56



Audit Activity through CBS * TDS Related What to verify? TDS Information and Reports Source from where to verify? In Finacle: "TDSIP" – TDS Inquiry & Reports Month-end report on accountwise / transactionwise Tax deduction. Bank specific customized Menu / report In Bancs: Through offline monthly report on accountwise / transactionwise Tax deduction.

Audit Activity through CBS

★ Few Important Reports

Exception Report:

- > Reports for the month end and two days prior and after month end should be verified.
- > Exceptions of following natures should be closely verified.
 - Balance exceeded Account Limit
 - Manual debits to Income Account
 - Value Dated Transactions
 - Manual entry for SI Failure cases
 - Instrument passed against Clearing

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Audit Activity through CBS

Irregularity Report:

- > Reports for the month end and two days prior and after month end should be verified.
- Report contains details of Accounts where Balance in Accounts are greater than the Limits Sanctioned. Check whether the same is due to,
 - Application of Interest
 - Granting of Intra Day TOD
 - Passing of Instruments against Clearing Effects

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Audit Activity through CBS

Accounts where Interest Code is '0':

- Interest will not be charged from Accounts where Interest Code is selected as '0'. Hence, a detailed checking is required. Possible reasons can be,
 - Whether NPA Account
 - Accounts with Moratorium?

Interest Collection Flag as "No":

If Interest Collection Flag is selected as "No", Software will not consider the account for calculation and entry for Debit Interest.

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Audit Activity through CBS

Report containing all Advance Accounts with Limits:

- Generally, CBS Software generate a Report wherein details of all Advance Accounts are listed.
- Excel can be used to verify cases of DP > SL, Margin Requirement etc.

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Audit Activity through CBS

- Report on Probable NPA / Health Code Accounts / Special Mention Accounts:
 - > Obtain reports containing list of Accounts with various deficiencies.
 - ➤ System identifies such accounts and a report on Probable NPA Account. Banks classify the accounts as Health Code Type 1, Health Code Type 2, SMA – 1, SMA - 2 etc.

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Audit Activity through CBS Report on NPA Accounts: Report will contain list of all NPA Accounts. Such accounts should be closely monitored. Verify whether account is correctly classified as per IRAC Norms? CA. Kuntal Shah, Ahmedabad 64

