



The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)



Women & Young Members Excellence Committee

Organises

यशस्विनी - An IDOL- Live Webinar



CA. Priti Paras Savla
Chairperson, WYMEC, ICAI



CA. Ravi Kumar Patwa
Vice Chairman, WYMEC, ICAI



Risk - Regulation - Reporting

360 degree Insight on Bank Audit

Presenter: CA Priyanka Palav

AGENDA FOR WEBINAR

- ❖ Overview of RRR in Banking Audits
- ❖ Overview of Bank Audit Procedures
- ❖ Verification of Advances
 - ❖ Life cycle based approach
 - ❖ Special aspects
 - ❖ Regulatory aspects
 - ❖ Issues noted
- ❖ Verification of Deposits and Issues noted
- ❖ Verification of Other Areas and Issues noted
- ❖ Testing of Internal Financial Control (IFC)
- ❖ Verification of Critical Disclosures – Issues noted
- ❖ LFAR reporting – Critical Points
 - ❖ Audit Trail
 - ❖ Weakness in Critical Process
 - ❖ Other key points
- ❖ Communication to Audit committee and RBI SSM
- ❖ Finalization & Reporting for upcoming audits
- ❖ Summary of NFRA Orders
- ❖ Key developments in Banking Sector
- ❖ Key areas highlighted by Governor



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MORE**

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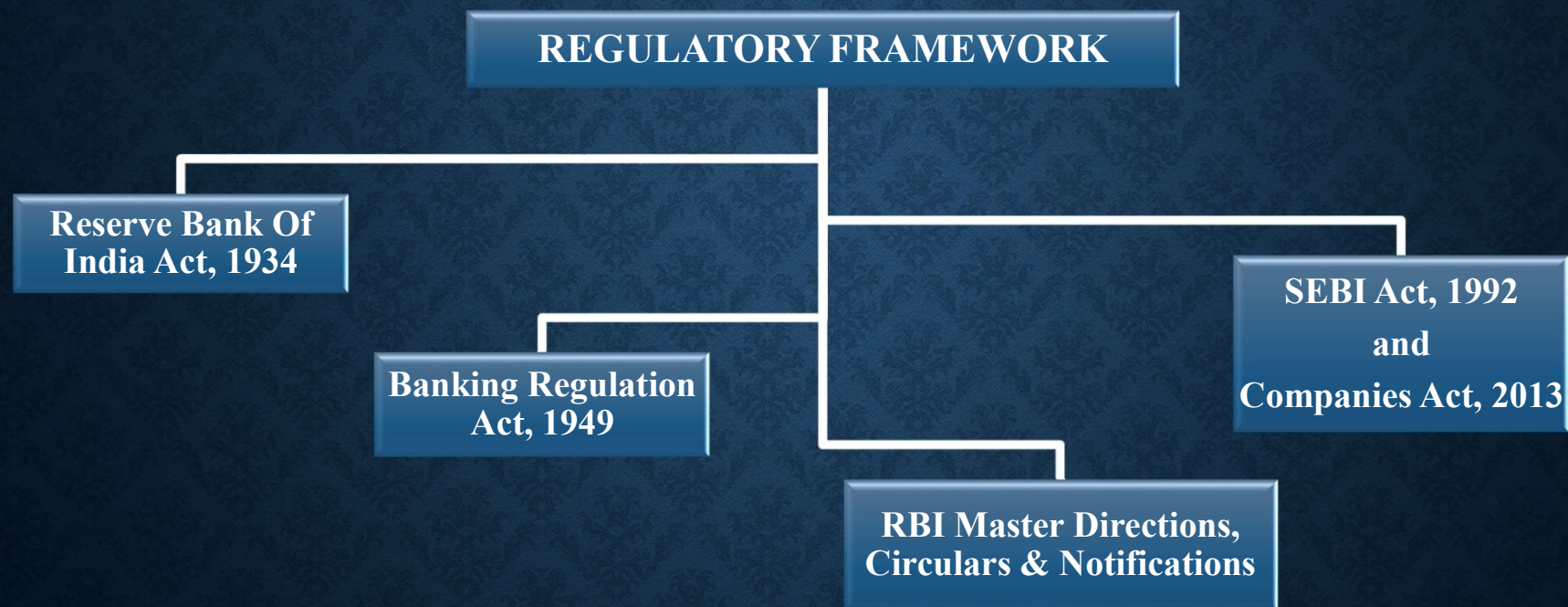
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**TIMELY PLAN &
EXECUTION**





STANDARDS ON AUDITING











Area of Audit	Overview of Audit Procedures
Advances (Schedule 9)	<ul style="list-style-type: none"> • Review of Credit Policy & Verification of Advances (including watchlist A/c) • Verification of System driven NPA recognition, classification & provision • Verification of security value for NPA provision • Analysis on Loan portfolio (Wholesale & Retail)- Net Interest Margin, Trends Analysis. • Others- Priority Sector, MSME, Wholesale Portfolio, Retail portfolio • Verification of new sanctions and various portfolio programs in credit cards
Deposit (Schedule 3, 5)	<ul style="list-style-type: none"> • Verification of Deposit product on sample basis (majorly cover during Branch visits) • Interest Expense Analysis on Deposit (Wholesale & Retail) • Analysis of Cost of Deposit including Trend Analysis
Visits (Branch and Credit Units)	<ul style="list-style-type: none"> • Visit to Retail Liabilities Branches and Credit Unit centers • Verification of Internal controls on process at Retail Liabilities Branches • Verification of controls at Loan processing Centers (CPC, CPU) & compliance of product policies, SOP's
Review of Disclosures and IFC-FR	<ul style="list-style-type: none"> • Critical Disclosures such as ALM, LCR, Capital Adequacy, PSL, Related Party Transactions etc. • Review of RCM and Testing effectiveness of internal control - Advances, Deposits, Investments and FS closure • Verification of internal control on other banking operations
Treasury Operations (Schedule 4, 6, 7, 8) <i>(not covered in detail presentation)</i>	<ul style="list-style-type: none"> • Review of Investment Policy- Acquisition & Valuation (HTM, AFS HFT) • Walkthroughs with front, mid and back office for its operations & Substantive verification of deal • Test of automated controls around income recognition, accrual profit and loss on treasury products • Adequacy of valuation and provision for NPI across the book for various products as per regulations • Reviewing transition from LIBOR
IT Systems and Controls <i>(not covered in detail presentation)</i>	<ul style="list-style-type: none"> • Understand and testing the controls established by the Bank, including general IT and application controls • Sample test of key controls over IT system for financial accounting and reporting system- for accuracy of automated calculations • Review management's response to cyber security related threats and incidents

VERIFICATION OF ADVANCES – LIFE CYCLE BASED

- Onboarding borrower/ customer
- Credit Underwriting/ Sanctioning
(Eligibility parameters, Critical deviations)
- Mandatory checks like CRILC and CFR *(reference to RBI mandated certification)*
- Disbursement *(adherence to pre/ post disbursement T&C)*
- Sample account selection criteria
- Interest, Fee and Other charges
- Security Valuation
- Review / Renewal
- Regular monitoring and oversight
- Manual intervention/ exceptional entries
- Closure of loan accounts

VERIFICATION OF ADVANCES – LIFE CYCLE BASED

- SMA accounts
- IRAC Norms
- OTS cases (*reverse checks*)
- Framework on Early Warning Signal (EWS)
- Framework on Borrower under Financial Difficulty (BUFD)
- Master review
- Transactions in CC/OD – related party
- Evergreening of loans
- Identify and address **FRAUD RISK** in audit process



{92% of total frauds pertains to Advances as per RBI report "Trends and Progress of Banking in India"}

VERIFICATION OF ADVANCES – SPECIAL ASPECTS

DIGITAL LENDING:

- AI-driven credit scoring, blockchain-based security and mobile-first interfaces
- Digital lending platforms - more sophisticated, secure and user-friendly
- Verification process
- Common issues and areas of attention

PRIORITY SECTOR LENDING:

- Identification and Classification
- Verification process
- Common issues and areas of attention (SOF, Agri docs)

INTEREST SUBVENTIONS:

- Types of subventions/ government schemes (ISKCC, NRLM, NULM, PMSVANIDHI, AIF, IES)
- Charging of interest cycles (not on monthly rests) – crop cycles viz. short duration/ long duration
- Compliance to subvention scheme guidelines
- Verification process (test check & overall process) – disbursement to repayment/ prompt payment
- RBI mandated/ non-mandated certification of subvention claims

INTERNAL FINANCIAL CONTROL (IFC):

- Control testing coverage
- Map existing audit processes/ routine checks to specific RCM control testing

VERIFICATION OF ADVANCES – REGULATORY ASPECTS

- Fair Lending Practice code - Penal charges (Aug'2023)
- Handover security documents (Sept'2023)
- Fair Lending Practice code - ROI (Apr'2024)
- Key Facts Statement (KFS) for Loans & Advances (Apr'2024)
- Fraud Risk Management (Jul'2024)
- Treatment of Wilful Defaulters and Large Defaulters (Jul'2024)
- Irregular practices in Gold loan (Sep'2024)
- Amendment to KYC norms (Nov'2024)
- Credit Flow to Agriculture – Collateral free agricultural loans (Dec'2024)

VERIFICATION OF ADVANCES – ISSUES NOTED

IRAC Norms:

- In certain banks NPA system not running on holidays/non-working days as against requirement of daily basis
- Board approved Policy on Manual intervention - issues observed in cases overrides done through backend without complying with the requirement
- Common borrower and Co - borrower identification/ tagging
- Challenge in classification of other accounts of primary and co-borrower & reporting to credit bureaus
- PAN based identification to classify all account as NPA & ensure Compliance with IRAC Norms
- Challenge in implementation - Wrong PAN furnished by Borrower/ Non-availability of PAN
- Originator / NBFCs submits overdue position on monthly basis - results in delayed classification of account as NPA by Bank
- New facilities sanctioned to potential defaulters in Buyout/Direct Assignment portfolio

One Time Settlement (OTS) cases:

- Classification of OTS cases as restructured with settlement period > 3 Months
- OTS tagging for Buyout portfolio
- Provision of sacrifice amount in OTS cases - Different practices - few banks post recovery of entire amount as agreed in settlement & others as and when OTS is approved

VERIFICATION OF ADVANCES – ISSUES NOTED

Security Value Assessment for NPA provisioning:

- Security valuation in case of loans secured by immovable properties - IRAC circular prescribes valuation once in three years – varied practice followed – few have adopted dual model i.e. Residex model and Valuation report
- Product wise methodology differs – adequate sample coverage to be ensured

Credit review/verification of advances (loans and credit cards):

- Auditor may verify the functioning of system to ensure fresh retail exposure not disbursed to existing NPA/ Technically written off account – potential area of lapses
- Auditor may also verify the system considered for computing Average Banking Balance for various loan products – system bugs by which loan credits are considered while determining ABB of customer
- **In case of under-construction property home loans** - RBI Master Circular on Housing Finance states exclusion of Stamp duty and registration charges ONLY while calculation of LTV ratio - lack of clarity on treatment of GST - industry wide practice to include GST component for determining LTV ratio
- **Backdated up-dation of credit limits in CBS** – two different dates in CBS (effective date & up-dation date) – potential impact on IRAC norms – recommendation to management to revisit the Operations process

VERIFICATION OF ADVANCES – ISSUES NOTED

- Differed practices amongst credit underwriters – interpretational issue of the credit policy and guidelines
- Inconsistency between loan agreement vis a vis system implementation
- **Sourcing based on pre-approved models and internal scorecards:**
 - Various inputs for deriving internal scores - Waivers/deviations considered based on these scores
 - Effectiveness, reasonableness and accuracy can be evaluated
 - Potential risk of higher defaults due to aggressive pre-approved sourcing - regulator's concern on sustainability of such business models
- **Reversal/ waiver of charges in case of credit cards:**
 - Whether overdue status (DPDs) to be reinstated/ purged on such reversals/waivers in card account
 - Probable impact on IRAC norms compliance – NPA identification and asset classification
 - System logic can be revisited for considering such reversal/ waiver of charges as actual repayments

VERIFICATION OF DEPOSITS - ISSUES NOTED

Transfer to Depositor Education and Awareness Fund (DEAF):

- As per RBI guidelines, any credit balances in any account or any deposit in a bank remaining unclaimed or inoperative for ten years or more are required to be transferred to DEAF.
- Few banks adopt practice wherein the assessment is done at the client relationship level- inoperative and eligible to be transferred to DEAF will be scoped out if there are other operating accounts of the same customer i.e., active account
- The RBI circular indicates that the compliance of the DEAF guidelines to be ensured at the inoperative account level and not customer level
- Assessment at client relationship level indicates non- compliance of DEAF guidelines.

Interest on Deposits:

- No interest on deposit due to system issue/system upgrade- analytical review/ratio analysis
- Errors in data entry with respect to updating the date of birth- wrongly considering the account holder as a Super Senior Citizen- higher rate of interest on deposits

VERIFICATION OF OTHER AREAS - ISSUES NOTED

Provision towards Reward Points/ Other Schemes:

- Auditor to verify the reasonableness and timely review of the management assumptions
- Auditor to perform required audit process as per SA 620 - Using the Work of an Auditor's Expert including testing reasonableness of assumptions
- Substantive testing to be performed to ensure reward points provisioning ONLY for eligible transactions – industry wide issue of customer-merchant collusion to misuse loopholes and earn points fraudulently
- Issues observed in areas such as redemption rates, expiry rates, cost incurred etc. (especially in scenarios of downgrading reward features on cards and management's re-estimation of original assumption)

Employee Benefit:

- Auditor to verify the reasonableness and timely review of the management assumptions
- The Code on Social Security 2020 received Parliament's assent in Sep 2020
- Currently awaiting notification of effective date of implementation
- Potential gratuity liability arising post implementation for on-roll employees – how Banks are treating

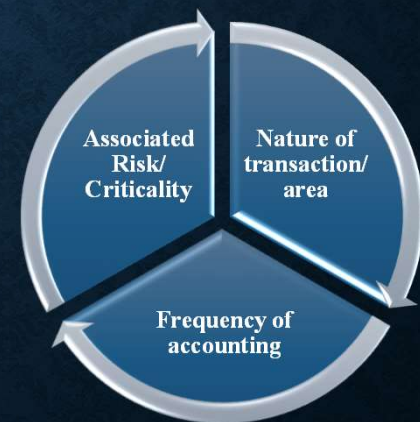
VERIFICATION OF OTHER AREAS - ISSUES NOTED

Audit of Consolidated Financial Statements (CFS):

- Fit-for-Consolidation (FFC) financial statements of group companies in Banking Format - challenges in classification of items as per banking format
- Group Review Instructions/ Group Audit Instructions for Material Group companies
- Professional judgement in case modified auditor's report issued by the Component Auditor - nature and significance
- Consolidation of associates in case financial information of reporting quarter not available due to restriction (UPSI)

Review of Memorandum of Change (MOC):

- How the MOC has been derived and accounted by the Management along with Reasons/ rationale
- Maker-checker oversight on process of MOC and Appropriate levels of approval
- Prone to manual errors
- Compliance test (internal and external requirements)
- Rectification of MOC
- Process of sign-off and documentation
- RBI's comment on multiple MOCs



TESTING OF INTERNAL FINANCIAL CONTROL (IFC)

- Verification and testing of controls – Samples & Coverage (N-T-E)
- Special focus on below aspects – areas of potential lapses:
 - Scope and coverage in common areas of verification – any observations raised by SA but not identified by IFC team during their verification
 - Sampling methodology adopted by IFC vis a vis SA
 - Development of RCM pursuant to new regulations, internal processes, observations by SA and RAR, etc.
 - Overall sanity checks on key RCMs controls – redundancy and relevance of legacy controls

VERIFICATION OF DISCLOSURES - ISSUES NOTED

Disclosure of Extra ordinary/ exceptional items:

- Listed banks also disclose results as per the format prescribed under SEBI guidelines - disclosure of exceptional/ extra-ordinary items
- Disclosure by way of notes in FS - with suitable reconciliation & impacts on various ratios
- **Impact on materiality assessment** in next year- exclusion of such exceptional item- IG on SA 320

Disclosure of Liquidity Coverage ratio (LCR):

- Special focus on identification and classification under Financial Institution and Non-Financial institution – potential area of lapses – erroneous classification can pose direct impact on applicable weightage (40% vis a vis 100%)
- Current system and process of computing LCR – whether manual/ semi-auto/ fully automated
- Treatment of funds lying in routing GLs (temporarily parked due to awaited appropriation)

VERIFICATION OF DISCLOSURES - ISSUES NOTED

Disclosure of Asset-Liability Management (ALM):

- Maturity bucketing for fixed term deposits and advances
- Behavioral analysis for demand deposits, CC OD advances and Credit card
- Historical data base, evaluation of factors in case of new products introduced

Disclosure of Ratios:

- NIM ratio - considering daily vs. monthly average balances
- Gross NPA (GNPA) ratio- considering investments in the nature of loans ('credit substitute') in addition to gross advances

LONG FORM AUDIT REPORT – CRITICAL POINTS

Reporting on Audit trail: Applicable for FY24 onwards:

- Various system/ applications used by the bank for the purpose of various banking operations - Loan origination system, Loan management system, CBS etc.
- Completeness to be ensured for list of software/system used by auditee
- Test of applicability on above identified list - which constitute books of accounts
- Initial points to note:
 - Board approved policy of the auditee
 - Independent verification performed internally by the Management
 - Reporting by the Management
- Expectation of nature of audit trail and key features:
 - Maintained throughout the year
 - No functionality to disable at any given point in time
- Verification could be on-site/ live or sample evidence based

LONG FORM AUDIT REPORT – CRITICAL POINTS

Reporting on Weakness in Critical process:

- RBI communication dated July 8, 2022 – requires SCA/SA report on mechanism of identification & remediation of weaknesses in critical processes
- Varied practice on reporting by SCA/SA on the above communication- most of the banks were in process of developing the mechanism
- Challenges in identification of “critical processes” by the bank – few like LCR, Credit Appraisal etc. highlighted in RBI communication
- Auditor to verify overall process and report in addition to main report and IFC-FR
- Auditor to comment on efficiency of sustenance testing performed by Management of the Bank
- Key points to consider – scope of critical process review by management, frequency of testing, method of reporting and update to audit committee
- Challenges in designing the scope of this review and expectation of regulator from SCA/SA

LONG FORM AUDIT REPORT – CRITICAL POINTS

- Implementation & Compliance of new RBI circulars/ directions
- New policies/ practices adopted by the Bank during the year
- Revision in accounting estimates during the year
- Weakness in critical processes and Internal Controls
- Comment on IT Controls
- Status of Previous period – observations & RMPs
- Any material event occurred during the year bearing financial impact

COMMUNICATION TO AUDIT COMMITTEE AND SSM

AUDIT COMMITTEE

- Audit plan for the period
- Coverage & Joint Auditors responsibility
- SA 260, 265 & 299 and other SAs
- Audit procedures & process
- Branch visit plan & Advance coverage
- Significant & material events during audit
- Regulatory action
- Significant observations including Statutory noncompliance of any L&R
- Recommendations and Audit opinion

RBI SSM

- Update on any open points from previous SSM meetings
- Status of previous year's LFAR open observations
- Points discussed at last conducted Audit Committee meeting
- Critical observations (concluded/ in discussion with Management)
- Material events, Frauds, etc.
- Discussion on issues based on industry wide practices/trends
- Peer bank - observations

FINALIZATION AND REPORTING FOR UPCOMING AUDITS

Time management for balance sheet finalization:

- Systematic and pro-active audit planning well before commencement of audit period work
- Communication and management / F&A Team's buyout of plan, process and expectations
- Agree upon broad timelines of sharing audit data and deadlines and levels of escalations
- Coordination with various departments/ credit units of Banks - SPOCs
- Communicating well in advance any new requirements and additional procedures planned
- Regular update meetings with ET (internally) & with management (preferably on weekly basis during crucial time)
- Pre yearend and post yearend procedures
- Timings of dry run, new disclosures, additional notes etc.
- Discussions on issues and documentation on conclusions drawn

UDIN process:

- UDIN details requested at time of conducting external reviews for evaluating firm's profile and eligibility
- Very important to keep regular track of UDIN register maintained internally by the firm

SUMMARY OF NFRA ORDERS

- Between June 2022 - September 2024, 94 disciplinary orders issued - rapid escalation in enforcement activity
- Systematic lapses flagged in areas such as:
 - Inadequate planning and poor documentation
 - Violation of auditor independence
 - Acceptance of branch audit appointments that were not AGM approved and failing to maintain proper audit documentation
 - Poor scrutiny of RPT
 - Inadequate testing of Internal Controls
 - Failure to report fraud, inadequately assessing fraud risk and lapses in provisions
 - Improper opinion issuance and audit planning shortcomings
 - Audit failures on loan recoverability, documentation tampering, and lack of professional skepticism
 - Incorrect accounting policy disclosures
 - Derivative/ treasury accounting and controls
- NFRA emphasizes robust communication between auditors and audit committees
- NFRA has proposed updating SA 600 to mirror ISA 600 for tackling complexities in group audit structures
- Banks and Financial institutions faced penalties from regulators majorly in areas like – KYC, IRAC, Cybersecurity, CRILC and Regulatory reporting

KEY DEVELOPMENTS IN BANKING SECTOR AUDIT

- **Banking Laws (Amendment) Act, 2025:** Came into effect on August 1, 2025, amending key statutes (e.g., RBI Act, Banking Regulation Act) to enhance governance, depositor protection, audit quality for public sector banks, and extend director tenures in cooperative banks
- **New Digital Credit Assessment for MSMEs & Banking Laws Amendment Act, 2025:**
 - Enables banks to automate loan appraisals using verifiable digital data
 - Auditors must assess the integrity and validation of digital data sources, algorithmic decision points and governance changes reflected through amended laws
- **Anti-Mis-Selling Guidelines (In Draft):** Auditors might need to assess sales practices, disclosures, documentation, and complaint handling—especially for advisory or third-party product sales.
- **Fraud Detection via Financial Fraud Risk Indicator (FRI):** Auditors should evaluate FRI integration into transaction monitoring systems, review flagged incidents, and assess how effectively fraud risks are addressed.

KEY DEVELOPMENTS IN BANKING SECTOR AUDIT

- **Risk Based Internal Audit (RBIA) Framework:** Statutory auditors can build on RBIA outputs, integrating internal audit findings into their risk assessment and prioritizing high-risk areas.
- **ICAI's enhanced IT audit standards:** Aims at developing new IS Audit Standards for digital-first firms (e.g., fintech, startups), to bolster audit quality in tech-heavy environments
- **RBI's push for compliance automation:** RBI mandated automated compliance monitoring, real-time audit trails, KPI reporting, board responsibility in governance.
- **AI in financial services - risks and regulation:**
 - Aims explainability, data privacy, AI bias mitigation, and ethical governance frameworks in financial AI applications.
 - Adaptive, technology-neutral policies are recommended to balance innovation with risk control

KEY AREAS HIGHLIGHTED BY GOVERNOR

- Management's constant vigil on internal & external vulnerabilities
- Banks to keep depositors' & customers' interest uppermost (avoid panic amongst public)
- Focus on Business strategy and plan & Business continuity & Succession planning
- Corporate Governance and role of BOD, ID, MD & Chairman, avoidance of conflict of interest & ensure independence
- Qualifications & fit and proper criteria for Directors – knowledge & experience of industry
- Role of assurance function (both internal & external) & Risk Management – direct access to BOD & committees – clear communication
- Thrust on Information Technology & fraud Risk – use of risk models used for credit assessment
- Staff Accountability
- Growth strategies – caution over aggressive policies & strategies
- ACB to ensure transparent & prudent financial reporting – accounting policies & engagement with Statutory Auditors
- Oversight over subsidiaries
- Systematic risk areas – e.g. personal loan growth (credit card, PL, unsecured consumer loans etc.)
- Co-branded cards

THANK YOU!!

