

INTERNAL AUDIT MANUAL FOR RURAL COOPERATIVE BANKS

[A guidance Document]

**Centre for Professional
Excellence in Cooperative
(C-PEC)**



Bankers Institute of Rural Development (BIRD), Lucknow
(An autonomous Institute Promoted by NABARD)

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(Version-1.0)



Centre for Professional Excellence in Cooperative (C-PEC)

Bankers Institute of Rural Development, Lucknow

LDA Colony, Sector-H, Kanpur Road, Lucknow-226012

E-mail: bird@nabard.org / cpec.bird@nabard.org

Website: www.birdlucknow.nabard.org / bird-cpec.nabard.org

Preface

The Short Term Cooperative Credit Structure (STCCS) comprising of State Cooperative Banks (StCBs) at the apex level, District Central Cooperative Banks (DCCBs) at the intermediary level in the districts, and PACS (Primary Agricultural Credit Societies/Farmers Service Societies/ Large Sized Adivasi Multipurpose Societies) at the grass root level in the villages play an important role in deployment of credit to agriculture and allied activities. The STCCS also provides efficient banking and other ancillary services to contribute effectively to the overall socio-economic development of the country. As per the latest data available with NABARD, the STCCS consisted of 34StCBs, 351 DCCBs and 102559 PACS.

The StCBs and DCCBs perform the role of both credit providers and banking organizations. They are covered under the provisions of Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949 (AACS), respective State Cooperative Societies Act and Rules etc. Presently, the STCCS has a market share of almost 11.78% of agriculture credit while they have collectively issued highest number of the Kisan Credit Cards issued by the entire banking industry in the country. The policies of Reserve Bank of India with regard to banking operations and practices as well as other statutory regulations and requirements such as maintenance of CRR and SLR, etc. including investment of funds as per the prescribed norms, are also applicable to the StCBs and the DCCBs. The Prudential Norms of Income Recognition, Assets Classification, Provisioning and Capital Adequacy have also been made applicable to StCBs and DCCBs.

The cooperative credit and banking institutions are expected to be democratic in their functioning and member driven in their character. Notwithstanding number of constraints in maintaining these important features on a continuous basis, the cooperative credit and banking institutions have been functioning as an important channel for deployment of rural credit and other services, particularly in the rural areas. After constitution of union Ministry of Cooperation, the Government of India is providing necessary framework, encouragement, support and assistance to ensure cooperative organizations function as autonomous, self-reliant, accountable people's institutions and ensure significant contributions to the mainstream economy. Further, there is a need for innovations in the Cooperative Societies Acts with regard to banking as well as cooperatives in other sectors. The successive National Policy on Cooperatives identified number of constraints related to legislative and policy matters, availability of resources, infrastructural deficiencies, institutional inadequacies, insufficient awareness among members, lack of member participation, erosion of democratic character and management constraints, avoidable bureaucratic & political interference, etc. in their operations. In spite of the visible quantitative as well as qualitative improvement in the functioning, STCCS is faced with number of policy as well as operational hurdles which do not facilitate the growth of a robust cooperative credit delivery system in the country. In view of the digitalization of cooperative credit, union cabinet has approved digitalization of 63000 primary agriculture credit societies in India. The process of their computerisation has been started.

Banking, being the most delicate and important operation, depends on public trust and active participation. The banks, in addition to offering prompt and satisfactory customer services, also have additional responsibility of ensuring safety of funds of the investing public. StCBs and DCCBs, keeping in line with the banking norms and procedures of the country, are expected to develop suitable and appropriate systems and procedures to streamline their operations, including banking operations, both at Head Office and the Branches, and are required to constantly upgrade the same to comply with the regulatory and supervisory requirements.

In the present context, the internal inspection and audit strategy should aim at ensuring the effectiveness of supervision over banks and also to serve as a useful management tool for banks. The focus of internal audit and inspection should be on the core areas of the banks' functions mainly Capital Adequacy, Management, Earnings, Liquidity and Systems and Controls (CAMELSC). The important role of the internal inspection and audit is to improve the systems, operational efficiency and financial soundness.

The Working Group on Risk Based Supervision has made many recommendations to strengthen the short term cooperative credit structure, one of which was to strengthen the internal audit of rural cooperative banks, and for the purpose Working Group has suggested, to provide a manual at the supervisory entity(S/E) level which should include the appropriate indicators to be collected from the system/auditors. This will be helpful for supervisory entity to analyse and make use of the outcome to strengthen the internal control function.

In the light of above, this Manual has been prepared by Centre of Professional Excellence in Cooperative (C-PEC), Bankers institute of Rural Development (BIRD) Lucknow on the basis of the available/published secondary data of audit circulars, guidelines, and policy of different StCBs/DCCBs under RBI/NABARD guidelines as on July 2023. The contents of the Manual are designed to provide guidelines to the supervised entity to enquire into the various aspects relating to the financial health of the bank and to avoid the possibilities of any incidence of fraud and malpractice in the bank.

The readers are advised to learn and tailor the information contained herein to suit their needs for internal inspection and audit under the purview of latest guidelines of RBI and NABARD. Efforts have been made to make this Manual as comprehensive and useful as it should be. Therefore, the readers of this Manual are advised to use it as a tool for general guidance. C-PEC & BIRD shall have neither liability nor responsibility to any person or entity with respect to any damage or loss caused directly or indirectly, by the information contained in this Manual.

C-PEC, BIRD

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Table of Contents

Chapter	Contents	Page No.
Chapter 1	Audit & Inspection Policy	1
Chapter 2	Coverage and Structure of Audit Report	21
Chapter 3	Inspection of Cooperative Society	30
Chapter 4	Prime Aspects of Internal Audit & Inspection	43
Chapter 5	Cash and Bank Balance	47
Chapter 6	Investment & Treasury Operations	50
Chapter 7	Retail Lending	62
Chapter 8	Advances of ST Crop Loan/ working capital for AH & Fisheries/working capital of societies/MT/MT (Conversion)/LT	81
Chapter 9	Legal Aspect of Advances	86
Chapter 10	Share Capital & Free Reserves	92
Chapter 11	Deposits and Borrowings	95
Chapter 12	Examination of Profit & Loss Account	106
Chapter 13	Internal Checks and Controls	113
Chapter 14	Management Information System	125
Chapter 15	Information System (IS) Audit	127
Chapter 16	Deen Dayal Antyodaya Yozna, National Rural Livelihood Mission (DAYNRLM) and Joint Liability Group(JLG)	137
Chapter 17	Risk Based Internal Audit	143
Chapter 18	Management	153
Conclusion		165
References/Sources		166



CHAPTER 1

AUDIT AND INSPECTION POLICY

The main objective of internal inspection and audit is to improve the existing banking practices by way of plugging deficiencies in documentation, credit appraisal, compliance to terms of sanction, post-disbursement supervision, proper payment of bills and cheques, cash management at branch level, reconciliation of accounts etc. This report should highlight the deficiencies observed in day to day banking business of branches and sensitize the concerned officials about the same, besides ensuring compliance with statutory and regulatory requirements. Any suspected case of fraud/ embezzlement or serious breach of procedure may also be brought to the notice of Controlling/Head Office.

The coverage of such reports should also be made more comprehensive, to include a thorough examination of the internal checks & control system in the branches including various periodical statements and control returns submitted to the controlling/head offices. The inspection officials should also critically analyse and make study of the gaps found in appraisal of credit proposals, balancing of books, reconciliation of inter-branch/inter-bank accounts, settlement of clearing transactions, suspense accounts, premises and stationery accounts during the course of inspections leaving no scope for malpractices/ irregularities remaining undetected. The internal inspector should scrutinize all temporary/intermediary heads during inspection / visit and give specific instructions for early reversal/settlement of entries.

Before initiating the inspection/ audit of a branch / office for a particular period/year, Inspecting Officer should also physically check the previous Inspection Note/Report and compliance reported by the branch on a random basis. Any wrong compliance or non-compliant issue should directly be reported to the concerned authorities at HO. In order to avoid duplicity and repetition, wherever possible, inspection of a particular branch should only be carried out after the concerned branch has reported compliance of previous Inspection Note.

1.1-Introduction

- Presently the internal audit/ inspection machinery in banks has often failed to highlight and pinpoint the existence of gross and serious irregularities such as improper credit appraisal, disbursement without observing the terms of sanction, failure to exercise proper post-disbursement supervision, suppression of information relating to unauthorised excess draws, revenue leakages, improper KYC verification, improper classification of NPA, etc.
- The Internal audit/Inspection reports rarely make comments on the failure of Controlling / Head Offices. the very few cases of frauds and malpractices come to light through internal inspection / audit reports indicates that the quality of inspection needs to be improved. The failure of the internal audit / inspection machinery can be attributed to the lack of skill of the internal auditor/ inspection personnel, ignorance of policies, non-adherence to the terms and conditions of sanction of loans & advances, non-analysis of data and the casual manner in which the entire work is carried out.
- The cooperative banks should introduce a sound system of internal audit with a view to strengthening the credibility of the system in detecting cases of frauds/malpractices. Steps should be taken to gear up the inspection/audit machinery and to improve the quality of officers of the inspection department. The head of the inspection /audit department at the Head Office should be a sufficiently senior person and should report directly to the Managing Director. The Controlling Office should also have audit machinery under an official of sufficient seniority to conduct the periodical audit of branches under its jurisdiction.



- The officers posted to this department should have sufficient experience and exposure and the department should be headed by an official of sufficient seniority and proven integrity.
- The thrust of the team should be on strengthening internal control systems, compliance with various statutory and regulatory requirements, identifying revenue leakages, giving concrete suggestions for improving asset quality, increasing business, diversification of loans & advances portfolio and increasing income. Further, the follow up of the inspection also needs to be carried out seriously.

1.2-Objectives of Audit

- To verify that the business is conducted in an orderly and prudent manner in accordance with the established policies and practices, and adherence to systems and procedures for timely detection of lapses/irregularities so that the necessary remedial measures could be taken without any loss of time.
- To verify whether the transactions or banking activities are in conformity with the policy parameters laid down by the Head Office in line with the rules, regulations, guidelines etc. issued by NABARD, RBI, Government of India, RCS and other higher authorities and various banking activities are being conducted in conformity with the provisions of the relevant acts, rules regulations etc.
- To ensure that the assets are safeguarded and liabilities are properly controlled.
- To ensure that the documents are complete in all respects and legally enforceable
- To ensure soundness of internal checks and controls to minimize the chances of serious errors and fraudulent manipulations
- To ensure proper Cyber Security Mechanism is in place.
- To ensure various Risks are managed properly.
- To ensure timely submission of statutory and other returns to Head Office, RBI, RCS, NABARD, GOI , State Govt. and all other higher authorities.
- To examine the performance of branch in consonance with the budget, market, competition, growth rate and social objective
- To assess profitability and productivity of branch.
- To evaluate the quality of customer service/ grievance redressal mechanism
- To detect and check income leakage
- To assess the overall performance of the branch/section and offer suggestions for further improvement.
- The summary of the important findings and irregular accounts over a cut-off point may be put up to the Audit Committee of the Board from time to time.

1.3. Functions of Audit Section

At present most of the cooperative banks have internal inspection and audit section in Head Office looking after the audit and inspection related work of the branches and head office departments/sections. This section plans the conduct of audit & inspection and looks after compliance of the audit/inspection observations. The internal inspection and audit is done mostly by the officers posted in this section. The system to Review of Audit Report before its issue to the branch/department/section concerned is lacking in most of the banks. The banks should, therefore, develop a system of review of the audit report within a prescribed time schedule before its issue to the branch/ section/ department concerned. The main function of the audit section is to help the organization to accomplish its objectives by bringing a systematic,



disciplined approach to evaluate and improve the effectiveness of risk assessment, management, control and governance processes as well as to provide vital assurance to the Bank's Board of Directors and Senior Management as to the quality of the Bank's internal control system. In doing so, the audit function helps to reduce the risk of loss and reputational damage to the Bank. It is, therefore, indispensable and an integral part for the safe and sound operation of a Bank.

Audit Section should look into the following activities:

- Preparation of annual audit budget with quarterly/monthly break-up.
- Conduct of audit of branches/HO departments/sections and select indebted societies
- Monitoring the internal audit work at Head Office and large branches.
- Review and issue of audit reports
- Receipt of compliance and scrutiny thereof
- Monitoring compliance of internal checks and controls - inter-branch adjustment accounts, reconciliations position of suspense account, long outstanding entries, frauds, etc.
- Follow up and compliance of statutory auditors' report and NABARD inspection report
- Major observations along with compliance after closure of the audit reports.

Implementation of Audit system

Planning:

The auditor will review prior audits and professional literature. The auditor will also research applicable policies and statutes and prepare a basic audit program to follow.

Notification:

The Internal Audit department will notify regarding the upcoming audit and its purpose, at which time an opening meeting will be scheduled.

Opening Meeting:

This meeting will include management and any administrative personnel involved in the audit. The audit's purpose and objective will be discussed as well as the audit program. The audit program may be adjusted based on information obtained during this meeting.

Fieldwork:

This step includes the testing to be performed as well as interviews with appropriate department personnel. The Auditor will examine the documents and transactions that took place at the branch/ section/ department during the period covered under audit. He will examine as to whether all the instructions regarding execution of documents, custody/ verification of documents, delegation of powers, reporting, compliance with the statutory and regulatory requirements, etc. have been observed and take note of the deficiencies/ irregularities, if any. For the purpose, he will **test check some** of the documents/ transactions.

Report Drafting:

After the fieldwork is completed, a report is drafted. The report includes such areas as the objective and scope of the audit, relevant background, and the findings and recommendations for correction or improvement. The draft report shall be reviewed by an appropriate authority before issue to the branch/ section/ department.



Management Response:

A draft audit report will be submitted to the in-charge of branch/ section/ department for their review and responses to the observations/ recommendations. Management responses should include their action plan for correction.

Closing Meeting:

This meeting is held with the management of the branch/ section/ department audited by the IA. The audit report and management responses will be reviewed and discussed. This is the time for questions and clarifications. Results of other audit procedures not discussed in the final report will be communicated at this meeting.

Follow-up:

After the audit report is issued, the internal audit department will perform a follow-up review. The purpose of this review is to conclude whether or not the corrective actions were implemented.

Closure of the Report

After major/ important observations/ irregularities pointed out in the audit report are complied with/ rectified, the report will be closed.

Benefits of Audit system:

Compliance

Obviously this is one of the main reasons to conduct an audit: to meet the statutory requirements and regulations. An audit provides complete peace of mind for bank and shareholders that the organisation is 100% compliant with all of its current statutory and regulatory obligations. Non-compliance runs the risk of incurring heavy fines, loss of customers and a tarnished reputation – damage that far outweighs the cost and any minimal, temporary inconvenience that may be caused by an audit.

Business Improvements / System Improvements

A thorough, in-depth audit takes an impartial look at the bank's internal systems and controls. This means it's an ideal opportunity for the auditing experts to suggest improvements that can make bank business more efficient. Ways to improve internal controls, business systems, accounting practises, efficiencies, governance and culture can all be identified through the audit process.

Credibility

An audit provides independent verification that the financial statements are a true and fair representation of the entity's current situation. This provides invaluable credibility and confidence to bank's customers/ clients, stakeholders, investors or lenders. It is confirmation that financially everything is as it appears to be.

Detect and Prevent Fraud

Workplace fraud can occur for years without being detected and can be so substantial that sometimes never recover financially or repair the reputations. An audit can be an effective tool for identifying fraud and opportunities to commit fraud. Experienced auditors are skilled at pinpointing weaknesses in bank's systems and controls and suggesting ways to strengthen these to prevent fraud occurring.



Better Planning and Budgeting

An audit confirms the accuracy of bank's financial statements by analysing its financial transactions. It's a detailed process and can result in certain types of income, expenditure, assets and liabilities being scrutinised. This critical examination, coupled with the auditor's financial expertise, can then be used by bank for better financial planning, budgeting and financial decision-making for the future

1.4-Surprise Inspections

The internal audit should be supplemented by surprise/short inspections at irregular intervals, particularly of large branches/high risk branches, and should be carried out by Regional Manager & Head Office officials of appropriately senior levels. The audit section should also identify high risk branches based on parameters other than size. The comprehensive risk assessment, inter-alia, shall bear the following factors while evaluating the risks perceived:

- Volume of business and complexity of activities;
- Substantial variation from the budgets fixed;
- Changes in business activities, industry trends and environmental factors;
- Significant changes in Management (including officers handling key portfolios).
- Any control weakness and risk mitigation steps initiated.
- Surprise inspection will help the audit to look into:
 - General working of the branches,
 - Achievement of budget for the year,
 - Adherence to various statutory/regulatory requirements,
 - Submission of returns,
 - Compliance of audit/inspection report,
 - System improvement,
 - Reconciliation of old entries,
 - Proper cash management,
 - Ensuring proper Locker safety and key maintenance,
 - Ensuring No lapse in System access and password management,
 - Ensuring that no branch officer is indulging in any malafide practices.
 - Ensuring the adherence to all other Credit function, Non-Credit function, IT functions, compliance function and Branch management.
 - Any other relevant functions/areas not mentioned above

While audit of branch will be w.r.t. financial position of last financial year, the supplementary visit/inspection should be for the current financial year.

1.5-Revenue Audit

Besides internal audit and short inspections, a regular system of revenue audit of the large branches should also be put in place. The objective of revenue audit is to identify the areas causing income leakage, besides control of expenditure.



The following areas cause income leakage to the bank:

- Wrong computation of interest – payable as well as receivable
- Non-application of interest on time,
- Application of incorrect rates of interest – payable as well as receivable,
- Not charging penal interest on overdue instalments or late submission of stock statements or non-compliance of any other conditions of sanction,
- Non-charging of processing charges on renewal of limit,
- Non-recovery, short/ excess recovery of service charges on guarantees and letter of credit, etc.,
- Non-recovery, short/ excess recovery of processing charges and documentation fees,
- Non-recovery, short/ excess recovery of inspection charges and other services charges,
- Non-recovery, short/ excess recovery of commitment charges/ CIBIL charges.
- Delay in sanction of loan applications
- Delay in disbursement of loan
- Any over estimation/booking of expense which is nature of income shortage/leakage

This is an indicative list and the auditor may look into more such areas depending upon the nature of business being handled by the branch/ section/ department audited.

Criteria for selection of branches: The bank may prescribe suitable criteria for selection of branches/ sections/ departments like size, advance portfolio, previous history, and periodicity etc. Such criteria may be as follows:

- The auditor should scrutinize all expenditure heads, with emphasis on expenditure GL heads, where the increase over previous half year is more than say 10% or so.
- Cent percent transaction audit to be done where the expenditure head shows an increase of more than say 20% or so over the previous year.
- Top 10/20 (or as per bank criteria) branches businesswise as on previous March / September should be subjected to Revenue audit.
- All branches having total advances of Rs. 2.00 crores (or as decided by bank, excluding Jewel Loans and Loan against deposits) and above should be subjected to revenue audit on half yearly basis as on 30thSeptember and 31st March every year.
- Regional Office identifies such of those branches and revenue audit is arranged by them to find out the income leakage and abnormal expenditure in various heads.
- For branches having total advances of less than Rs. 2.00 crores (or as decided by bank), such exercise shall be carried out along with the regular inspection of the branch, covering the period since last inspection to the current inspection.
- Revenue Audit of Regional Offices should also to be conducted once in a year.

Submission Channel

- The reports of branches and rectification replies are to be compiled by Regional office and should be submitted to HO Inspection & Audit Department on completion of every financial half year. Regional offices have to analyse the reasons for leakage and take appropriate corrective action. Revenue Audit shall be completed within a month of the closure of the half year.



- The details of leaked income and recovery to be reviewed periodically and HO Inspection & Audit Department to place half yearly note to internal audit committee of officers incorporating the leakage of Income identified and recovered during the half year and annual note to ACB (including those identified during regular inspection & Concurrent Audit).
- Revenue Audit of Regional offices is to be conducted once in a year along with annual Management audit. Copies of Revenue Audit Reports of RO are to be submitted to Regional Manager, HO Expenditure Department and Inspection department for necessary follow up and monitoring respectively

Staff accountability and penal provisions.

Detection of leakage is not the sole purpose of the revenue audit. Examination of the reasons for leakage of income should be verified in-depth and action to be taken against the intentional mistakes done by officials responsible for such lapses. A separate report on intentional mistakes by officials on income leakage can be annexed with the report.

1.6-Advances portfolio Audit

The main function of the bank is to obtain the deposits from the public and make advances/loan in the various segments as per guidelines of Govt./RBI/NABARD. Hence security of loans, its repayment is the main focal area of the audit and the financial health and viability of the bank depends on the quality of loan portfolio. The coverage under advances portfolio audit may include compliance with the laid down procedures for appraisal, monitoring, sanction, pre and post disbursement of loans, availability of security, documentation, time-barred documents, if any, and the reasons therefor, areas with high exposure, level of NPAs and the efforts being made for recovery in NPAs

Therefore:

- A system of exclusive scrutiny of credit portfolio with focus on larger advances to individuals and units having high level of exposure at regular intervals may be introduced. A special scrutiny of high value accounts shifted to the bank from other banks, if any, should be specially done.
- Periodical legal audit for the title deeds and other documents in respect of all credit exposures of Rs. 50 lakh and above or as decided by bank and re-verification of title deeds with relevant authorities as part of regular audit exercise till the loan stands fully repaid should be there in banks. Banks should furnish a review note to Board / Audit Committee of the Board at quarterly intervals on an ongoing basis giving therein information in respect of such legal audits which should cover aspects, inter alia, like number of loan accounts due for legal audit for the quarter, how many accounts covered, list of deficiencies observed by the auditors, steps taken to rectify the deficiencies, number of accounts in which the rectification could not take place, course of action to safeguard the interest of bank in such cases, action taken on issues pending from earlier quarters.
- It is high time to have a separate section of internal inspection machinery for scrutinising credit portfolio only. It is necessary to introduce this section with competent and experienced personnel who will make an in-depth examination of the credit portfolio. The section should be made responsible particularly for scrutinising larger accounts and group exposures. To be effective, apart from the competent officials, the section should be under the charge of a senior personnel reporting directly to the CEO/ Managing Director of the bank. The summary of important findings should also be put up to the Audit Committee of the Board.
- The Head Office officials should have a squad for making surprise verification of the cash, goods pledged/ hypothecated to the bank, etc. The H.O. should also have a squad for Snap audit for serious findings.



1.6.1-Snap audit

Snap audit covers select branches with specific reference to house-keeping problems. Respective Head of Department may take a decision for Snap Audit of branches based on the serious nature of the findings in the Inspection reports / based on the views of Regional Office / the level of compliance / the level of rectification of irregularities / on occurrence of a fraud. Such audit normally should not exceed 2 days. Bank shall have provision for undertaking special audit under critical circumstances. Snap/Special audits also be conducted based on :

- Signals from offsite risk assessment,
- Specific requests from Controlling Offices / Departments,
- Serious issues / malpractices / frauds noticed during other audits or based on information
- From other sources

1.6.2-Special Report

The inspectors are required to submit special reports to the CEO/Chairman under copy to the in-charge head of the section where they come across major irregularities which warrant the submission of a special report. The special reports shall be closed only with the approval of the Chairman based on the proper resolution of the Regional manager/Audit Department/audit committee of the executive/ board functioning in the bank.

1.6.3-Submission Channel

The reports shall be submitted to HO, RO and in-charge of the H.O. The snap audit report of branches and rectification replies are to be compiled by Regional Office and placed to audit department/audit committee of the executive/ board functioning in the bank for discussion and closure. Quarterly review note on significant audit findings under Snap Audit should be placed to Audit Committee of Board. However the special reports may be closed by the Chairman based on the proper resolution of the Regional manager/Audit department /audit committee of the executive/ board functioning in the bank. Simultaneously the competent authority may take necessary action against erring official in case serious irregularities are observed and not rectified. Quarterly snap inspections of the branches should be made by the branch level senior officers or by officers of Head Office / Regional Office to especially verify whether drawing power / limit, interest rates, etc. are correctly entered in the system.

1.7- Investment audit

As per section 5 of BR Act 1949 (AACS) the main function of cooperative bank is collecting the deposits from public and make a secure lending and investment. Detailed guidelines on 'Management of Investments by StCBs/DCCBs' have been circulated by NABARD in terms of its Circular No.100/DoS-15/2008 dated 27 June 2008. Further, in terms of its Circular No.124/DoS-1/2010 dated 24 June 2010, NABARD has issued guidelines for preparation of questionnaire/ check list for the use of Auditors for reviewing the efficacy of investment management and treasury arrangements. While keeping these guidelines in view, the internal auditor shall examine the following points under the head investments of the bank and report any discrepancy thereon in the report;

- Whether the existing Investment Policy has been prepared in keeping with the instructions/guidelines of RBI/NABARD, is duly approved by the Board of Directors and contains therein the objectives to be achieved while undertaking investment transactions.



- Whether the Investment Policy is reviewed each year. The Board/Committee/Top Management should actively oversee investment transactions.
- The bank's Investment Policy should clearly indicate the authority to put through investment deals, the procedure to be followed for obtaining sanction of the appropriate authority for putting through deals, fixing various prudential exposure limits, and reporting system.
- The Investment Policy of the bank should include guidelines on the quantity (ceiling) and quality of each type of security to be held on its own investment account. It should be prepared strictly observing the instructions issued by NABARD and the Reserve Bank from time to time and should clearly spell out the internal control mechanism, accounting standards, audit, and review and reporting system to be followed.
- Every transaction should be clearly recorded indicating full details. The Top Management should undertake a periodic review of investment transactions in a critical manner and put up details of large transactions to the Board, for information.
- Internal Investment Policy guidelines framed by the bank with the approval of its Board should also be forwarded to the concerned Regional Office of NABARD certifying that the policy is in accordance with the prescribed guidelines and the same has been put in place. Subsequent changes, if any, in the Investment Policy should also be advised to the Regional Office of the NABARD.
- In respect of non-SLR investments, banks should review their Investment Policy and ensure that it provides for the nature and extent of investments intended to be made, the risk parameters, and cut-loss limits for holding / divesting the investments. The banks should put in place proper risk management systems for capturing and analysing the risk in respect of non-SLR investments and taking remedial measures in time. Banks should also follow the directions and guidelines issued by NABARD /RBI from time to time which include compliance with maintenance of SLR and non-SLR investments, provision for depreciation in investments and their valuation.

1.8-Concurrent Audit

- Ghosh Committee had recommended introduction of concurrent audit at large and exceptionally large branches of banks to serve as administrative support to branches, help in adherence to prescribed systems and procedures and prevention and timely detection of lapses/irregularities. Accordingly, all State Cooperative Banks and District Central Cooperative Banks with deposits over Rs.50 crores or as approved by the Board of directors were required to introduce the system of concurrent audit. Subsequently, based on the recommendations of the Joint Parliamentary Committee (JPC), which enquired into stock market scam and matters relating thereto, all cooperative banks are required to introduce the system of concurrent audit
- The concurrent audit system is to be regarded as part of a bank's early-warning system (EWS) to ensure timely detection of irregularities and lapses. This helps in preventing fraudulent transactions at branches. It is, therefore, necessary for the bank's management to bestow serious attention to the implementation of various aspects of the system such as selection of branches, coverage of business operations, appointment of auditors, appropriate reporting procedures, follow up /rectification processes and utilisation of the feedback from the system for appropriate and quick management decisions.
- The Board should review the effectiveness of the system and undertake necessary steps to correct the lacunae in the system, at least once in a year.



- Managements of the banks should decide the details of the concurrent audit system which broadly defines the concept and scope of concurrent audit, such as coverage of business/branches, types of activities to be covered during the audit reporting system.
- While framing a concurrent audit system, the banks may clearly spell out the linkages between different forms of internal inspections and audits that are already in existence and the proposed concurrent audit.
- The concurrent auditors shall certify that the investments held by the bank as on the last reporting Friday of each quarter and as reported to NABARD are actually owned/held by it as evidenced by physical securities or the custodians statement. The concurrent auditors should specifically verify compliance to the instructions contained in NABARD circulars issued on the subject from time to time regarding transactions in Govt. Securities.

1.8.1- SCOPE:

- Concurrent Audit is an examination, which is contemporaneous with the occurrence of transactions or is carried out as near thereto as possible. It attempts to shorten the interval between a transaction and its examination by an independent person not involved in its documentation. There is an emphasis in favour of substantive checking in key areas rather than test checking. This audit is essentially a management process integral to the establishment of sound internal accounting functions and effective controls and setting the tone for a vigilance internal audit to preclude the incidence of serious errors and fraudulent manipulations.
- A Concurrent Auditor may not sit in judgment of the decision taken by bank/branch manager or an authorised official. However, the auditor will necessarily have to see whether the transactions or decisions are within the policy parameters laid down by the Head Office/Board of Directors, they do not violate the instructions or policy prescriptions of the Reserve Bank of India and that they are within the delegated authority and in compliance with the terms and conditions for exercise of delegated authority.

1.8.2-COVERAGE OF BUSINESS:

The suggestive coverage of business/branches may be as under:

- The Departments/Divisions at the HO dealing with treasury functions viz., investments, funds management including inter-bank borrowings, bill rediscount, and foreign exchange business are to be subjected to concurrent audit. In addition, all branch offices undertaking such business, as also large branches and dealing rooms have to be subjected to continuous audit.
- The problem branches, which are continuously getting poor or very poor rating in the bank's annual inspection/audit and where the house keeping is extremely poor may be covered.
- Banks may also include additional branches at their discretion on the basis of need; that is their professional judgement about the overall functioning of the branches.

1.8.3-ACTIVITIES TO BE COVERED

The main role of the concurrent audit is to supplement the efforts of the bank in carrying out simultaneous internal check of the transactions and other verifications and compliance with the procedures laid down. In particular, it should be seen that the transactions are properly recorded/documented and vouched.

The concurrent auditors should broadly cover the following areas:



1.8.3.1-Cash

- Check the Daily cash transactions with particular reference to any abnormal receipts and payments.
- Check the Proper accounting of inward and outward cash remittances.
- Check the Proper accounting of currency chest transactions (if any), its prompt reporting to Reserve Bank of India
- Check the Expenses incurred by cash payment involving sizeable amount.

1.8.3.2- Investments

- Ensure that in respect of purchase and sale of securities, the section/ department has acted within its delegated power having regard to its Head Office instructions.
- Ensure that the securities held in the books of the section/ department are physically held by it.
- Ensure that the section/ branch is complying with the NABARD/RBI/Head Office/Board guidelines regarding Bank receipts, SGL forms, and delivery of scrips, documentation and accounting.
- Ensure that the sale or purchase transactions are done at rates beneficial to the bank.
- Ensure that the bank is following RBI/ NABARD instructions for maintenance of SLR and non-SLR investments, categorisation of investments, provision for depreciation in investments and their valuation.

1.8.3.3-Deposits

- Check the transactions about deposits received and repaid.
- Percentage check of interest paid on deposits may be made, including calculation of interest on large deposits.
- Check new accounts opened. Operations in new Current/SB accounts may be verified in the initial period itself to see whether there are any unusual operations. Also examine whether the formalities connected with the opening of new accounts have been followed as per RBI instructions.

1.8.3.4-Advances

- Ensure that loans and advances have been sanctioned properly, after due scrutiny and at the appropriate level.
- Verify whether the sanctions are in accordance with delegated authority.
- Ensure that securities and documents have been received and properly charged/registered.
- Ensure that post disbursement, supervision and follow-up is proper, such as receipt of stock statement, instalments, renewal of limits, etc.
- Verify whether there is any misutilisation of the loans and advances and whether there are instances indicative of diversion of funds.
- Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions.
- Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates.
- Ensure proper follow-up of overdue bills of exchange.
- Verify whether the classification of advances has been done as per RBI guidelines.
- Verify whether the submission of claims to DICGC is in time.



- Verify that instances of exceeding delegated powers have been promptly reported to Controlling/Head Office/Board by the branch and have been got confirmed or ratified at the required level.
- Verify the frequency and genuineness of such exercise of authority beyond the delegated powers by the concerned officials.

1.8.3.5-Foreign Exchange transactions

- Check FCNR and other non-resident accounts, whether the debits and credits are permissible under the rules.
- Check whether inward/outward remittance have been properly accounted for.

1.8.3.6-Housekeeping

- Ensure that the maintenance and balancing of accounts, Ledgers and registers including clean cash and general ledger is proper.
- Ensure prompt reconciliation of entries outstanding in the inter-branch and inter-bank accounts, Suspense Accounts, Sundry Deposits Account, Drafts Accounts, etc. Ensure early adjustment of large value entries.
- Carry out a percentage check of calculations of interest, discount, commission and exchange.
- Check whether debits in income account have been permitted by the competent authorities.
- Check the transactions of staff accounts.
- In case of difference in clearing, there is a tendency to book it in an intermediary suspense account instead of locating the difference. Examine the day book to verify as to how the differences in clearing have been adjusted. Such instances should be reported to Head Office/Board of Directors in case the difference persists.
- Detection and prevention of revenue leakages through close examination of income and expenditure accounts/transactions.
- Check cheques returned/bills returned register and look into reasons for return of those instruments.
- Checking of inward and outward remittances (DDs, MTs and TTs RTGS/NEFT).

1.8.3.7-Other items

- Ensure that the branch gives proper compliance to the internal inspection/audit reports.
- Ensure that customer complaints are dealt with promptly
- Verification of statements, HO returns, statutory returns.

The aforesaid list is illustrative and not exhaustive. The banks may, therefore, add other items to the list, which in their opinion are useful for the purpose of proper control of the branch operations. In the context of volume of transactions in the large branches it may not be always possible for the concurrent auditors to do a cent percent check. They may, therefore, consider adopting the following norms:

- In certain areas, such as off balance sheet items (Letters of Credits and Bank Guarantees), investment portfolio, foreign exchange transactions, fraud prone/sensitive areas, if any unusual feature is observed, the concurrent auditors may conduct cent percent check.
- In the case of areas such as income and expenditure items, inter-bank and inter-branch accounting, interest paid and interest received, clearing transactions, and deposit accounts, the check can be restricted to 10 to 25 per cent of the number of transactions.
- Where any branch has poor performance in certain areas or requires close monitoring in Housekeep-



ing, loans and advances or investments, the concurrent auditors may carry out intensive checking of such areas.

- Concurrent auditors may concentrate on high value transactions having financial implication for the bank rather than those involving lesser amount, although number-wise they may be large.
- If any adverse remark is required to be given, the concurrent auditors should give reasons therefore.
- Concurrent auditors may themselves identify problem areas at branch level/bank and offer their suggestions to overcome them.

1.8.4-APPOINTMENT AND REMUNERATION OF CONCURRENT AUDITOR

1.8.4.1-The option to consider whether the concurrent audit should be done by the external auditors (professionally qualified Chartered Accountants) or its own staff may be left to the individual banks. In case bank decides to appoint external auditors for the purpose, the terms of their appointment and remuneration to be paid may be fixed by the banks within the broad guidelines approved by the board and/or by the Registrar of Co-operative Societies of the State concerned.

1.8.4.2-The audit firms will be responsible for any omissions or commissions in respect of transactions seen by them. In case any serious act of omission or commission is noticed in the working of the concurrent auditors (external), the bank may consider terminating their appointment and a report may be made to the Institute of Chartered Accountants of India for such action as they deem fit under intimation to RBI/NABARD/RCS.

1.8.4.3-In case the bank prefers to entrust the audit to its own officers, the bank has to ensure that these officers are well experienced and of sufficient seniority in order to exercise necessary independence and objectivity while conducting concurrent audit. It would be desirable and necessary to rotate the auditors, whether internal or external, periodically. Progressively, it may be considered whether reliance on external auditors may be reduced as soon as requisite skills for audit work are developed by the proper selection and training of officers from within the bank.

1.8.5-REPORTING SYSTEM

1.8.5.1-The concurrent auditors may report the minor irregularities, wrong calculations etc. to the Branch Manager for an on-the-spot rectification and reporting compliance.

1.8.5.2-If these irregularities are not rectified within a reasonable period of time say a week, these may be reported to the head office. If the auditors observe any serious irregularities, these should be straight away reported to Head Office immediately. The auditor will have to lay emphasis on the propriety aspect of the audit. Banks may institute an appropriate system of follow-up of the reports of the concurrent auditors. There must be a system of annual review of the working of concurrent audit.

Concurrent auditor should integrate the audit with other systems of internal audit/inspections, which are already in existence. One of the drawbacks hitherto has been non-integration of the different systems of internal audit and inspections and lack of response to audit objections/qualifications. It is necessary that the entire system of audit, inspection and their follow-up is properly documented and the performance of the integrated audit system is reviewed from time to time. It may be noted that even if the concurrent audit is out-sourced, the entire responsibility for the actions taken by the auditors on behalf of the bank, shall be that of the bank.

1.9-Information System Audit

Presently, most of the Co-operative Banks have been fully computerised. Therefore, an Electronic data processing (EDP) audit cell should be constituted as part of their Inspection and Audit Department to carry



out EDP audit in branches/offices having computerised operations. However, those co-operative banks, which do not have an independent Inspection & Audit Department, should create a team of dedicated persons, who, when required, can perform functions of an EDP Auditor. The overall control and supervision of these EDP Audit Cells should be vested in the Audit Committees of Board. In this regard, all co-operative banks should ensure to comply with the norms stipulated as follows;

- The bank should develop a team of competent and motivated EDP personnel. It is beneficial to have a collective development system consisting of many persons, instead of a few, in order to ensure smooth running of the system. EDP auditors' technical knowledge should be enhanced on a continuing basis through deputation to seminars/conferences, supply of technical periodicals and books, etc.
- Duties of system programmer/designer should not be assigned to persons operating the system. A system programmer/designer should only be allowed to make modifications/improvements to programs and the operating persons would only use such programs without having the right to make any modifications.
- Major factors that lead to security violations in computers include inadequate or incomplete system design, programming errors, weak or inadequate logical access controls, absent or poorly designed procedural controls, and ineffective employee supervision and management controls. These loopholes may be plugged by:
 - strengthening physical, logical and procedural access to system;
 - introducing standards for quality assurance and periodically testing and checking them; and
 - screening employees prior to induction into EDP application areas and keeping a watch on their behavioural pattern
- There is a need for formal declaration of system development methodology, programming and documentation standards to be followed by the bank, in the absence of which quality of system maintenance/improvement might suffer. Auditors should verify compliance in this regard.
- Contingency plans/procedures in case of failure of system should be introduced/ tested at periodic intervals. EDP auditor should put such contingency plans under test during the audit for evaluating the effectiveness of such plans.
- An appropriate control measure should be devised and documented to protect the computer system from attacks by unscrupulous elements.
- To ensure that the IT applications have resulted in a consistent and reliable system for inputting of data, processing and generation of output, various tests to identify erroneous processing, to assess the quality of data, to identify inconsistent data and to compare data with physical forms should be introduced.
- If outside computer agencies are engaged, bank should ensure to incorporate the clause of visitatorial rights in the contract so as to have the right to inspect the process of application and also ensure the security of the data/inputs given to such outside agencies. Agreement with the vendor should take care of probable data leakage.
- The entire domain of IT activities (from policy to implementation) should be brought under the scrutiny of Inspection and Audit department. Financial outlay as well as activities to be performed by IT department should be reviewed by senior management at periodic intervals.

IS Audit:

NABARD vide Circular Letter No. NB. DoS. HO. Pol./ 3634 / J-1/2014-15 (DoS Circular No.33/DoS-



01/2015) dated 25th February 2015, enclosing the guidelines of Information System (IS) Audit in Banks. Under the guidelines the banks were instructed to adopt an IS Audit Policy, adopt appropriate system and practices for conducting IS Audit by a qualified audit firm or by a team of competent IS personnel on annual basis, covering all the critically important branches and functions at HO/Controlling Offices. Such IS Audits were to be undertaken prior to Statutory Audit so that the Statutory Auditors could incorporate comments from the IS Audit Report. Further, the IS Audit Reports were to be placed before the Top Management/Audit Committee of the Board/Board of Directors and the compliance was to be furnished within a stipulated time frame.

Various aspects of information system (IS) audit to be examined have been indicated in specific chapter.

1.10-Vigilance cell

Frauds/cyber frauds in Cooperative Banks are, cases of criminal breach of trust, encashment of forged instruments, manipulation of books of accounts, unauthorized credit facilities extended for illegal gratification, cheating and forgery etc. These are different types of modus operandi for frauds. However, frauds in large number of cases are perpetrated by bank staff by flouting established systems and procedures. NABARD vide its circular letter No.NB.DOS. HO.POL./3899/P-71/2005-06 (Circular No.16 / DoS.1/2005) dated 14 January 2006 requested the RCS of all the States to ensure that the Cooperative Banks set up Vigilance Cell keeping in view the increase in fraud cases in Cooperative Banks.

1.10.1-Role of Vigilance cell

The internal auditor should carefully watch the proper set up of vigilance cell and comment thereon:

- The Vigilance Officer should be a full time and an independent functionary, senior officer from within the bank or on deputation from outside, serving or retired, with a tenure of at least three years. If vigilance functions are assigned to an officer in addition to his/her normal duties, the vigilance function does not receive the required importance and may not develop into an effective instrument for curbing the growing trend of vigilance cases.
- The functions of vigilance cell should include detective vigilance and preventive vigilance. Detective vigilance will lead to unearthing frauds and corruption cases through the process of examination of cases of carelessness, unwanted departure from norms, abuse of authority, etc. Preventive vigilance will be through ensuring observance of rules, regulations, procedures and pinpointing the defects and timely rectification.
- All frauds need to be followed up and monitored. Police action as also internal inquiries need to be initiated so that the bank recovers its funds along with interest and avoid the possibilities of loss.
- Speedy action to plug operational loopholes have to be initiated and fraud cases should be put up to the BOD for information. Weak follow up action on frauds by bank will send wrong signals to other staff members having similar inclination and may encourage more such frauds.

NABARD had advised the cooperative banks to strengthen internal checks and controls due to considerable increase in the amount involved in incidences of frauds. Some of the common factors considered to be responsible for perpetration of frauds are as under:

- Absence of well documented system and procedures with defined authority and responsibility at each stage of operation.
- Non-adherence to laid down system and procedures, processes responsibilities, etc.
- Lack of accountability and job specification of staff and lack of deterrent punishment for staff involved in fraud cases.



- Inadequate internal checks and control system. Arrears in internal inspection/ concurrent audit and inadequate supervision by senior officers, especially in one man branches.
- Inadequate scrutiny of branch returns at HO level.
- Lack of adequate exposure to internal inspectors on fraud detection techniques/ skills of staff conducting internal inspection under computerised environment.
- Arrears in balancing of books of account and delay in reconciliation of inter-branch and inter-bank accounts.
- Inadequate staff at branches resulting in compromising the distinction between the ‘maker’ and ‘checker’.
- Management of some of the banks were not very serious in getting the pending fraud cases reviewed in their Board meetings. Most of the banks had not constituted “Fraud Risk Group”.
- Inadequate customer education measures
- Ineffective vigilance mechanism.

A brief modus operandi of certain frauds that had surfaced in the past has also been circulated by NABARD.

Further, NABARD vide circular no. NB/DOSCFMC/625/P-80 dated 31.5.2019 has issued monitoring and reporting guidelines regarding reporting of frauds for cooperative banks. Some of the important points to be examined are:-

- Whether the bank has framed internal policy for fraud risk management and fraud investigation function.
- Whether an annual review of the frauds is done and a note is placed before the Board of Directors for their information and guidance.
- Whether fraud cases are analysed to identify the root causes, examine whether the systems and procedures are scrupulously followed or lapses observed. If so, necessary improvements in systems and procedures has to be made.
- Whether in cases of fraud where the systems and procedures have been flouted, staff accountability is fixed or not.
- Whether frauds are reported to the local Police / CBI for investigation as per extant guidelines.
- Whether Audit Committee of the Board (ACB) is monitoring all the cases of frauds.
- Whether the bank has constituted any Special Committee of the Board for monitoring and follow up of cases of frauds (SCBF) involving amounts of Rs 20.00 lakh and above exclusively.
- Ensure that 100% provision is made covering the total amount of fraud. Adequacy of provision to be examined quarterly and also updated in the reporting platform (ENSURE) of NABARD.
- Whether the bank has put in place a system for monitoring of Early Warning Signals (EWS) and Red Flagging of Accounts.

1.11- Audit Committee of Board

NABARD has, from time to time, emphasized the need on the part of the Board of Directors of the co-operative banks to ensure timely review and action on the findings of statutory inspection/audit and submission of the compliance reports thereto. The Audit Committee of the Board of Directors (ACB) may consist of three to four Directors, one or more of them being Chartered Accountant(s) or person(s) having expe-



rience in management, finance, accountancy and audit system, etc. The MD/CEO and Chairman of the bank will not be members of this committee. This also implies that the bank needs to constitute, wherever necessary, a board with an adequate number of such professionals as per RBI/NABARD guidelines.

1.11.1-Role of the Audit Committee

- To review and follow-up on the observations and suggestions made in the inspection reports of NABARD, statutory audit reports and the reports submitted by the internal Audit / Inspection Department, Vigilance Cell.
- To examine follow-up action on the findings of inspection reports and guidelines, circulars etc., issued by NABARD/RBI as also the internal audit/inspection department, etc., to strengthen the overall functioning and operational efficiency of the bank.
- In order to ensure and enhance the effectiveness of internal audit/inspection as a management tool, Audit Committee should oversee and provide direction to the internal audit/inspection machinery and other executives of the co-operative bank.
- To review the implementation of KYC, AML & CFT norms, submission of CTR, STR, CCR and NTR and other guidelines issued by NABARD / RBI and submit a note thereon, to the Board at quarterly intervals.
- To issue the directions and oversee the operations of the entire audit function in the bank. The entire audit function implies the organization, operationalisation and quality control of internal audit and inspection within the bank and follow-up on the statutory audit of the bank and inspection of NABARD.
- To issue the directions for preparation of a suitable App for uploading data of loan accounts/societies/parties relating to their functioning, financial position, borrowings from bank & loans issued and outstanding at member level, compliance with terms and conditions of sanction, etc. This data should be used at the time of audit / inspection of branches.
- To issue directions for preparation of suitable software for off-site surveillance of indebted societies, compliance with KYC/AML/CFT norms, incorporating compliance of terms and conditions in CBS at the time of sanction & monitoring of loans, availability of data for two financial years with growth percentage/analysis from CBS for audit of branches to the Inspecting Officer & Manager for inspection of branches for effective supervision.
- To review the internal inspection/audit function in the bank - the system, its quality and effectiveness in terms of follow up.
- To review the follow up action on the internal inspection reports, particularly of “unsatisfactory” branches and large branches. Compliance with the Statutory Audit Reports/Concurrent Audit Reports/Internal Inspection/ Audit Report/NABARD Inspection Reports.
- Analyse and detect serious irregularities omitted/committed by the internal inspecting officials.
- To review bank’s compliance with various statutory, regulatory and supervisory requirements.
- Review of quarterly financial statements with management.
- Scrutiny of interconnectedness w.r.t. loans, investments etc. to ensure there is minimal credit risk, market risk and liquidity risk.
- Valuation of the Assets/ undertakings of the entity, if necessary
- To review the whistle blower mechanism

To undertake periodic review of the accounting policies/systems in the bank with a view to ensuring great-



er transparency in the bank's accounts and adequacy of accounting controls. It should specially focus on the follow up of:

- Inter-branch adjustment accounts
- Unreconciled long outstanding entries in inter-branch and inter-bank accounts
- Sundry debtors /creditors and other intermediary accounts
- Frauds
- Risk management system
- Cyber security management
- All other major areas of housekeeping

1.12-Strategy for Branch Audit

1.12.1-Planning

A calendar highlighting branches to be audited in a financial year should be made in last quarter of the financial year (say in the month of February/ March) and programme for audit should be made and put up to the relevant authority for approval

1.12.2-Periodicity

The periodicity of the internal audit of the branches can be half yearly /annually or as per the Bank's policy. In any case, every branch/HO department must be inspected/audited at least once in every 12 months.

1.12.3- Period of audit

1.12.3.1 The internal inspection/audit may be undertaken with reference to the financial position as on 31 March/30 September or any other date as may be decided by the Bank. However, serious/major irregularities/issues, if any observed, may be covered even beyond the reference date.

1.12.3.2 The number of working days to be allowed for conduct of audit may be decided by the bank depending upon the level/type/volume of business handled by the branch/HO department, level of recovery/NPAs and profitability of the branch.

1.12.4- Audit team

The team should consist of one Principal Inspecting/Auditing Officer and one Associate Officer. Branches doing a business of Rs. 50 crore or above (as decided by H.O.) should be audited by a senior officer. Further, newly posted officers in the Department should be sent for under study/under supervision of an experienced officer to acquire skill for audit.

1.13-Compilation of data before audit

The Department of Information &Technology (IT section) must include a menu in CBS for downloading data from CBS. Audit Section may associate with the IT section for the purpose with special focus on the following:

- The audit trail in the system is to facilitate quick and reliable audit of branches/constituents as well as to further improve the report so as to help auditors in concluding deviation made by the branches from the standard instructions.
- A link in the CBS menu should be provided for automatic extraction of pre-audit information of the branch as per the prescribed format. This will help in faster audit/inspection work.

- The basic structure of audit/inspection report should also be provided in the system so that the auditor may prepare the report instantly and move to next branch as decided. The report should be available to all concerned logging on CBS.
- The branch should be enabled to furnish compliance as also review by HO in the system (online).

1.14-Inspection /audit Report

Audit team should submit its report on prescribed format within the stipulated period as decided by H.O. The bank may prescribe the level of officer for finalisation of the audit report depending upon the level of business, recovery, NPAs, etc. It is suggested that the audit report on branches having large volume of business/NPAs (cut off point to be decided by the bank) and those having serious irregularities, frauds, etc. may be finalised by the CEO himself or an officer authorised by him.

1.15-Follow up action

Follow up action on the audit reports and rectification of the deficiencies should be accorded high priority by the Head Office.

1.16-Compliance of Inspection/audit Report

Compliance on the defective features pointed out in the audit report may be furnished by branch to Audit & Inspection Department online or by mail, within 15 working days from the date of receipt of inspection report. The compliance report may be scrutinised and, if needed, the Audit Department shall call for further compliance.

1.17-Closure of Inspection/audit Report

Inspection report may be closed if compliance has been made to the satisfaction of the Department. The inspection report should be closed within a period of 1- 2 months (as decided by bank) from the date of issue of inspection report. In case certain observations could not be complied with or branch has made commitment to comply later, these observations may be reviewed during the next audit and a paragraph may be added in the audit report to this extent. A monthly report of issue of reports compliance and closure of inspection reports shall be put up to the General Manager of Inspection/Audit Department and quarterly status will be put up to the Audit Committee of the Board.

1.18-Circulation of common observations

Common observations/deficiencies observed in audit reports will be communicated to all the branches on quarterly basis so that branches are careful and can take timely steps to avoid similar deficiencies.

1.19- Internal inspection/audit of the branches; important notes:

- Minor irregularities/shortcomings as observed during the inspection of the branches shall be rectified on the spot and are to be recorded in reports.
- Major/serious irregularities/ shortcomings/ aberrations, including fraudulent transactions, noticed/ observed/detected during inspection should immediately be brought to the notice of Head Office authorities after return from inspection/audit immediately in separate detailed notes.
- The inspecting /auditing officer should physically check the compliance report(s) of previous audit/ inspection/ visit notes and comment on all persisting irregularities/ shortcomings. He should seek the reasons for such persisting irregularities and obtain commitment of Branch Manager to address these irregularities within a time frame.



- The inspecting /auditing officer to certify that they have checked the income leakage (with sample size) and to report, instances of revenue leakage, if any.
- The inspecting/auditing officer to share/report the sample size of accounts and vouchers checked.
- All inspecting/auditing officers will not comment in form of 'Yes' and 'No' in inspection/audit note but they shall ensure to comment in detail on concerned matter so that very purpose of inspection of the branches may not defeat.

1.20- Internal audit of Head Office Departments and CTI

Inspection / Audit of all departments including vigilance cell should be done to ensure compliance of policies approved by Board, guidelines issued by RCS, RBI, NABARD, and other regulatory bodies. The inspection team may also examine proper maintenance of record, computerisation and suggestions to improve systems and productivity. The details of various aspects to be examined during the course of inspection/audit are covered in the respective chapters.



CHAPTER 2

COVERAGE AND STRUCTURE OF AUDIT REPORT

The main role of internal auditor is to supplement the efforts of the bank in carrying out simultaneous internal check of the transactions and other verifications to ensure compliance with the procedure laid down. Guidelines /Instructions to be followed / taken into consideration strictly during internal audit of the branches by Internal Auditors of the Bank broadly may be focused on following:-

2-Coverage

- 2.1 Minor irregularities/shortcomings** as observed during the audit of the branches by the Internal Auditors of the Bank shall be rectified on the spot and is to be recorded in reports.
- 2.2 Major/serious irregularities/ shortcomings/ aberrations**, including fraudulent transactions noticed/ observed/detected during audit should immediately be brought to the notice of Head Office authorities.
- 2.3 Previous compliance reports of audit/ inspection:** Auditor should visit the compliance report(s) of previous audit/inspection notes and comment on all persisting irregularities/ shortcomings. He should seek the reasons for such persisting irregularities and obtain commitment of responsible officer to address these irregularities within a time frame.
- 2.4 Cash verification-** The physical verification of cash by the audit team should be done in the presence of custodian(s) of cash in the Branch.
- 2.5 Review of Cash Retention Limit-** The audit team should review the cash retention limit fixed for the branch by HO and comment on its adequacy or otherwise. If the limit fixed by HO is inadequate, the audit team may make recommendations for its increase indicating the reasons therefor. In case the limit fixed is adequate but the branch has breached it continuously for a long period (say 15 days and above), the audit team may incorporate the same in the report.
- 2.6 Trend of income and expenditure:** The auditors of the Bank to check, analyse and report all divergence in trends of Income & Expenditure heads as compared to last two years figures in comparison with current year's business. Comments may be made on positive or negative growth.
- 2.7 Deposits Position:** The audit team to check all divergence in trends on each quarter end and during first few working days of next quarters to check and comment on window dressing in deposits as well as in loans. Specific comments on existence of window dressing or non-existence of same be incorporated in report.
- 2.8 Account opening forms:** The auditors to check all account opening forms of non-individual accounts (as there are very few accounts other than individual cases). Test check individual cases w.r.t. all KYC compliant documents and comment upon same.
- 2.9 Tax Deduction at Source:** The auditors to take feedback at H.O. as the TDS has now been centralized and the respective Cell is coordinating with branches on TDS compliance. However, audit team can check all instances of TDS reversals and should write a detailed note on reasons of wrong deduction of TDS and reversal thereof. Further, ensure to check that there is absolutely no credit in TDS payable head after 7th of preceding month and entire amount is transmitted to HO before specified date. If there remains any credit, audit team to report with Branch Manager's comments.



- 2.10 Scrutiny of Temporary/Intermediary Heads:** The auditors of the Bank should examine and analyse age-wise pending entries and check the reasons for non-adjustment of long old outstanding entries and report such entries only which are pending for a long time in each temporary head. The Branch Manager's comments on reasons for long old outstanding entries should also be incorporated in audit report. Auditor should also check the adherence of blocked account treatment.
- 2.11 Revenue Income Leakage:** The audit team to certify that they have checked the income leakage (with sample size) and to report, instances of revenue leakage, if any.
- 2.12 Observations on overdraft:** In case the branch has not sanctioned overdraft to any client, a certificate to this effect be obtained.
- 2.13 Vouchers;** The audit team to share/report the sample size of accounts and vouchers checked.
- 2.14 Loan & Advances:** The auditors of the Bank shall ensure physical verification of securities, checking the observance of delegation of powers for sanction, Security Charge Creation, end-use of funds, verification of accounts with excess overdrawn drawings, monitoring of project loans etc. by the Branch Manager.
- 2.15 Non-Performing Assets (NPA):** The auditors of the Bank to verify and certify the NPA Classification and report, if there is any divergence and also verify SMA-0, SMA-1, and SMA-2 and displaying the example of term loan and cc/od in the website of the bank. Verify age wise classification of NPA accounts and report divergence, if any. It should be noted that if audit team does not report any divergence and divergence is noticed at later stage by any other inspecting authority, audit team should be held responsible.
- 2.16 Inoperative/Dormant/Un-Claimed Deposit Accounts:** The audit team to verify each case of dormancy where any account has been moved - out from dormancy and check, if all latest KYC documents have been obtained, normal cash transaction carried out, proper application has been obtained from the account holder and such movement is duly authorized by the Branch Manager or competent authority.
- 2.17 Death Claims and Settlement:** The auditors of the Bank to report on death claims in detail. The auditors to check whether all death claims settled during the period are duly supported by all requisite documents as per HO instructions and is also duly sanctioned by the competent authority. Auditor also to verify the position of displaying the list of unclaimed deposit accounts in the bank's website.
- 2.18 Examination of all heads;** The auditors will ensure that while auditing the branch, no loan/ deposits head existing in the branch remains unattended /un-audited. Besides above, audit team to check and report on each type of loans and advances head on sample basis.
- 2.19 Big exposures:** In big exposure accounts auditor should check and cover all irregularities/shortcomings including specific comments on report in terms of sanction, availability, valuation & enforceability of primary as well as collateral security, margin money contribution, non-completion of projects in time, delayed repayments and also report restructuring & rescheduling of loans and NPA marking etc. Among other things, the following points should be covered specifically:
- Note on appraisal part
 - Note on compliance with each term of sanction (comment on one and each term)
 - Note on margin money contribution by promoters
 - Note on utilization or miss-utilization of funds and system of branch to verify this and comment on sufficiency of the same.
 - Note on availability and valuation of security and its enforceability.



- Note on availability of stock and fixation of DP in case of c/c limits.
- Reasons for account becoming NPA, if so.
- Status of availability and valuation of security after account become NPA.
- Comments on current category of accounts as per IRAC norms
- Certification of correct / incorrect categorization.
- Comments on any indication of fraud in account if any.
- Comments on any instance of diversion of funds, if any.
- Note on adherence of exposure limits.
- Details of recovery efforts, arbitration and execution cases / or lack of efforts made by branch in NPA marked cases. Also note on recovery efforts through SARFAESI ACT.
- Comments on branch strategy for recovery or regularization of account.

Indicative Sampling for Loan Accounts can be as under:

- All loans sanctioned during the period of audit.
- All accounts (TL/ CC) having exposure of more than 25.00 lakhs (irrespective of date of sanction or disbursement).
- All Housing and similar Projects.
- All Industrial and sugar mill loan all newly marked NPA accounts and stressed accounts.
- All accounts which are likely to be NPA upon default of next 1 EMI.
- All C/C Limits as well as staff loans irrespective of year of sanction.

2.20-Asset Classification

- Check NPA statement at the end of last financial year for accuracy.
- NPA - correctness of classification as per IRAC norms, movement of NPAs. IA team to verify and certify the NPA classification & age wise classification done by the branch and report divergence, if any. In case IA Team does not report any divergence and subsequently found / reported by branch auditors / inspection team, the IA team shall be held equally responsible.
- Whether all NPA accounts have been marked properly and exhibited in the statement as per IRAC norms.
- Memorandum of Change (MOC) to be reported in case of any deviation. MOC may be relating to suggested changes in various items of Balance Sheet / Profit & Loss Account / Advance portfolio/yearly provisions/ fixed assets, etc.
- NPA management – recovery of NPA loans, position of incremental NPAs.
- Purpose-wise/ age-wise NPAs
- Restructuring/rescheduling
- Concentration of NPAs.
- Whether any window dressing of NPA has been done?
- Whether adequate steps have been taken for reduction of NPAs?
- Critical review of large NPA advances.
- Whether statements of irregular accounts monitored on a monthly basis?
- Suggest steps for reduction of NPAs.
- Comment on Upgradation of NPA's if any.



2.21-Recovery of Loans

Auditor should Examine and comment on the following:

- Purpose-wise over dues
- Age-wise over dues
- Concentration of over dues
- Details of Overdue Interest
- Any irregularities to be commented
- Whether adequate steps taken for recovery?

2.22-Legal action taken

- Progress under arbitration/liquidation/execution, etc.
- Analyse legal action initiated for the recovery of loans
- Whether adequate legal action initiated?
- Progress details of action taken under SARFASEI
- Progress of recovery through Lok adalat.

2.23-Deposits

- Targets & achievements of deposit mobilization
- Status of issue of RuPay Debit cards and activation of cards
- Comment on CD ratio of the branch
- Comments on nominations obtained by the branches.

Other aspects to be examined in its specific chapter.

2.24-Earnings / Profitability / Income leakages

Auditor should examine;

- Profit & loss and income & expenditure – comparison with previous year, analysis of Profit and Loss Account, comment on increase / decrease in income from loans & advances & investments, misc. income & expenditure,
- Interest paid on deposits & borrowings, overdue interest provision, provisions for income tax, prepaid insurance & comments on cost of management, cost of funds, risk cost, ROA and suggest measures for increasing income and profitability of the branch.
- The income leakages and confirm if the branch is charging commission on drafts/cash orders/ collection of cheques/transfer of funds and other charges as per HO guidelines. Also examine levying of incidental and minimum balance charges as per bank's policy.
- To certify having checked the income leakage (with sample size) and to report if they found / not found instances of revenue leakage.
- Whether any overdraft has been allowed by the branch in any current or savings account or any other head. Internal audit team to indicate in the inspection report the sample size of accounts and vouchers checked

2.25-Lockers

- Comment on existence of locker policy as per RBI guidelines.
- Status of lockers occupied / vacant lockers.
- Status of settlement of locker in case of deceased.
- Whether KYC norms followed before allotment of locker?
- Whether operations were allowed strictly in terms of the contract of hiring?
- Whether the signatures of the operators were verified before allowing access to the lockers?
- Whether the keys of the vacant lockers were kept in an orderly and identifiable manner and accounted for?
- Procedure for collection of rent and maintenance of due date diary.
- Rent outstanding for long period (details regarding total no. of cases, total amount of rent outstanding, action to recover the arrears). List to be attached with the report for compliance.
- Whether the surrenders were in order with the cancelled agreements?
- Whether the locks were changed when a locker was surrendered before letting out to another hirer?
- Examine the cases where lockers were broken open.
- Comments on nominations obtained.
- Comments on preparation of locker waiting list

2.26-Frauds & embezzlements

- Particulars of frauds detected and dacoities, etc. occurred in the branch. Details, indicating the amount involved, modus operandi, amount recovered, action taken by the branch for recovery, reasons for such occurrence, should be furnished in the report.
- Status of submission of return to HO
- Suggestions for improvement in internal checks and controls.
- Were there any losses incurred by the branch through theft, etc.?
- Adequacy of **insurance coverage**.

2.27-Other Assets & Liabilities, Sundries, Suspense Entries

- Land, building, furniture, fixtures, sundry debtors (comments on long outstanding entries and their realis ability)
- Inter-bank/ inter branch a/c – Pending entries (comments on **long pendency**)
- Depreciation and charging to profit and loss account
- Details of DD paid ex-advice etc. if any.
- Interest payable on deposits – whether interest provision worked out correctly.
- Sundry creditors (age wise)
- Bills payable
- Other assets & liabilities and suspense/sundry entries to be examined as per instruction of head office.

2.28- Management and Operating System:

- Maintenance of Books of account, including vouchers, cheque books & DDs, quality of documentation & enforceability of documents and Internal Checks and Control system & accuracy of statements & returns should be seen.



- Check vouchers month-wise on a random basis for the period under audit and also check whether these are in accordance with HO guidelines.
- Comment on the average vouchers of the branch for six months.
- Comment on adequacy of insurance policies & whether renewed timely?
- Compliance of policies, laid down procedures, observance of KYC/AML/CFT and prudential norms .Compliance with various provisions of Income Tax Act, 1961, Payment of bonus Act, Gratuity Act etc.
- Examine compliance of provisions of the Banking Regulation Act, respective State Co-operative Societies Act and Rules, etc.
- Comment on the quality of inspection notes of societies and timeliness in issuance of inspection reports & receipt of compliance.

2.30-Information System audit

Aspects to be examined as per guidelines/ instructions issued by Head Office from time to time.

2.31-Cooperative Training institute (CTI)

The internal audit and inspection team will also visit the CTI/ACSTI of the state/district and mainly comment on the following;

- TNA analysis
- Standardisation of training programme
- Compliance of NABARD inspection Report.
- CTFC certification of Faculty members
- Syllabus committee meeting
- Standing committee meeting
- Position of guest faculty programmes
- Position of on location programmes
- Efforts of CTI for increasing the CPEC membership
- Adequacy of infrastructure, and Utilisation of budget.

2.32- Other aspects

- Housekeeping – maintenance of premises & counters; whether premises owned or on lease; whether lease deed executed and renewed timely?
- Financial literacy camps
- Customer service & customer meets
- Branch upkeep/maintenance of premises & safety measures
- Staff productivity
- Status of farmers' clubs
- Promotion of SHGs & JLGs
- Participation in Govt. Social sector schemes viz., Pradhan Mantri Jeevan Joti Bima Yojna (PMJJBY), Prime Minister Suraksha Bima Yojna (PMSBY) and Atal Pension Yojna (APY), etc.
- Suggestions for improvement in the working of the branch viz facility for senior citizens, differently abled persons, drinking water facility etc.



2.33-Loans to societies

- Primary Agricultural Credit Societies(PACS)
- Primary Handloom Weavers Co-Op. Societies(PHWCS)
- Other types of societies, such as Industrial Societies, Salary Earners Cooperative Societies, Marketing/ Processing Societies,

The auditor should watch the main T&C of loan to Societies, / Sugar Societies as follows;

- In case of advance to cooperative society, the bye-laws should be studied. Borrowing Powers have been ascertained, resolution by the managing committee have been passed.
- In case of sugar society whether the letter of ceding charge has been obtained from other financial institution.
- Whether the borrower /guarantors have duly acknowledged the sanction letter and copy thereof is held by the bank along with the documents.
- Whether all the documents have been adequately stamped and properly cancelled prior to execution of the document
- Whether search at the office/website of Registrar was carried out to rule out any prior charge over the assets /properties charged/mortgaged.
- Whether Govt.guarantee obtained for financing to cooperative sugar mills incurring losses.

2. 34- Imbalance

- Examine whether the borrowings made by the affiliated societies are fully covered by the loans and advances outstanding from the members at society's level.
- In case the borrowings outstanding are more than the loans outstanding, what are the reasons for the imbalance?
- Examine whether the branch had been monitoring recoveries at the societies' level and whether it had ensured that all the recoveries had been passed on to it?
- Suggest suitable remedial measures to reduce the imbalance.
- Examine amongst the total indebted Societies, how many were inspected by the Branch /RO and District Manager if any in the year under audit, and the status of compliance?
- Examine no. of societies under liquidation affiliated to branch.
- Examine status of full time Secretaries, MC held, audited, financial statements received, recovery performance, etc.
- Whether records & latest audit / financial reports maintained in respect of societies financed?
- Examine share linkage of indebted societies, deficit, and efforts made for achieving requirement link

This is an indicative coverage. Auditor may cover others aspects as per their requirements.

3-Structure of the Internal Audit Report

Basic elements

Though any specific layout/ format of internal audit report has not been available, and the auditor can include as many as aspects they have examined, in their report, yet as per the standards on internal audit (SIA 4) reporting issued by ICAI, the internal auditor's report may include the following basic elements, ordinarily, in the following layout:



- Title;
- Addressee;
- Report Distribution List;
- Period of coverage of the Report;
- Opening or introductory paragraph;
 - identification of the processes/functions and items of financial statements audited; and
 - a statement of the responsibility of the entity's management and the responsibility of the internal auditor;
- Objectives paragraph

Statement of the objectives and scope of the internal audit engagement;

- Scope paragraph (describing the nature of internal audit):
 - a reference to the generally accepted audit procedures in India, as applicable;
 - A description of the engagement background and the methodology of the internal audit together with procedures performed by the internal auditor;
 - A description of the population and the sampling technique used.
- Comments for Executive Summary, highlighting the key material issues, observations, control weaknesses and exceptions;
- Observations, findings and recommendations made by the auditors;
- Comments from the local management;
- Comments on action taken/ not taken pursuant to the observations made in the previous internal audit reports;
- Date of the report;
- Place of signature; and
- Internal auditor's signature with Membership Number.

A measure of uniformity in the form and content of the internal auditor's report is desirable because it helps to promote the bank's understanding of the internal auditor's report and to identify unusual circumstances when they occur. The internal auditor should exercise due professional care to ensure that the internal audit report, inter alia, is:

- Clear
- Factual - presents all significant matters with disclosure of material facts.
- Specific
- Concise
- Unambiguous
- Timely
- Complies with generally accepted audit procedures in India, as applicable.

Adherence for writing audit report

- The report should have an appropriate title expressing the nature of the Report. The report should be appropriately addressed as required by the circumstances of the engagement.
- The report should identify the systems, processes, functional lines or other items of the entity that have been audited, including the date of and period covered.

- The report should include a statement that the operation of systems, procedures and controls are the responsibility of the entity's management and a statement that the responsibility of the internal auditor is to express an opinion on the weaknesses in internal controls, risk management and governance (entity level controls) framework, highlighting any exceptions and cases of noncompliance and suggest or recommend improvements in the design and operations of controls based on the internal audit.
- The report should describe the scope of the internal audit by stating that the internal audit was conducted in accordance with generally accepted audit procedures as applicable. The management needs this as an assurance that the audit has been carried out in accordance with established Standards.
- The report should include a statement that the internal audit was planned and performed to obtain reasonable assurance whether the systems, processes and controls operate efficiently and effectively and financial information is free of material misstatement.
- The internal auditor's report, in line with the terms of the engagement, should describe the internal audit as including:
 - Examining, on a test basis, evidence to support the amounts and disclosures in financial statements;
 - Assessing the strength, design and operating effectiveness of internal controls at process level and identifying areas of control weakness, business risks and vulnerability in the system and procedures adopted by the entity
 - Assessing the accounting principles and estimates used in the preparation of the financial statements; and
 - Evaluating the overall entity-wide risk management and governance framework.
- The Report should include a description of the engagement background, internal audit methodology used and procedures performed by the internal auditor mentioning further that the internal audit provides a reasonable basis for his comments.
- The report should clearly indicate the highlights of the internal audit findings, key issues and observations of concern, significant controls lapses, failures or weaknesses in the systems or processes.
- The Observations paragraph should clearly mention the process name, significant observations, findings, analysis and comments of the internal auditor.
- The Comments from Local Management should contain the observations and comments from the local management of the entity provided after giving due cognizance to the internal auditor's comments. This should also include local management's action plan for resolution of the issues and compliance to the internal auditor's recommendations and suggestions on the areas of process and control weakness/deficiency. The management action plan, should contain:
 - The timeframe for taking appropriate corrective action;
 - The person responsible; and
 - Resource requirements, if any, for ensuring such compliance.

Further comments from the internal auditor, in response to the auditee feedback, are to be clearly mentioned along with auditor's suggestions and recommendations to mitigate risks, strengthen controls and streamline processes with respect to each of the observations and comments.



CHAPTER 3

INSPECTION OF COOPERATIVE SOCIETY

Under the rural cooperative credit structure in India, primary societies like PACS/LAMPS/MPSS/FSS are playing a great role in providing rural credit and thereby have a big role in the growth of Indian economy. The cooperative banks are financing many societies, therefore auditor should examine all major aspects regarding inspection of cooperative societies as follows:-

3.1-PACS. Short term agriculture loans

- Has the PACS received recapitalization? If yes, has it been able to attain required CRAR.
- Has the society implemented the Common Accounting System prescribed under the Revival Package?
- Did the society have separate owned or rented premises to house its office?
- Whether the society has increased the membership during the last two years with special reference to small and marginal farmers and steps taken to increase the membership of the society?
- Whether the rural artisans were also enrolled as members and financed by the society
- See the details of the members covered and financed under Dindyalantodya yozana National Rural Livelihood Mission (DAY NRLM) and special programmes / schemes for women and weaker sections.
- Obtain state partnered particulars of the amount of contribution received from the Government.
- Examine the normal credit limit statements of the society for the previous and current years; and bring out deficiencies, if any, in regard to following aspects in particular: -
 - Whether the statement had been prepared in two parts Small and marginal farmers and part II for other farmers, and whether the classification of farmers was made correctly? [This should be checked with reference to the land registers maintained by the society]
 - Whether there is variation in acreage recorded in the register of lands cultivated and the normal credit limit statements?
 - Whether all the members have been issued KCC?
 - Whether there is a system in the society to verify the crops financed by it?

The Auditor should verify if the society had granted advances against the pledge of produce, comment and bring out deficiencies in regard to the following aspects with instances:

- Advances/stocks outstanding for more than one year
- Deficit in margins stipulated and action taken thereon
- Adequacy of storage arrangements/segregation of stocks of different members
- Effective custody of produce
- Periodic verification of stocks by the officers of the Bank. Insurance of produce pledged; and
- Recovery of short-term and medium term loan instalments out of pledge advances.
- Loan issued against warehousing receipts.

The auditor should verify whether the Society is working as Multi Service Centre (MSC) which is a new initiative, verify the eligibility as per guidelines, mainly:



- Proactive management of PACS.
- Earning of operating profit.
- Loan regulatory with DCCBs.
- Audit should have been completed for the preceding year.
- Feasibility and viability of the project.
- Proper maintenance of books.
- Satisfactory working of PACS.
- Recovery should be **more than 60%**.
- Number of borrowing members shall be more than 50% of the total members.

3.1.1. PACS. Medium term loans:

- Examine the medium term loans granted by the Bank/Society to members and bring out deficiencies, if any, in the procedure followed for the sanction and disbursement of loans.
- Adequacy of the loan for the purpose it was sanctioned.
- Arrangements for ensuring that the medium-term loans are properly utilised for the purpose for which they are advanced.
- Verification of utilisation of loans by the paid secretary/supervisor and submission of utilization statements/certificates to the CCB.
- Verify utilisation of a few medium-term loan accounts by undertaking field visits to bring out the deficiencies/misutilisation, if any, wherever possible.
- Adherence of unit cost for various activities.
- Insurance coverage of the assets created out of loan.
- Examine the loan documents obtained by the society from the borrowers for short-term and medium-term loans to see if they are in order or if there had been any time barred pronotes or other documents.

3.1.2. Recovery

- Was there a system of issuing receipts / Pass Books to members for recoveries/ loans advanced?
- Whether recoveries effected from members **were genuine**, and accounted for on the same day and promptly remitted to the Bank? (Comments to be made after examining cash book, loan ledger, member's passbook, counter foils, receipts, etc.).

3.1.3. Maximum Borrowing Power (MBP)

- Examine MBP of society and the individual maximum borrowing power of members for short-term and medium-term agriculture loans.
- In case the society has breached its MBP or its borrowings are nearing its MBP, suggest for amendment in byelaws for increasing the MBP.

Examine short-term and medium-term loan disbursement statements sent to the bank with reference to the relative loan applications, cash book and loan ledgers and bring out discrepancies/irregularities, if any, noticed with instance.



3.1.4. Linking of credit with marketing

- Examine the arrangement of linking of credit with marketing in the area of operation of the society?
- Did the members of the society deliver their produce to nearby marketing societies? The role played by the credit society in this regard and genuineness or otherwise of the recoveries effected through linking of credit with marketing may be commented.

3.1.5. Over dues

- Examine the Demand Collection Balance (DCB) position of the society for the last 2/3 years and comment on the steps taken to recover the over dues, the reasons for increase in the over dues, if any, and whether DCB position was correctly worked out?
- Examine the period-wise and purpose-wise classification of the over dues in detail to ascertain the reasons and suggest remedial measures to improve the recovery from farmers.
- Were all over dues over one year as on the date of inspection/audit covered by legal action?
- Was legal action initiated by the bank/society on the lines specified in the Act/Rules/Bye-laws, such as issuing registered notices, obtaining decrees, & execution of decree etc.?
- Was there any delay in taking legal action at any stage (with instances where arbitration proceedings not filed within 6 months against wilful defaulters/where arbitration references were filed lying pending for more than 6 months/where EPs filed but pending for more than 6 months).

3.1.6. Other aspects to be examined

- Did the society undertake any other activity besides loaning? If it had borrowed from the Bank for such purposes, whether it had adhered to the terms and conditions stipulated by the Bank?
- Comment and bring out irregularities, if any, in regard to the arrangements for custody of valuables.
- Whether the arrangements, were satisfactory? What was the limit fixed for keeping overnight cash balance and whether this was adhered to?
- Whether the society has implemented the Income Recognition, Asset Classification and Provisioning (IRAC) norms as prescribed by NABARD and as communicated by the Registrar of Cooperative Societies? Bring out deficiencies in this regard.
- Adherence to norms for valuation of old/expired stock of non-credit business - Provision for diminution in value.
- Comment on CRAR of the society-Improvement or deterioration in comparison with the previous year(s).
- When was the society last audited and for which year? Was the copy of the Audit report promptly received by it and rectification report sent within a reasonable time?
- Whether the Annual General Body and Managing Committee meetings were held regularly as required under the By-laws/Act/Rules/Registrar's instructions?
- Was any of the Managing Committee members a defaulter to the society? Was any of them elected to office when in default or continued on the Board of Management despite being a defaulter? [This should be examined with reference to the provisions of By-laws/Acts/Rules and full details viz., name of the defaulting director, date of election, due date for payment, amount of default at the time of election and due date etc., should be furnished].
- Was there any instance of misappropriation/embezzlement of funds etc.? If so, give full details
- Examine the balance sheet of the society as on the date of Inspection and Comment on important items of the liabilities and assets.



- Whether rates of interest charged by the society for different types of loans and advances were in accordance with the directives/instructions of the RCS/ StCB/DCCB?
- Completeness or otherwise of documents obtained from the borrowers in respect of different types of loans and advances.
- In case of deposit taking PACS, Profit and Loss of Deposit Nikhep Kendra to be worked out and commented.
- Similarly, examine the other business undertaken by the society, such as PDS, fertilizer business, procurement and marketing of cloth, distribution of cooking gas, etc. and comment on the profitability of each type of activity.

3.1.7. Cash verification

- Verify Cash Balance as on the date of visit and bring out deficiencies, if any (Excess/Shortage, etc.)
- Comments on adequacy of arrangements for custody of overnight Cash Balance.
- Adherence to limit for retention of overnight Cash Balance vis-à-vis provision of Bye-Laws/Insurance Policies, safety measures adopted by the society.

3.1.8. Cost of Establishment

Whether the proportion of the establishment and contingent charges per month to the monthly turnover under sales was reasonable as per latest guidelines.

3.1.9. Accounts

- General quality of maintenance of important books of account like general ledger, cash book, personal ledgers, etc.
- If the society maintained any accounts (other than cash credit) with the DCCB, the need for maintenance of such an account.

3.1.10. Audit and Supervision

Bring out delays/deficiencies in regard to:

- Annual Audit of the Society
- Submission of Compliance Report thereon
- Periodical visits/Inspection by staff of DCCB/Department
- Availability of technical guidance to and supervision over the Society on a continuing basis.

3.1.11. Interest subvention claims;

Examine whether society has received the entire amount of interest subvention claims and any Market Development Assistance (MDA) if any, and it has been utilized properly

3.1.12. Balance Sheet

Discrepancies/deficiencies, if any, in regard to important items in the Balance Sheet such as investments, long outstanding items under other liabilities, other assets, suspense, sundries etc.

3.1.13. Annual General Body and Committee Meetings

- Whether Annual General Body and Managing Committee Meetings were held regularly as required under the Bye-laws or Act/Rules/Registrar's instructions?
- Were there any delays? If any, mention the reasons.



3.1.14. Management

- Whether any of the Managing Committee members are in arrears to the Society in respect of return of finished goods or wage advances?
- Whether there were any Government nominees on the board? If so, were they taking active interest in the working of the Society?

3.1.15. Staff

- Did the Society is computerised and have a whole-time paid Secretary/Manager?
- If so, were any training imparted to the person?

3.1.16. Miscellaneous:

- Were there instances of misappropriation, embezzlement of funds? If so, give details.
- Any other aspect which the Inspecting Officer consider important.

3.2-Non agriculture societies

3.2.1. Primary Weavers' Cooperative Societies (PWCS)

The internal auditor should examine:

3.2.1.1-General

- If the Society was functioning as a production-cum-sale Society and undertaking production of silk, woollen or cotton handloom or polyester cloth? If there were power looms, were they owned by the society or by its members?
- Extent of its area of operation, effective membership in relation to weavers in its area, number of looms-active and / or dormant, etc.

3.2.1.2. Viability

Comment, was the Society identified as viable or potentially viable by the concerned department of the State Government as per the norms prescribed in this behalf?

3.2.1.3. Yarn Purchases

Comment whether the Society buy its yarn requirements from the Apex/Regional WCS at concessional rates? If not, what are the alternative sources of purchase of yarn and long-term arrangement, if any, giving it advantage of concessional rate, whether payments for purchase of yarn were made by cheque drawn on the Cash Credit Account?

3.2.1.4. Production

- Was the Society getting cloth produced on its own account by issuing yarn to members and paying wage
- Was the Society working out a production chart for each type of cloth produced by its members on its behalf? If so, how often was it revised?
- Was there any linkage between the shareholding of a member in the Society and the value of raw materials given to the members for production?
- Whether the Society stipulated any time limit for the return of finished goods by its members and the latter generally adhered to the time-frame for returning the goods?



- In case of defaults by members, was the Society prompt in taking action for recovery? If yes, what were the steps taken for recovery and amount of advances which are likely to prove bad or doubtful in this behalf.
- Problems faced in production as also the difficulties, if any, in getting surplus of input.

3.2.1.5. Purchase of Finished Goods

- Value of cloth purchased on outright basis from other Societies/depots/weavers Society,
- The profit / loss, earned / incurred in such business during the last few years.

3.2.1.6. Marketing Arrangement

- What were the marketing arrangements for sale of cloth? Whether the location of office, showroom, godowns, etc., satisfactory?
- Problems faced by the Society in marketing of its products and reasons for accumulation of stocks, if any, and suggestions thereof?

3.2.1.7. Sales

- Examine the basis for fixing the sale price of cloth produced by members and profit margin added to the cost price.
- Examine the proportion of total sales to the value of cloth produced during the last calendar year .In case the Society has made credit sales, the authority sanctioning credit sales and the amount due thereon. If yes whether the Bye-Laws permit credit sales?

3.2.1.8. Stock

- Were the stocks of raw material, finished goods etc., stocked properly?
- Check a few items of the stock of goods with reference to the stock register and to bring out deficiencies, if any.
- If there were old stocks, say above 24 months, any special measures adopted to clear such stocks?
- How often were the stocks verified by the bank's / Department's Supervisors?
- Were the stocks of finished goods and yarn adequately insured against fire, theft and other risks and policies held in the joint names of the Society and the bank?

3.2.1.9. Share capital

Examine the composition of share capital – Increase/decrease in comparison with previous period (s) – Reasons if there was decrease - Comment on the Government Share Capital contribution received and the breach of terms and conditions stipulated by the RCS / Government in this regards.

3.2.1.10. Borrowings

- Whether the DCCB has taken into consideration the NDR, value of annual production, sales turnover, the remittances into Cash Credit Account during the previous year while sanctioning/renewing the C/C Limits?
- Whether the Society's NDR was adequate to provide margin for its borrowings? Whether the percentage of margin was fixed as per the instructions of the NABARD/Bank. (For normal/additional limit against pledge/hypothecation limits).
- Whether the stocks were valued as per age-wise classification. In case of deficits in margin, whether the deficits were covered by other admissible items?



- Whether the draws from the Cash Credit Account reflected: cost of yarn, dyes, chemicals, etc., purchased and wages paid and the total repayments with the sale proceeds during the previous financial year?
- If deficits in cover, whether further operations were allowed on the Cash Credit Account and how long did the deficits continue?
- Did the Society submit a monthly stock statement to the bank regularly within the prescribed time limit? (While examining the stock statements find out whether the value of stock was shown at cost price or sale price and the norms prescribed for valuation of stocks were adhered to?)
- Whether the rate of interest charged by the DCCB to the Society for pledge/hypothecation advances for Working Capital purposes conformed to the rate of interest prescribed by the NABARD/ BANK policy?
- If the Society had been sanctioned any block capital finance (i.e. for acquisition/modernisation of looms, construction of work shed, installation of new looms, etc.) the basis adopted for such sanction
- Violations, if any, in the terms and conditions of sanction stipulated by the DCCB for block capital finance.
- Violations, if any, in the terms and conditions of sanction in regard to medium-term loans to members of the Society for purchase of shares in consumer type of Co-operative Spinning Mills, as stipulated by the DCCB.
- Whether the Society's dues to the DCCB were covered under the Guarantee Scheme? (I.e. 90% Loss Guarantee Scheme, 90% Default Guarantee Scheme, Credit Guarantee Scheme or, any other similar scheme etc.)
- Was the Society maintaining cover for its borrowings (other than deposits) from other sources like NCDC, KVIC, etc.?
- Violation of the terms stipulated by the credit agencies.
- Were there over dues under any category of borrowings as on date of inspection/audit? If so, the amount and period of default and the steps taken to clear the default?

3.2.2. Cooperative Marketing Society

3.2.2.1. Operational activity

- Particulars of any activity carried on in violation by Bye-Law provisions.
- Approximate distance to the nearest regulated market or Mandi and whether it was located within the area of operation of the Society?
- The principal commodities dealt with by the Society/sold in the Mandi /regulated market?
- Links, if any, between the Marketing Society and the procuring agency operating in the area, e.g., FCI, Civil Supplies Department, etc.?

3.2.2.2. Membership and Share Capital

- Provision in the Bye-laws for nominal membership and purposes for which persons were admitted as nominal members. Was the provision misused in anyway?
- Receipt and utilization of Government Share Capital contribution for Marketing activities and processing activities if any.
- The effect of Government Share Capital contribution on the working of the Society and violation, if any, of the terms and conditions of state partnership.
- Refund of Government Share Capital contribution, if any.

3.2.2.3. Borrowings

- Type of Cash Credit Limits sanctioned by the DCCB to the Society and the extent and manner of utilization of the limits.
- Compliance or otherwise with the terms and conditions stipulated by the bank in regard to following:
 - Submission of periodical financial and stock statements prescribed in respect of different types of credit limits.
 - Proper compilation and submission of the prescribed statements/returns in time.
 - Maintenance of prescribed margins
 - Whether the borrowings from the bank under pledge finance were fully covered by the advances outstanding against its members.

3.2.2.4. Operational deficiency

- Admissibility of draws on the basis of the available drawing power on the account?
- If there were deficits in cover, did the bank allow further draws on the limits? To indicate whether the account was regularized thereafter.
- If marketing finance was provided by the bank, whether the terms and conditions laid down by the bank had been adhered to by the Society?
- Instances of misutilisation, if any, by traders, of concessional finance available to the society from the bank.

3.2.2.5. Pledge Advances

- Examine who is authorized under the Bye-Laws/Board Resolution to grant pledge advances and who was exercising the authority? Whether pledge advances granted are reported to the Board for ratification?
- The margins prescribed by the Society for different commodities and adequacy thereof?
- Maintenance of prescribed margins while granting pledge advances and during the currency of the loans?
- Whether the advances were outstanding against any individual in excess of the prescribed ceiling in the Bye-Law/by the Registrar?
- Was any advance granted/outstanding for more than the period specified in the Bye-Laws or say, 6months?
- Action taken by the Society in cases where members failed to redeem the stocks before close of the period for which the advance was granted?
- Effective custody of goods pledged by members.
- Proper storage of the goods pledged.

3.2.2.6. Other Advances

- If the Marketing Society granted/advanced for other purposes to Societies/Individuals whether it was permissible under the Bye-Laws?
- Whether the Bye-Law provisions were strictly adhered to?



3.2.2.7. Outright Purchases

- Were the powers of outright purchase vested?
- Were they judiciously used? Were the Bye-Laws provisions and/or other prescribed norms in this regard adhered to?

3.2.2.8. Distribution of Supplies

- If the Society was undertaking the distribution of fertilizer, pesticides, etc., was the procedure adopted by the Society for the distribution of fertilizer pesticides, etc., to members against authorizations from their credit Societies satisfactory? Where the sale proceeds promptly remitted to the Bank/Marketing Federation/Government?
- Whether the fertilizer distribution business of the Society was affected owing to competition from other agencies or by the inefficiency and ineffectiveness of the functioning of the Marketing Society itself?

3.2.2.9. Godowns

- Whether structure constructed in scientific manner as stipulated in the Govt.guidelines.
- What is the Godown capacity available to the Society and its utilization?
- Were the different types of commodities/stocks insured for their full value against risks such as fire, theft, natural calamities? If the Society had borrowed for any type of activity from the bank, were such policies in the joint names or with bank clause?
- Were the goods stocked properly making the verification/ counting convenient?
- Was there any periodical verification of stocks owned/pledged with the society by the responsible officials of the Society?
- Verify some of the stocks held by the Society as owner/pledge and to bring out deficiencies, if any.
- Did the Society have old stocks of goods which had depreciated very much in value? What would be the likely loss if the goods were sold at the current market price?

3.2.2.10. Audit and Supervision

- When was the Society last audited and for which year? What was the classification given? Comment on receipt of Audit/Inspection Report and compliance by the Society.
- Details of the assets considered by the Auditor/Inspecting Officer as bad/doubtful of realization?

3.2.2.11. Staff

- Was the Manager and other key personnel trained in Co-operative Marketing?
- Was adequate security obtained from the members of the staff as per Bye-laws/Rules/Instruction of the RCS?

3.2.2.12. Accounts

- Did the Society maintain and updated all the prescribed books of account and registers in order to bring out deficiencies/Shortcomings/Omissions in regard to maintenance of important books and records?
- Examine the balance sheet of the Society as on the date of inspection and to comment on important items of the liabilities and assets.
- Comment on the profitability of the society.

3.2.3. Salary Earners' Societies

- Whether the branch has obtained all required documents before sanctioning the limits such as applica-



tion in the prescribed format, resolution of the board of the society, financial particulars of the society for the last 2/3 years, Audit reports, list of members for whom the society proposes to finance and assessment of financial requirements.

- Indicate name of the documents (other than those as indicated above) being obtained by the bank from the society
- Whether draws were allowed based on requirements and how it was ensured by the branch.
- Whether the branch had ensured that the outstanding borrowing by the society is fully covered by the outstanding loans to members and how frequently it is watched?
- The operations on the limit may be examined and comments

3.2.3.1. Eligibility Criteria & check points

- The Society is registered as Non-Agriculture Credit Society at least one year before availing the loan.
- The Bye-Laws of the Society explicitly provide for advancement of loans to its members.
- The affairs of the Society are managed in accordance with the State Cooperative Societies Act, and Rules.
- The Society has elected Management Committee & accounts of the Society are audited by Statutory Auditors preferably till the preceding financial year.
- Whether Maximum Borrowing Power (MBP) of the Society has been fixed in terms of extant guidelines of Rules and byelaws.
- Examine whether the Society shall undertake that its borrowing members are not defaulters to the Cooperative Society/any bank/any other financial institution.
- The Society has not incurred losses in the last three consecutive year's as per last audit reports.
- In case of Salary Earner Societies 'it shall be ensured that the MCL of an employee member is fixed in such a manner that entire loan amount along with interest is repaid, six months prior to the date of superannuation.
- The Loan advanced by the society to its employees and/or their near relations (if allowed by their byelaws) shall not be more than the limit prescribed by the RCS/Byelaws.
- Methodology followed by the society for effecting recovery from the members – Recovery by employer and passing on to society.

3.2.4. Sugar cane societies

Auditor should verify all aspects of financing to sugar cane societies mainly on the following points:

- What is the installed capacity of the mill?
- Is plant is working on its full utilization?
- Whether all sugarcane cultivators of the area of operation are member of the society/mill.
- Is there is any govt. Contribution in the share capital of the mill, if yes verify the contribution.
- Are all members supplying cane to the society?
- Compare the sugar production of current crushing season with last two years.
- Is there is any variation in the target for actual working days and actual days of crushing days. If yes, reasons thereof.
- Is the sugarcane production in the area of operation of the mill adequate? If not what steps have been made.



- Whether instructions regarding cane purchase, cane price payment, sugar production by the sugar cane authorities under the Act are followed by the mill.
- Type of credit facility sanctioned.

3.2.4.1. Adherence to the terms and conditions of sanction

- Verify the limit availed by the mill, if it is fully utilised or not?
- Verify the c/c account is properly maintained in the books of society.
- Examine the method of calculation of DP. If it is properly calculated as per norms or not.
- Whether the payments are made on due dates.
- Examine the stock position and its submission in due time.
- Examine the valuation of stock, whether on cost price or on market price.
- Examine the periodical checking of stock is done or not.
- Examine, whether any old or damaged stock are being included in the stock. If so it should be corrected and reported immediately.
- Verify adequate cover is available for borrowing after excluding ineligible stocks.
- Examine the storage facility of the mill, is it adequate.
- Examine, whether proper insurance cover is available for the stock.
- Verify the advances granted to members and ensure that such advances are in the line with the terms and conditions stipulated in the bye laws.
- Examine the demand, collection and balance statement and examine the steps to reduce the overdue.
- Examine the position of cane dues to members. If it is settled in time or not, if not what is the pendency and why.
- Examine the position of short margin, if any time, if yes how and why, and the remedial measures taken by society.

3.2.5. Dairy and fisheries societies

Financing to dairy and fisheries societies is an important focus area of government under different agriculture developmental schemes. Therefore the auditor should examine it very carefully specially on the following areas:

- Whether society is registered under respective act and the bye laws of the society has been framed accordingly and duly approved.
- Whether the market is in the area of operation of the society. If not, what arrangements are made to access the market?
- Whether the members have been admitted as members as per byelaws of the society.
- Is there any government contribution in the share capital of the society. If yes verify the same.
- If there is any provision of refund of government share money, if yes, the time and procedure etc.
- If society is financed by bank, whether the terms and conditions laid down by the bank had been adhered to the society.
- Whether the loan outstanding to the society is covered with the society's outstanding against members (in case society is lending to members by borrowing from the bank).
- In case society is borrowing from the bank only for payment to members against procurement of milk/



fish – Whether borrowings are covered by the stock (if society is undertaking processing) or by its book debts (if society is procuring from members for onward bulk sale only)

- If there were deficit in cover did the bank allow further draws on the limit? When account was regularised thereafter.
- Was the society following the guidelines of RCS/NABARD/GOVT. in this regard? If there is any variation, indicate in the report.

Beside above if any other type of society is financed by bank, the auditor should examine them as per guidelines of NABARD/RBI/StCBs./RCS issued from time to time.

Important Notes

While undertaking inspection of any society, the auditor should invariably examine the following items/points:

- First of all, the auditor should go through the Bye-Laws of the society and critically understand its functions and working, so as to ensure that it follows its Bye-Laws and functions on perceived lines and follows laid down norms and procedures prescribed for the type of activity (ies) being undertaken by it, and make comments/observations on deviations/violations, if any.
- Analysis of all important items of balance sheet in comparison with the previous period (s) and comment on increase/decrease and make a purposeful analysis. The auditor has to ensure that the balance sheet reflects society's true and fair picture of its resources and should make comments/observations wherever irregularities are found
- There may be societies which may be manufacturing some goods or may be trading in goods (like consumer cooperatives). Such societies may, therefore, be maintaining Manufacturing/Works Account or Trading Account. These accounts are ultimately merged with the P&L Account. However, the societies are expected to earn profits from manufacturing/works/trading. The Auditor may examine these accounts, stocks and its valuation (there may be expired/old stock which cannot be sold) and make appropriate comments/recommendations.
- Critical analysis of various items of income & expenditure in comparison with the previous period (s), ratio analysis of various items of income and expenditure, adequacy of provisions (NPAs, old/expired stock, depreciation, etc.), so as to ensure that the P&L A/c reflects true and fair picture of its operations during the year, and make observations wherever irregularities are observed.
- Some societies may be undertaking more than one activity, like a PACS undertaking custom hiring, distribution of food grains under PDS, marketing of agri. inputs, etc. In such cases, the societies are supposed to maintain separate records/accounts for each type of activity so that profitability may be worked out unit-wise/activity-wise because each type of activity is a separate unit and is expected to earn profit for the society. To give an example for accounting purposes, if one employee is engaged in more than one segment/activity, his/her salary is appropriated proportionately to all such units/activities based on the time being spent for each such unit/activity.
- The auditor should examine whether the society was observing various provisions in the Cooperative Societies Act, society's Bye-Laws, directions/ instructions of higher authorities/institutions, observance of various statutory and regulatory/supervisory requirements and comment on violations, if any.
- Examine the current level of business being undertaken by the society and potential for increase.
- The auditor may examine the membership vis-a-vis potential for increasing the membership, collection of membership fee/share capital, deficit therein, etc.



- Comment on the management of society which may include holding of AGMs, meetings of BoD/Managing Committee/Executive Committee, agenda discussed, audit of the society and compliance with audit report, so as to ensure that society is being managed properly and make comments on areas requiring improvement.
- The above items are not exhaustive. The auditor may examine and comment on any other items felt necessary keeping in mind the objectives of internal audit/ inspection.

CHAPTER 4

PRIME ASPECT OF INTERNAL AUDIT

An effective internal audit and inspection system is the backbone of the financial accuracy and soundness of the bank. Therefore, the following steps may be taken for improving the quality and content of internal audit:

4.1. Deputation of Experienced Staff for Inspection

To place suitable/experienced staff to conduct inspection who should be posted in the Department for a minimum of three years.

4.2. Capacity Building of Audit & Inspection Staff

Depute the officers for suitable training programmes and refresher programmes with specialized training on investment portfolio, credit portfolio, KYC/ALM/CFT, prudential norms, cybercrime, fraud prevention, etc.

4.3. Internal Meetings with the Inspecting Officers and Other Officials

Hold internal meetings of Inspecting Officers with other departments periodically (say monthly or once in two months) so as to provide them a forum for exchange of discrepancies observed in audit/inspection, updating knowledge of inspecting officers on latest policies & circulars and also for obtaining required clarifications. Such meetings should also be attended by Heads of other Departments under the guidance of Managing Director.

4.4. Quality Scrutiny of Audit / Inspection Reports

The inspection reports/audit reports should be subjected to random quality checks, and the findings should be discussed with the Inspecting Officers periodically in the internal meetings.

4.5. Pre and Post Inspection/audit Discussions with Departments

Encourage Inspecting Officer to discuss with the Department Heads at Head Office at pre and post inspection stages for mutual benefit

4.6. Time Schedule of Inspection Jobs

It is important to keep the time schedule right from programming stage to submission of reports and finally for obtaining proper compliance to the inspection findings.

4.7. High level discussion on Inspection/Audit Findings

The inspecting officer may discuss the findings of inspection with the heads of operational departments of HO, such as Planning, Advances, Recovery, etc., so that the findings may be utilized by them for policy refinement. Priority should be given for system improvements which can bring operational and functional efficiency through sustainable and effective actions.



4.8. Important tips to inspecting/auditing officers for conducting Inspections and Audit

4.8.1. Planning

Planning of Inspection well in advance. In case the audit/inspection is taken up by a team of officers, team leader may identify the strength of team members and distribute various items of inspection assignments. Convey the branch to furnish information/statements one month in advance of inspection with instructions to send the same within fifteen days so as to analyse the same at Head Office before going for audit.

4.8.2. Spade Work

The inspecting team should pre gather the information about Branch/Department related special reports, if any; previous inspection/compliance report, operations, audit report, other returns, if any; position regarding concentration of over dues, cash credit accounts, special types of societies, frauds/enquiry reports, issues of various departments to be examined, reports pending for receipt in Head Office, business targets allocated to the branch by various departments, etc. The inspecting officer has to keep himself abreast of full background information before commencement of the inspection by obtaining them. Data available from CBS should be made use of and the information not available in CBS should be asked from the branch.

4.8.3. Update Knowledge

The team should keep the latest circulars/guidelines issued by Head Office/RBI/GOI/NABARD/RCS.

4.8.4. Important Points/Defects Observed

The team should note down separately portfolio-wise observations. For convenience, compare them with the earlier observations as per the last inspection report - list out points to be probed/further examined and follow it up.

4.8.5. Be Alert

The team should always keep eyes and ears open, should make a mental note or note down important points that may come to their notice for examination/ further probing. Take the earliest opportunity to complete the job in time.

4.8.6. Collect important Particulars

It should be always kept in mind the way in which an observation or a deficiency has to be presented in the inspection report. Collect information accordingly. Relevant particulars, such as, loans sanctioned, outstanding data, etc., should be furnished invariably.

4.8.7. General banking development

For placing general banking development vis-à-vis the position of the bank, collect information for making valuable suggestions if required.

4.8.8. Informal Consent on Important Observations

Avail every opportunity involving discussion with the Branch Manager or Officer next to him on important issues or findings to get his viewpoint on the important findings/observations (positive or negative)

4.8.9. Punctuality and Sincerity

Be punctual and show seriousness in attending to the inspection work for completing the assignment in time.



4.8.10. Visit plan

Plan visits in such a manner so as to spend the required time at branch/society and minimise the wastage of time at each stage.

4.8.11. Mid-Term Review

Take a mid-term review of the work done so as to schedule the balance work to be done within the available time.

4.8.12. Communication of Serious Irregularities

Try to communicate information on serious irregularities to the Head of Audit/Inspection Department, as such a communication helps in taking a decision even before completion of the inspection. The matter should be handled in a confidential manner.

4.8.13. Be Conscious of Developmental Role

During the inspection, the Inspecting Officer has to play developmental role by helping the officials to expand their horizon and framing the observations/defects with developmental touch. Rectification of minor defects may be done on the spot as far as possible. Introduction of a system is more important than the rectification of a single defect. Improvement in the systems, operational efficiency and financial soundness are the triple goals of the inspection team.

4.8.14. Final Review of Work

Final review of the work prior to the last day of inspection - note down information gap/missing points/work to be done - try to have a quick coverage of the points to improve the adequacy level of the content.

4.8.15. Arrangement of Statements Collected

Arrange the collected material in the proper order, and place it safely by indexing before the actual departure from the branch.

4.8.16. Objective Presentation

Objective presentation with all facts and figures giving adequate coverage by keeping the quality and effectiveness (of the points made) in view, within the overall frame-work laid down by the authorities would serve the purpose well for observing the time schedule and for appropriate action.

4.9. Writing of Audit/inspection Report

The Audit/ Inspecting Officer(s) should carry a laptop with him/them and start drafting the report so as to ensure its submission within the prescribed time. The report should be analytical and not simply furnishing of data and facts. Audit of another branch by this team should not be taken up till submission of the audit report of the presently inspected branch.

4.9.1. Attributes of a quality Inspection/Audit Report

- Depiction of the true state of affairs of the Branch/Department.
- Adequate and proper coverage of all important aspects/observations in an in-depth manner, data and ratios in analytical manner.
- Presentation of defects/observations to be in such a manner as to indicate their magnitude.
- Clarity of expression in the report-precise and to the point.
- Instances furnished should support the observations/defects adequately.



- Correctness of the facts and figures. No inconsistencies in the observations/defects.
- More focus on the systems and deficiencies thereof should be brought out clearly.
- Appropriate classification of defects and arrangement of the same in order of importance.
- Suggestions made to be appropriate and practicable.
- Non-compliance with legal/regulatory requirements to be brought out clearly.
- Proper headings and sub-headings to the paragraphs.
- Grammatical and spelling mistakes to be avoided lest they leave poor impression on the report.
- The contents of the inspection/audit report should be clear and specific so that a satisfactory compliance could be expected.

4.10. DO'S AND DONT'S FOR INSPECTING/AUDIT OFFICERS

DO's

- Take up the inspection/audit with an open mind.
- Ensure proper team spirit (where inspection/audit is conducted by a team) before, during and after inspection.
- Create an impression on the Branch that the inspection/audit is a fact finding rather than a fault finding mission.
- Maintain secrecy of the matters relating to the Branch/Department under inspection.
- Ensure that inspection/audit does not hamper the normal functioning of the Branch/Department.
- Be alert so as to get important clues or information which facilitate inspection/audit.
- Use your tact for obtaining crucial/confidential information.
- Treat staff with courtesy and dignity.
- Be polite in pointing out deficiencies/irregularities noticed in the face of any provocation.
- Ensure that minor defects are rectified during the course of inspection/audit itself to the maximum extent.

DONT's

- Do not place yourself under any obligation whatsoever to any of the staff.
- Do not take up inspection/audit with any bias.
- Do not keep confidential information/documents in such a manner that they are easily accessible to outsiders.
- Do not unnecessarily magnify the deficiencies observed in the inspection/audit.
- Do not be carried away with hearsay/tell-tales.
- Do not overemphasize your importance and authority.
- Do not express your personal opinion in regard to controversial matters.



CHAPTER 5

CASH AND BANK BALANCES

5.1 -CASH

The important points to be kept in mind while undertaking verification of cash;

- Verification of cash balance at the branches visited and tallying the cash verified with the balance of cash shown in Cash Balance Book, Day Book and General Ledger. Observations to be recorded in the report, including comments on soiled notes. The cash verification should be done in the presence of custodian(s) in the branch.
- Ensure that the branch is observing the usual safeguards while handling cash in the safe room, in transit, in the cashier's cabin etc. Also verify cash in ATM/Mobile cash van, wherever applicable.
- Examine whether the cash is kept duly sorted separately into re-issuable, soiled and slightly mutilated notes?
- Verify whether cash issued from the safe to the cashier exceeds the normal requirements?
- Verify the cash excess/shortage register and ensure that postings are up to date and that the shortages are not frequent.
- Ensure that excess cash is promptly credited to the Head Office account.
- Verify whether cash cabin is locked/latched during business hours?
- Verify whether the customers' movements inside Banking Hall near the safe room and cash cabin are properly monitored/restricted?
- Verify petty cash held, if any, at the branch and ensure that it is under proper control.
- Verify whether Manager's scroll and cash Receipts and Payments are properly maintained and tallied daily?
- Ensure that cash vouchers are signed by the cashier in full and all vouchers are signed in full by the authorized officer. Also, ensure that receipts are properly accounted and payments are properly authorised.
- Verify whether inward and outward mail transfer/money order register is maintained?
- Confirm whether surprise verification of cash is being done by Head Office periodically?
- Confirm whether the rubber stamps "Cash Received" "Cash Paid" and tokens are kept under lock and key, overnight?
- Confirm that cash paid vouchers are stitched, sealed and kept in safe custody on a day to day basis after due verification with scroll/ Cash Receipts and Payments Register / Daybook.
- Whether remittances are escorted as per the procedure prescribed by the Bank?
- Procedure being followed for remittance/receipt of cash by the branch to/from another branch/HO/bank – Booking of transactions on the same day -Whether the mode of conveyance used for carrying cash is safe, considering the law and order situation prevailing in the area enroot?
- Verify whether the duplicate keys of the safe & safe room, locker room are deposited with nearest commercial bank and safe custody receipt has been obtained?
- Indicate whether duplicate keys of the safe are rotated at least six months' interval?



- Verify whether there are any claims pending under any insurance policy in respect of losses due to theft, burglary or fraud?
- Verify whether the Branch has furnished the requirements called for, by Insurance Company in respect of the claims, if any, submitted. Are all such particulars properly recorded and follow-up action initiated?
- Examine whether the cash retention limit fixed for the branch is adequate, considering the daily turnover and the facilities available to raise funds?
- Examine whether cash retention limit exceeded? Comments of Branch Manager for having cash in excess of cash retention limits to be recorded in inspection report.
- Work out the average cash balance usually maintained by the branch and see if it is in excess of the requirement continuously for a long period.
- Examine whether there is a large accumulation of cash and comment on reasons for accumulation and solution for disposal of such funds?
- Verify whether there is an unduly large accumulation of small notes/ coins and soiled currency notes? If so, suggest remedial steps taken to reduce the same.
- Report common irregularities observed at the time of regular inspection.
- Verify the joint custody arrangements are strictly adhered to and the joint custodians are personally operating their respective keys.
- Examine the surprise verification of cash is done periodically or not.
- The banks are required to report certain cash transactions to FIU-India under RBI (KYC) Directions 2016. The CBDT has also mandated reporting of certain cash transactions by banks to Income Tax authorities. Examine the adequacy of system being followed, reporting done regularly in time and point out deficiencies/violations, if any.
- Whether the bank is following the system of Reserve cash? If so, that entire cash balance held overnight need not be handed over to the cashier and a portion of it may be kept in the safe.
- Adequacy of insurance cover for cash in hand [in safe and at counter] and cash in transit. Violations of the conditions in the insurance policies, if any, and timely renewal of the insurance Policies.
- .Comments on the strong room?
- Comment on security aspects for cash at counters, at strong room, overnight.
- Installation of alarm system, watch & ward staff / security, CCTV, Gun Man etc.
- Examine RBI's clean note policy instructions are well placed in branch for customer awareness.

5.2-Balances with other banks

- Verification of balances held with other banks with reference to pass books, statement of accounts, deposit receipts etc.
- Limits, if any, fixed for keeping call deposits with commercial banks. Whether they were exceeded?
- Whether RCS has issued any instructions regarding permission for keeping funds in other banks, if yes, whether the permission of RCS was obtained, wherever necessary.
- Procedure for operation of bank accounts either singly or jointly. Was there a practice of keeping blank cheques signed?
- Monthly reconciliation of bank accounts with the statement of accounts obtained from other banks?



- Whether the reconciliation of Bank accounts was checked by the responsible officer?
- Long outstanding items pending for more than 6 months on which no action was taken by the bank [with details of total number of items, aggregate amount involved, etc.]
- Yearly/half yearly balance confirmation letter from the other banks.



CHAPTER 6

INVESTMENT AND TREASURY OPERATIONS

AUDIT OF INVESTMENT

6.1-General guidelines for Investments

As per section 5 of BR Act 1949 (AACs) the main function of cooperative bank is collecting the deposits from public and make a secure lending and investment. Detailed guidelines on 'Management of Investments by StCBs/DCCBs' have been circulated by NABARD in terms of its Circular No.100/DoS-15/2008 dated 27 June 2008. Besides keeping these guidelines in view, the internal auditor shall examine the following points under the head investments of the bank and report any discrepancy thereon in the report;

- Board approved Investment policy and Investment Committee as per guidelines issued by RBI -Proceedings of meetings, Issues discussed, delegation of powers to various officials, adherence thereto, violation, if any
- Composition of SLR and NON-SLR investments, Adherence to the RBI/NABARD guidelines in respect of various limit fixed time to time
- Go through the salient observations of concurrent auditors, statutory auditors and NABARD inspection reports and follow up action taken
- Whether there is a functional separation of trading, settlement, monitoring, control and accounting?
- Whether the limit for the dealer and authority to put through transactions have been followed?
- Whether deal slip is prepared for every transaction entered?
- Whether deal tickets are serially numbered and are there adequate controls with regard to unauthorised/unaccounted use of the deal tickets?
- Do the deal tickets give all the required particulars including the time of the deal and are these checked/signed/initialled by the dealer?
- Ensure that alterations and cancellations on deal slips are authorised by the Treasury Manager
- Check that the copy sent to the counterparty is signed by the client and deals are supported by confirmation letter from the counter party
- Does the bank have an approved panel of brokers?
- Whether the deals done through brokers are only with the approved ones?
- To be ensured that the role of the broker is restricted to that of bringing the two parties to the deal together
- Brokerage paid is at the approved rates and TDS is deducted as per the provisions of the Income Tax Act, 1961
- It should be ensured that all transactions made by the bank are in accordance with the approved investment policy and RBI regulations
- To check whether the counter party exposure limits have been separately specified for all transactions? To check for the excesses and to be ensured that they are ratified by the competent authority
- Is there seamless interface between the front and back offices? In other words, how are deals put

through by front office, captured by back office and what is the system of reconciliation between the two?

- Are there any oversold positions?
- To ensure that rates at which the deals are done are in line with market rates
- Identify a sample of purchase and sale of investments and vouch them keeping in mind internal procedures, RBI regulations, authorisation powers, counter party contracts, price feeds, etc.
- Whether all investments are appropriately categorized at the time of acquisition?
- Whether capitalisation of charges is done as per the internal policy? To be ensured that charges to be considered as revenue are not capitalised
- Whether any shifting of securities is effected? Are they in accordance with the RBI guidelines? Is the loss at the time of shifting provided?
- Ensure that broken period interest paid to seller is not capitalised as a part of cost but treated as expenses
- Ensure whether classification of NPI and their accounting is as per statutory regulations
- Check for the accuracy and completeness of:
 - Book value of securities in the portfolio
 - Interest accrual in case of dated Government/debt securities
 - Amortization in case of securities under HTM category
 - Income/dividends accounted in case of discounted instruments/shares/mutual funds
 - Profit/loss calculation on sale and booking of sale proceeds
 - Valuation as per norms – Mark to Market (MTM)
- Timely collection of interest/dividend.
- Funds management, Fixation of cash retention limits to branches, periodical review, adherence to such retention limits by branches
- Review of investment by board of directors as per guidelines of NABARD, and submission of report to NABARD. As regards Non-SLR investments, the half-yearly review should include:
 - Total business (investment and divestment) during the reporting period
 - Compliance with prudential limits prescribed for Non-SLR investments
 - Compliance with the prudential guidelines issued by RBI
 - Rating migration of the issuers/issues held in the bank's books and consequent diminution in the portfolio quality
 - Extent of NPIs in the Non-SLR category and adequacy of provisions thereof
- Review of Non-Performing Investments(NPI)
- Maintenance of Amortization Account.
- Procedure followed for shifting of securities from Permanent to Current categories and vice versa.
- Accounting procedure of investment.
- Procedure for valuation of investments, Creation of Investment Fluctuation Reserve (IFR) and Investment Depreciation Reserve (IDR).
- System adopted by bank in dealing with investment.
- Disclosure of Non-SLR investments as 'Notes on Accounts' as per the format prescribed by RBI.



6.1.1. Inspection of CRR and SLR

Cash Reserve Ratio (CRR)

Every bank shall maintain in India by way of cash reserve, a sum equivalent to such percent of the total of its Net Demand and Time Liabilities (NDTL) in India, in such manner and for such dates, as the Reserve Bank in terms of Section 42(1) of the RBI Act, 1934 and Section 18(1) of BR Act, 1949 [including provisions of Section 18 (1) of the BR Act as applicable to cooperative banks], may specify, by notification in the Official Gazette, from time to time having regard to the needs of securing the monetary stability in the country. The scheduled banks are required to maintain CRR with RBI and the non-scheduled banks are required to maintain by way of cash with themselves and/ or net current account balance with other banks.

CRR Computation

In order to improve cash management by banks, as a measure of simplification, a lag of one fortnight is allowed to maintain CRR based on the NDTL of the last Friday of the second preceding fortnight.

The auditors are required to check and verify that:

- The NDTL as on the relevant Friday has been worked out correctly and the CRR has been maintained as prescribed by RBI. The list of item of liabilities to be included/excluded while working out the NDTL has been provided separately in this chapter.
- There is no default in maintenance of CRR and in case of default whether it has been reported to top management or board.

Statutory Liquidity Ratio (SLR)

Banks, in addition to the cash reserves, shall maintain in India, assets, the value of which shall not be less than such percentage not exceeding forty per cent of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight as the Reserve Bank may, by notification in the Official Gazette, specify from time to time and such assets shall be maintained in such form and such manner, as may be specified in such notification.

SLR assets shall be maintained by banks as under:

- Cash
- or Gold as defined in Section 5(g) of the Banking Regulation Act, 1949 (AACs) (10 of 1949) valued at a price not exceeding the current market price:
- Or (c) Unencumbered investment in approved securities as defined in section 5(a) of the Banking Regulation Act, 1949 (10 of 1949) read with section 56 thereof:

Provided that the instruments that have been acquired from Reserve Bank of India under reverse repo, shall be considered as eligible assets for SLR maintenance.

Provided further that the following securities shall not be treated as encumbered for the purpose of maintenance of SLR assets, namely:-

- Securities lodged with another institution for an advance or any other credit arrangement to the extent to which such securities have not been drawn against or availed of;
- Securities offered as collateral to the Reserve Bank for availing liquidity assistance under MSF up to the permissible percentages of the total NDTL in India, carved out of the required SLR portfolio of the concerned bank.



Further, CRR maintained in excess of the requirement prescribed by RBI shall be counted towards SLR.

The auditors are required to check and certify that:

- The bank had correctly computed DTL/NDTL and has maintained required SLR on daily basis and no default has taken place during the period. In case of any default, the same is reported to appropriate authority with amount of penalty paid to RBI.
- Bank is submitting to the RBI before 20th day every month a return in Form VIII showing the amounts of SLR held on alternate Fridays during immediate preceding month with particulars of their DTL.
- Bank is also submitting a statement as annexure to form VIII giving daily position of
 - Value of securities held for the purpose of compliance with SLR and
 - The excess cash balance maintained by them with RBI in the prescribed format.

To be examined in SLR investments:

- GOI securities.
- Treasury bills
- State government securities.(SDL)
- GOI/SG guaranteed bonds
- Other approved securities.

Maintenance of CRR/SLR – Calculation of NDTL

The banks are required to maintain prescribed percentage of their NDTL as CRR/SLR. The following items of liabilities are required to be included/excluded while working out the NDTL:

Items or Liabilities which are to be included in DTL

- Demand liabilities
 - Current deposits.
 - Demand portion of SB deposits. (The bank has to follow RBI instruction. It should have a consistent policy, either based on savings pattern or interest pay out)
 - Margin held against LC/bank guarantee.
 - Balance in overdue term deposits (fixed, recurring, etc.).
 - Outstanding TT/MT/DD payable.
 - Unclaimed deposits.
 - Deposits held as security for advances payable on demand
- Time Liabilities:
 - Fixed deposits/cash certificates/recurring deposits
 - Time portion of SB deposits.
 - Staff security deposits.
 - Margin held against L/C if not payable on demand.
- Other demand and time liabilities;
 - Interest accrued on deposits
 - Bills payable



- Unpaid dividends and suspense account balances representing amounts due to other banks or public
- Provision for payment of gratuity.
- Provision for payment of arrears of salary.
- Unremitted amount of EPF & interest accrued thereon
- Provision for payment of audit fee.
- Provision for payment of IT (in case of excess provision that the actual income tax payable, the excess provision is not to be considered as a liability)
- Provision made for payment of minimum bonus to employees as per Bonus Act, 1965.
- Any contingent liability which has turned into a real liability, such as guarantee issued by the bank and invoked by the party.
- Premium remittable to DICGC in advance but not remitted by the bank.
- Subsidy Reserve, except fund under subsidy reserve fund (SRF) under Govt. sponsored programmes.
- Borrowings, other than those from the higher financing agencies.
- Any other items specified by RBI from time to time.
- Total of credit entries outstanding for more than 5 years in inter-branch account to be segregated and reported as 'Blocked Account' and included in DTL
- After segregating credit entries as at (xv) above, the net balance in total credit entries and total debit entries is to be seen and if the net balance is in credit, the same has to be included in DTL.

Items or Liabilities which are not to be included in DTL

- Owned funds/internal liabilities, such as paid-up capital and reserves, any credit balance in the P&L A/c of the bank, etc.
- Any advances taken from higher refinancing agencies, which include the RBI, the EXIM Bank, NHB, NABARD, SIDBI, NCDC and in the case of a CCB, the SCB of the State concerned, and loans from a State Government. In case of borrowings from other agencies of the State Govt., the same would form part of liability unless otherwise notified by State Govt./RBI.
- Reserve funds of cooperatives, within its area of operation, deposited with the bank.
- In the case of any cooperative bank which has granted an advance against any balance maintained with it, such balances to the extent of the amount outstanding in respect of such advance.
- The amount of any advance or other credit arrangement drawn and availed of against approved securities.
- Excess provision towards income tax, contingent liabilities, etc.
- Inter-bank deposits, i.e. deposits kept by other banks with it (for StCBs)

C. Miscellaneous

- The liabilities to the banking system does not include inter-bank liabilities of original maturity of 15 days and above and up to 1 year.
- The amount of net inter-bank liabilities is to be calculated after reducing assets with the banking system from the liabilities of the banking system.

Detailed Guidelines for System of compiling Net Demand and Time Liabilities (NDTL) position are giv-



en in RBI Master Circular RBI/2015-16/98 DBR.No.Ret.BC.24/12.01.001/2015-16 “Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)” dated July 1, 2015 , master direction of RBI on CRR/SLR no RBI/DOR/ 2012-22/80 DOR.No. RET. REC. 32/12.01.001/2021-22 dated 20.07.2021. The auditor may go through the guidelines of these directions as well as updated guidelines time to time at the time of verifying compliance with CRR/SLR requirements.

6.2- Guidelines for Non SLR investments.

For providing greater flexibility to State and Central Co-operative Banks (StCBs/CCBs), the guidelines have been issued by RBI regarding Non SLR investment wide circular no RBI/2016-17/14 dated 14-07-2016. The main guidelines are:

6.2.1. Prudential Limit

Total Non-SLR investments shall not exceed 10% of the total deposits of a bank as on March 31 of the preceding financial year.

6.2.2. To examine in Non SLR instruments

- “A” or equivalent and higher rated Commercial Papers (CPs), debentures and bonds.
- Units of Debt Mutual Funds and Money Market Mutual Funds.
- Shares of Market Infrastructure Companies (MICs), e.g. Clearing Corporation of India Ltd. (CCIL), National Payments Corporation of India (NPCI), Society for World-wide Inter-bank Financial Telecommunication (SWIFT).
- Certificates of Deposits (CDs)-beyond 10% limit for Non-SLR investments.
- Deep discount/zero coupon bonds (Min.A Rating or equivalent) – comparable market yields for residual duration – creation of sinking fund by issuer for accrued interest and its investment in government securities

6.2.3. Restrictions

- Investment in perpetual debt instruments is not permitted.
- Fresh investments in equity of All India Financial Institutions (AIFIs) will not be permitted by RBI.
- Investment in units of Mutual Funds, other than units of Debt Mutual Funds and Money Market Mutual Funds, is not permitted. The auditor will examine the risk management policy of bank and ensure that the bank does not have disproportionate exposure in any one scheme of a Mutual Fund.
- Investment in unlisted securities shall be subject to a minimum rating of “A” or equivalent and shall not exceed 10 percent of the total Non-SLR investments of a bank at any time. If the bank has already exceeded the said limit, no further investment in such securities shall be made. Investment in Non-SLR debt securities (both primary and secondary market) where the security is proposed to be listed on Stock Exchange(s) may be considered as investment in listed security at the time of making the investment. If such security is not listed subsequently within the period specified, the same will be reckoned for computing the 10 percent limit prescribed for unlisted Non-SLR securities. In case such investments under the unlisted Non-SLR securities lead to breach of 10 percent limit, the bank will not be allowed to make further investments in Non-SLR securities (both primary and secondary market) till such time its investment in unlisted securities is brought within the limit of 10 percent.
- Investment in deep discount / zero coupon bonds shall be subject to the minimum rating of “A” or equivalent and comparable market yields for the residual duration. No investment shall be made in



zero coupon bonds unless the issuer has created a sinking fund for all accrued interest and keeps it invested in liquid instruments / securities (government bonds).

- Non-SLR investment, other than in units of Debt Mutual Funds and Money Market Mutual Funds, and CPs, shall be in instruments with an original maturity of over one year.
- All fresh investments under Non-SLR category shall be classified under “current” category only and marked to market as applicable to these categories of investments.
- All Non-SLR investments shall be subject to the prudential limits prescribed for single /group counter-party exposure.
- StCBs/DCCBs may invest in Certificates of Deposits (CDs) issued by scheduled commercial banks (other than RRBs and LABs) and select All-India Financial Institutions that have been permitted by RBI. Investment in CDs will be treated as inter-bank deposits and shall not be reckoned for computing the limit on Non-SLR investments.

6.2.4. Regulatory requirement for non SLR investment:

- Investment rating in debt securities to be carried out by rating agencies registered with SEBI.
- Rating agencies operating in India are identified by IBA/FIMMDA and rating should be reviewed by IBA/FIMMDA at least once in a year.

6.3-Investment committee and Role of Board

Auditor should examine whether the investment committee has been formed as per RBI guidelines. Role of the Committee should be seen in following contexts:

- Formulation of Investment Policy to facilitate, guide and provide a directional framework for all the investment activities undertaken by the Bank
- Ensure that investment decisions are taken and treasury operations are carried out in a prudent manner within the extant regulatory framework and Asset Liability Management strategies of the Bank.
- Board should adhere non SLR limit as prescribed and review at least twice in a year.
- Manage the surplus and other funds of Bank, to comply with CRR and SLR requirements, to optimize the portfolio yield in a manner consistent with the liquidity, ALM strategies and business needs of the Bank.
- Ensure the safety of funds invested, to earn as much income as possible from treasury operations, without compromising on the safety and liquidity requirements,
- Ensure management of risk, especially credit risk, interest rate risk and operational risk, to invest in Call Money, Notice Money and Term Money Market.
- To make a suitable plan even in adverse scenario analysis report based on contingency funding plan.
- To make asset liability management with information on interest risk and liquidity policy.
- To make a review of non-performing investment in the non SLR category.

AUDIT OF TREASURY MANAGEMENT

The Reserve Bank of India has allowed Rural Cooperative Banks (RCBs) to raise funds from people in their area of operation or existing shareholders through a variety of instruments like preference shares and debt instruments. Cooperative banks can now eligible to participate in the capital market too. Therefore the audit of treasury management has now become more important for the cooperative banks.



Objectives of Treasury management

- The objectives of treasury management may be as under:
- To plan, organize and manage funds profitably and to ensure compliance with respect to regulatory requirements (SLR/CRR).
- Treasury services are also being utilized for Balance Sheet management
- (CRAR-Capital Risk weighted Adequacy Ratio, Asset and Liability product hedging, etc).
- To optimize return on surplus funds invested and to keep cost of funds to the minimum.
- To keep investment portfolio healthy and liquid.
- To minimize non-performing investments.
- To take advantage of market volatility and trade/arbitrage in permitted products and avail arbitrage opportunities between rupee and forex treasury operations (if applicable).
- To invest in tax free instruments as per the tax planning of the bank.
- To conduct derivative transactions to hedge bank's own balance sheet gaps and exposure of the clients.

Areas in treasury management

Treasury management covers the following major areas:

- Liquidity risk management
- Interest risk management
- Currency risk management
- Equity risk management
- Commodity risk management
- Investment management.

TREASURY PRODUCTS

Money Market

- Money market desk is involved in management of assets and liabilities of the bank. The main function involves the following:
- Management of statutory reserves *viz.*, Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) of the bank.
- Daily Funds Management for the bank.
- Balance Sheet Management.
- Debt Securities Trading.

The Money Market Desk trades in the following Instruments with short-term period of maturity (up to one year):

Treasury-Bills

- Treasury Bills (T-bills) are short-term debt instruments issued by the Central/ State Governments for maturities of 91, 182 and 364 days.
- Commercial banks, primary dealers, mutual funds, corporates, institutions, provident or pension funds and insurance companies can participate.
- RBI issues a calendar of T-bill auctions. Periodic auctions are held for their issue and these are tradable in the secondary market, which is quite active.
- T-bills are issued at a discount to face value and are redeemable at par on maturity.



Commercial Paper (CP)

- A Commercial Paper (CP) is an unsecured money market instrument through which corporate entities raise short-term money.
- It is issued as per RBI guidelines.
- It is issued at a discount to face value
- It can be issued either in the form of a promissory note or in a dematerialised form.
- It attracts issuance stamp duty in primary issue.
- It has to be mandatorily rated for issuance by one of the main credit rating agencies.
- It can be issued for maturities between a minimum of seven days and a maximum up to one year from the date of issue.

Call Linked Products

- It can be issued for a maximum period of 89 days.
- Pricing is linked to a benchmark like, MIBOR.
- Flexible call or put option could be exercised.

Certificates of Deposit (CD)

- Certificate of Deposits (CDs) are unsecured, negotiable money market instrument usually issued at a discount on face value.
- The maturity period is from 7 days to 12 months.
- It attracts issuance stamp duty and is issued in dematerialised form or as a Usance Promissory note. .
- They are negotiable, and transferred by endorsement and delivery, after 15 days of issue.

Collateralised Borrowing and Lending Obligations (CBLO)

- CBLO is a money market instrument designed to meet the borrowing and lending needs of banks, financial institutions, mutual funds, NBFCs and corporates.
- Borrowing and lending is collateralised i.e., secured using GSec or T-Bills.
- Trades are screen based and with Clearing Corporation of India Limited (CCIL) being central counter party.

Repo/ Reverse Repo

The Reserve Bank of India has provided a legal definition of “repo” and “reverse repo” as an instrument for borrowing(lending) funds by selling (purchasing) securities with an agreement to repurchase (resell) the securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed (lent). Such a transaction is called a Repo when viewed from the perspective of the seller of the securities and Reverse Repo when viewed from the perspective of the buyer of the securities. Thus, whether a given agreement is termed as a Repo or Reverse Repo depends on which party initiated the transaction. Market participants may undertake repos from any of the three categories of investments, viz., Held for Trading, Available for Sale and Held to Maturity.

Liquidity Adjustment Facility (LAF) with RBI

Liquidity adjustment facilities are used to aid banks in resolving any short term cash shortages during periods of economic instability or from any other form of stress caused by forces beyond their control. Primary Dealers having current account and SGL account with RBI can use eligible securities as collateral through a repo agreement and will use funds to alleviate their short-term requirements, thus remaining stable.



Capital Market

The instruments having maturity of more than one year are traded in the Capital Market. Such instruments are equity (ordinary shares, preference shares, etc.) issued for raising resources by way of share capital contribution and the debt instruments (bonds, debentures, Government dated securities, etc.) issued for raising resources by way of borrowings. The banks are dealing/ trading in such instruments.

Regulatory Framework for Capital Markets in India

In India, the capital market is regulated by the Capital Markets Division of the Department of Economic Affairs, Ministry of Finance. The division is responsible for formulating the policies related to the orderly growth and development of the securities markets (i.e., share, debt and derivatives) as well as for protecting the interest of the investors. In particular, it is responsible for following:

- Institutional reforms in the securities markets;
- Building regulatory and market institutions;
- Strengthening investor protection mechanism; and
- Providing efficient legislative framework for securities markets, such as Securities and Exchange Board of India Act, 1992 (SEBI Act 1992), Securities Contracts (Regulation) Act, 1956, and the Depositories Act, 1996. The Division administers these legislations and the rules framed thereunder.

The Securities and Exchange Board of India (SEBI) is the regulatory authority established under the SEBI Act 1992. The Preamble of the SEBI describes the basic functions of the SEBI, as to protect the interests of the investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto". It involves regulating the business in stock exchanges; supervising the working of stock brokers, share transfer agents, merchant bankers, underwriters, etc; as well as prohibiting unfair trade practices in the securities market. The following departments of SEBI take care of the activities in the secondary market.

THE TREASURY DEALING ROOM

- The Treasury Dealing Room within a bank is, generally, the clearinghouse for matching, managing and controlling market risks. It may provide funding, liquidity and investment support for the assets and liabilities generated by regular business of the bank. The Dealing Room is responsible for the proper management and control of market risks in accordance with the authorities granted to it by the bank's Risk Management Committee. The Dealing Room is also responsible for meeting the needs of business units in pricing market risks for application to its products and services. The Dealing Room acts as the bank's interface to financial markets and, generally, bears responsibility for managing market risks in accordance with the instructions received from the bank's Risk Management Committee.
- The Dealing Room may also have allocated to it by the Risk Management Committee, a discretionary limit within which it may take market risk on a proprietary basis. For these reasons, effective control and supervision of bank's Dealing Room activities is critical to its effectiveness in managing and controlling market risks.
- It is critical to effective functioning of the Dealing Room that the dealer has access to a comprehensive Dealing Room manual covering all aspects of their day-to-day activities. All dealers active in day-to-day trading activities must acknowledge familiarity with and provide an undertaking in writing to adhere to the bank's dealing guidelines and procedures. The Dealing Room procedures manual should be comprehensive in nature covering operating procedures for all the bank's trading activities in which the Dealing Room is involved and, in particular, must cover the bank's requirements in respect of:



- All dealers active in day-to-day trading activities in the Indian market must acknowledge familiarity with and provide an undertaking to adhere to Foreign Exchange Dealers' Association of India (FEDAI) code of conduct (and Fixed Income Money Market and Derivatives Association of India (FIMMDA) Code of Conduct where applicable).
- All dealers must be aware of, acknowledge and provide an undertaking to adhere to the limits governing their authority to commit the bank to risk exposures, as they apply to their own particular risk responsibilities and level of seniority.
- All dealers must acknowledge and provide an undertaking to adhere to their responsibility to remain within RBI limits and guidelines in their area of activity.
- All dealers should be aware of, acknowledge and provide an undertaking to remain within the guidelines governing the bank's activities with brokers, including conducting business only with brokers authorised by bank's Risk Management Committee on the bank's Brokers Panel. The following are important aspects in this regard:
 - ✓ Ensuring that their activities with brokers do not allow for the brokers to act as principals in transactions but remain strictly in their authorised role as market intermediaries.
 - ✓ Requiring brokers to provide all broker's notes and confirmations of transactions before close of business each day (or exceptionally by the beginning of the next business day, in which case the note must be prominently marked by the broker as having been transacted the previous day, and the back office must recast the previous night's position against limits reports) to the bank's back office for reconciliation with transaction data.
 - ✓ Ensuring all brokerage payments and statements are received. Reconciled and paid by the bank's back office department and under no circumstances authorised or any payment released by dealers.
 - ✓ Prohibiting acceptance by the dealers of gifts, gratifications or other favours from brokers, instances of which should be reported in detail to RBI's Department of Banking Supervision indicating the nature of the case.
 - ✓ Prohibiting dealers from nominating a broker in transactions not done through that broker. Rules should be framed for prompt investigation of complaints against dealers and malpractices by brokers and reporting to FEDAI and RBI's Department of Banking Supervision.
- All dealers should be aware of the bank's normal trading hours, cut-off time for overnight positions and rules governing after hours and off-site trading (if allowed by the bank).
- All dealers should be aware of the bank's requirements in respect of maintaining confidentiality over its own and its customers' trading activities as well as the responsibility for secure maintenance of access media, keys, passwords and PINS.
- All dealers should be aware of the requirement to take at least one period of leave of not less than 14 days continuously per annum, and the bank's internal policy in regards to staff rotation.
- Banks usually have a 'Customer/User Appropriateness and Suitability Policy' in place for transacting in complex treasury instruments such as, derivatives. The objective of such policy is to protect the bank against the credit, reputation and litigation risks which may arise on account of 'misselling' products to users who may not understand the nature of the risks inherent in these transactions or products. All front office sales team or dealers, must be aware of and be educated about such policy. Sales dealers should conduct proper due diligence regarding 'user appropriateness and suitability' of products before offering derivative products or other complex treasury instruments to users.



STRUCTURE OF A BANK'S TREASURY

The various functions handled by a bank treasury can be divided as under:

- Front-office: Dealing – Risk taking
- Mid-office: Risk Management and Management Information
- Back-office: Confirmations, Settlements, Accounting and Reconciliation.

IMPORTANT ASPECT TO BE SEEN BY AUDITOR

Internal audit with reference to treasury function in bank, includes following important aspects:

- To ensure that policies and procedures relating to all treasury activities have been framed and are periodically reviewed for adequacy and coverage.
- To determine whether management has planned for liquidity needs for both normal operating conditions and emergency situations.
- To ensure adequate physical and access control procedures are in place in the department.
- To verify existence of satisfactory controls in the processing of deals.
- To ascertain that the bank receives favourable rates for all its deals.
- To check authenticity and appropriateness of the sources of inputs used for valuation of unquoted treasury instruments.
- To check that there is accurate recording and accounting of positions.
- To ensure that proper documentation procedures and filing systems are in place.
- To ensure that limits are set for different procedures and they are adhered to in a consistent manner.
- To verify that any violations are promptly reported and properly dealt with.
- To ensure that reconciliation is being made timely and accurately, including daily reconciliation of the dealer's profit and loss to the general ledger.
- To evaluate the adequacy and effectiveness of the internal control system and to suggest measures for improvement, if any.
- To indicate probable risk-prone areas within treasury, based on the prevailing external economic environment, and to offer views for safeguarding the interest of the bank.
- To aid and facilitate risk based supervision function of the RBI in regard to a bank's treasury/market risk business areas.
- To ensure compliance with the guidelines issued by the RBI, SEBI, FEMA, FEDAI, etc., and other guidelines issued from time to time.
- To verify that interest and dividend income is accounted for fully and correctly.
- To verify that all counterparty confirmations are received.

The precise scope of risk-based internal audit of treasury transactions must be determined by each bank for low, medium, high, very high and extremely high risk areas.

This is an indicative list. Auditor may verify any other related aspect while auditing the treasury management as per regulatory guidelines.



CHAPTER 7

RETAIL LENDING

The cooperative banks are accepting public deposits for the purpose of lending and investment. Banks are lending in various diversified portfolios of advances. Internal auditor should examine the various aspect of retail lending in diversified portfolio as under:

7.1-ADVANCES AGAINST DEPOSITS

- Verify all loan documents if they are properly obtained, stamped and executed. Confirm that documents contain discharged deposit receipts.
- Verify, at random, the lien noting on the deposit receipts as well as in the ledger and confirm that they are authenticated by an officer.
- Verify whether any loan has been granted against the deposit of other branches and the branch is holding proper lien acknowledgement letters?
- Verify whether any loan has been granted against Term Deposit issue from the compensation amount awarded by any Tribunal and/or court with specific instruction?
- Whether Deposit Section Officer is verifying the signature of the Depositors, and Officer verifying it has authenticated it with full signature for having verified the signature?
- Confirm that all closed loan accounts are authenticated with full signature by the officer.
- Verify whether any advance is continuing where the deposit remains unadjusted towards the outstanding even after maturity of the deposit?
- Verify that the branch is maintaining the required margin as per the guidelines.
- Verify whether the balance exceeds the permissible limit?
- When loan is arranged against Minor's deposit, the purpose of the loan is to be indicated by the Guardian and he has to certify that the advance is for the benefit of the Minor/for meeting the necessities of the Minor. Verify loans against Minor's deposits and confirm that the branch is following guidelines.
- When Term Deposit is withdrawn before the completion of a minimum term period, interest at commercial rate as communicated from time to time shall be charged on the advances granted against such Term Deposits. It is to confirm that the branch is obtaining undertaking letter from borrower agreeing to pay normal rate of interest on Loan/Overdraft in such cases.
- Verify, at random, the closed Loan/Overdraft account documents to confirm that there are no fictitious advances arranged.
- Verify that the branch is reporting all the Loans/Overdrafts sanctioned against third party deposits over a certain amount to HO as per the policy, and check the rate of interest on such advances is being charged as per the guidelines issued.
- Verify, whether the deposit is refunded at reduced rate of interest before maturity? If so, interest on Loan/Overdraft shall be charged at the prescribed rate. Test check whether the branch is allowing the concession?
- As per RBI directives, Loans and Advances cannot be granted against securities on composite basis. Verify from the branch for compliance.
- In case of deposit standing in joint names, irrespective of the conditions regarding repayment, all the



parties to the deposit should discharge the deposit receipt and sign all the papers and documents to be executed by borrowers. Verify such accounts for compliance.

- Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

7.2-Unsecured advances or Clean Cash Credit limits

- As and when the bank disburses loan for purchase of assets, the assets purchased with the loan amount are pledged, hypothecated or mortgaged to the bank. However, there are certain circumstances under which the borrower is required to make payment but no assets are created. Such advances are called unsecured advances or clean cash credit limits.
- Such advances are granted not because the borrower cannot provide security but because of business requirements and only on selective basis.
- A sugar mill may have to make advance payments to transporters and/or harvesters which does not result in any asset acquisition. Further, it may have to pay wages to its staff and incur expenses for maintenance of plant and machinery.
- Similarly, a marketing society may have to make advance payment to farmers for collection of agricultural produce, resulting in a short-term gap between incurring of expenses and acquisition of assets.
- Verify whether such advances were sanctioned only for a short period and only in deserving cases.
- Verify whether the loan/cash credit agreement provided for hypothecation/pledge of assets immediately on acquisition and whether this was actually done.
- In case a borrower has been sanctioned more than one type of limit/loan, verify whether withdrawals in one limit/loan were used for repayment in other limit/loan to avoid being classified as NPA/Out-of-order. If yes, make observations with instances.

7.3-ADVANCES AGAINST COMMODITIES UNDER PLEDGE

- Verify possession of goods with the bank – Physical or Symbolic (like possession of godown key, title deeds – Railway Receipt/Bill of lading, etc, Warehouse Warrant/Receipt, etc.)
- Verify that the goods pledged are not obsolete/non-saleable
- Verify whether the movement of keys is properly recorded in the Key Custody Register?
- Whether the duplicate set of godown keys duly sealed are held under dual control?
- Confirm holding of the original invoices/ lodgement letters and properly executed Delivery Orders.
- Confirm that the goods pledged are fully paid for required duty etc.
- Verify delivery of goods are against payment and not against pledge of goods.
- The value of the goods pledged is as per the invoices and the invoices are in the borrower's names.
- Whether proper stipulated margin is maintained? – Ensure maintenance of required margin on every delivery of goods and/or every drawl of funds
- Confirm that the value of pledged goods is not inflated to accommodate excess drawing power.
- Identify the accounts secured by long outstanding unsold/stale/obsolete stock. Furnish the steps taken by the Bank/Branch to close such Loans.
- Examine the suitability of the godown.
- Confirm that the Bank's name plate is displayed properly.



- Whether letter of access is obtained, wherever necessary?
- Verify whether the goods pledged are properly stored and identifiable?
- Carry out a test check of weight, contents and quality of goods pledged in the presence of the borrower or his representatives.
- Confirm that there are no other goods/stock stored in the godown other than the goods pledged to the bank.
- Verify whether godown chart and godown register are maintained and if it is up to date?
- Whether the drawing power is revised and recorded from time to time?
- Verify whether license/permits for advances against commodities like cotton and tobacco, requiring such license/permits for dealings/ storing/ transportation are obtained and held with the Bank/Branch?
- Confirm that the goods pledged are properly insured and bank's interest is noted in the Insurance Policy- Timely renewal of policy
- Ensure that the description of goods and godown agree with those mentioned in the policy.
- Verify whether the branch is maintaining market report book for local commodity and recovering the additional margin whenever the prices fall?
- Verify whether the locks used have the bank's name engraved on them?
- Confirm by test check that the goods pledged are as permitted in the sanction.
- Check whether the branch conducts surprise visits to the godown?
- Confirm whether all the borrowers under the scheme have been admitted as associate/nominal members of the bank.
- Examine and analyse any mismatches in the quantity of goods in the godown and size of the godown to accommodate such quantity.
- Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

7.4. ADVANCES AGAINST COMMODITIES UNDER HYPOTHECATION

- Verify whether the drawing power is properly fixed by taking into account paid stock as per stock statement on monthly basis?
- Ensure that value of stock is not inflated to accommodate fixing of higher drawing power – Valuation of stock to be as per cost price or market price, which is less
- Ensure that the stock shown in the stock statement do not cover stock which are already under pledge.
- Verify that the goods hypothecated are not obsolete/non-saleable
- Verify whether the stock declared in the stock statements match with that shown in the borrower's financial statements, whether the description of the hypothecated stock is given in stock statements?
- Test check the goods hypothecated with the invoices, stock books and confirm that they are in order and up to date.
- Confirm that the goods hypothecated are fully paid for.
- Verify whether physical verification of stock is done periodically with reference to stock statement and stock register and duly authenticated by officer verifying in the stock?
- Ensure that stock statements do not include unpaid stock/stocks already under pledge/stocks covered under unpaid letter of credit/stock of 'no value'



- Confirm that the goods hypothecated are insured for the full value as per the guidelines.
- Check whether the Insurance Policies are renewed regularly on due date?
- Confirm whether details of policy are recorded in Insurance Policy register?
- Verify whether the policies are assigned to the bank/ bank's lien is noted on the Policies?
- Whether the location of the godown/shop where hypothecated goods are kept is the same as mentioned in the insurance policy?
- List out cash credit accounts where the turnover in the account is not satisfactory Verify the stock statement obtained by the branch/bank and comment on promptness in obtaining stock statement, levying of penal interest for non-submission. Whether columns of stock statement are properly filled up?
- Comment on turnover in the account and stock statement.
- Confirm whether all the borrowers under the scheme have been admitted as nominal/associate members of the bank.
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically
- Verify whether the stock audit is done on regular intervals as per guidelines of NABARD.
- Verify whether required margin ensured while allowing drawals from the account
- Verify whether the operations in the account were satisfactory while renewing and/or increasing the cash credit limit.

7.5. VEHICLELOAN

- Verify whether the branch holds the following papers/documents?
- True copy of the R.C with Bank's hypothecation charge duly noted therein
- Copy of the valid route permit (for public vehicles) and Comprehensive Insurance Policy with bank clause included.
- Duplicate switch key or letter in lieu thereof.
- Original Invoice stamped receipt and/or valuation report (for second hand vehicle)
- Verify whether clause of hypothecation recorded in RC.
- Verify whether loan proceeds are released specifically to the seller/supplier of the vehicle and acknowledgement obtained from the borrower?
- Verify all copies of documents including insurance is in bank's records.
- Whether the latest Vehicle Inspection Report (for public vehicles) is on record?
- In case of default in payment of instalments, whether the branch makes arrangement to seize the vehicle?
- Confirm whether all the borrowers under the scheme have been admitted as associate/nominal members of the Bank.
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.
- Whether the branch had conducted periodic verification of the condition of the vehicle?



7.6. LETTER OF CREDIT/BANK GUARANTEE (BG) – CREDIT FACILITY

- Whether letter of credit/BG facility is sanctioned after duly processing the credit/guarantee needs of the unit/borrower. Verify whether the LCs/BGs are supported by due sanction by the competent authority?
- Whether all the terms/conditions of the sanction are complied with? If not, identify the cases, reasons thereof/approval sought/ obtained etc.
- Verify whether the LC/BG register has been properly maintained and the outstanding entries therein have been periodically balanced and tallied?
- Verify whether the bills under LCs/BGs are retired promptly on presentation of bills/ on arrival of goods. If not, identify the cases and steps taken to realize the bills?
- Verify whether the expired LCs/BGs are squared up in the books and the contingent liability is reversed after observing formalities in this regard?
- Whether the dates of expiry of LCs/BGs diarized and action taken to reverse the expired LCs/BGs?
- Ensure that the margin money is refunded only after all the bills drawn under the LC/BG are received and retired/paid by the client. In case BG has been issued for performance of an activity, release the margin money only after obtaining letter from the beneficiary for satisfactory performance of the activity and observance of all the terms and conditions of the guarantee by the client.
- In case the goods are supplied directly to the client and the title deeds/invoice is received by the bank, release the title deeds/invoice after the client pays for the goods received.
- In case of revolving letter of credit, verify whether a clause to the effect that the amount of the credit will be restored only on receipt of advice from the opening branch that the earlier bills have been paid by the client, is included in the terms and conditions of the letter of credit.
- Comment on arrangement made, such as sanction of credit facility earmarking in current account for clearing liability under LC on presentation of documents, etc.
- Confirm whether all the borrowers under the scheme have been admitted as nominal/associate members of the Bank.
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically

7.7. ADVANCES AGAINST GOVERNMENT SECURITIES / NSC/ KVP/ IVP

- Ensure that the security has to be in the name of the borrower or the borrower has to be the last endorsee – Genuine title of the borrower
- Ensure that the signature of endorsers tally letter to letter with the name(s) of endorsees in previous endorsements.
- If there are too many endorsements, insist on renewal of securities by sending them to respective issuing office.
- Whenever a customer approaches for loan against G.Secs held in demat after ensuring that the same can be taken as security as per HO guidelines, verify whether the branch has complied with all HO guidelines.
- Verify whether NSC/KVP/IVP taken as security has been transferred/endorsed in the name of the Bank and lien is noted in Bank's favour before releasing the loan/overdraft? Verify that proper margin is maintained.



- Verify whether all the joint holders of the NSC/KVP/IVP have signed the borrowing documents?
- Verify whether interest is collected on Government Securities promptly and a register is maintained for issuing income tax deduction certificates?
- Verify whether interest is collected on NSC/KVP/IVP periodically wherever applicable and steps taken to adjust the same to loan account on due dates?
- Verify whether on the date of maturity, the HO/Branch has made arrangements to collect the proceeds of the securities and adjusted towards loan account? Ensure that HO/Branch is maintaining due date register.
- Confirm whether all the borrowers under the scheme have been admitted as nominal/associate members of the Bank.
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.

7.8. ADVANCES AGAINST SHARES, DEBENTURES AND UNITS OF MUTU-ALFUNDS.

In the recent amendment made in 2020 in BR Act 1949 (AACS), RBI with its prior approval has permitted StCBs and DCCBs to raise resources by way of issuing shares and debentures/bonds under guidelines of RBI. Auditor should examine that banks cannot advance against their own shares/bonds etc. However advance against shares, debentures and units of mutual funds of other identified companies may be made under guidelines of NABARD/RBI. The auditor should examine:

- Verify whether branch had ensured genuineness of the title of borrower
- Verify whether units taken as security do not have any clause prohibiting pledging of the same?
- Verify whether the branch holds the blank transfer deeds/forms signed by the registered holder?
- Verify whether the units are transferred in the name of the Bank, in the absence of blank transfer forms.
- Verify whether the branch has obtained a letter of authority from the units' holders, authorizing the bank to collect the dividend on the pledged units from the Trust/Fund on behalf of the borrower and is forwarded to mutual funds with a forwarding letter in the prescribed form.
- Ensure that the shares/debentures/bonds accepted as security are of reputed companies, regularly quoted, fully paid (as far as possible, approved companies) and are in marketable lots and satisfy that the scrips/bonds pledged are bonafide and genuine by verifying latest dividend warrant/interest warrant in the name of the borrower.
- Verify in case of loans against partly / fully convertible debentures that the shares received on such conversion are taken as security for the advance.
- Verify and report whether the amount received on the redemption of the debenture is adjusted to the loan accounts.
- Verify that the shares and debentures are not clubbed together as security to sanction loan/advance as per the RBI directives.
- Verify that the Bank/Branch holds valid and enforceable blank transfer forms for each marketable lot/ folio and for each certificate odd lots, duly signed and witnessed.
- Verify whether the branch is keeping a watch on the periodical fluctuations in the market rate of shares noting them in share quotation register and revise the drawing power accordingly? Ensure that the stipulated margin is being maintained, and shortfall, if any, is recovered as per guidelines.



- Verify whether lien notices have been forwarded by Registered Acknowledgement Due to the companies and their acknowledgement or refusal letters are kept with the loan paper?
- Ensure that the part of security released has been recorded and acknowledged by the borrower.
- Ensure that the dividend/interest received from the company is credited to the concerned borrower's account.
- Verify whether dividend mandates have been obtained and registered with the respective companies?
- Whenever a customer approaches for loans against shares held in demat after ensuring that the shares can be taken as securities as per Bank's approved list and guidelines, the branch shall, after sanction of facility by the competent sanctioning authority, furnish to customers the regions pledge account member with NSDL, so that customer's DP can create pledge in Bank's favour. Subsequent to confirmation of creation of pledge, the loan can be released.
- Confirm whether all the borrowers under the scheme have been admitted as nominal/associate members of the Bank.
- Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.

7.9. ADVANCES AGAINST GOLD/GOLD ORNAMENTS (GOLD LOAN)

- Whether the branch has ensured ownership of borrower of gold/gold ornaments being pledged – Declaration may be obtained
- Confirm whether all the borrowers under the scheme have been admitted as nominal/associate members of the Bank
- Confirm that the officer has followed the instructions/guidelines issued to establish the proof of identity of the borrower before issue of Jewel Loan Application (Ration Card, Driving License, Employer Identity card, Bank Pass book, Telephone Bill, etc.)
- Confirm that all the Jewels have been appraised and valued by the duly appointed Jewel appraiser and also confirm that the Jewels are appraised in the branch premises itself.
- Verify that the appraiser's seal has been affixed on the knot in such a way that it is not possible to untie the knot without tampering the appraiser's seal.
- Ensure that the Jewels received from every borrower shall be separately bunched and kept separately under joint custody.
- Verify whether the branch is following the stipulation made by HO in repayment of interest or principal or any other dues; and such stipulation is in conformity with RBI instructions?
- Test check random Jewels pledge with regard to number of items, description, gross weight, net weight, appraised value, and margin etc. (where interest is in arrears for more than 3 months are to be invariably checked).
- Confirm that deposit and withdrawal of Jewels are being done according to the procedure stipulated and ensure that maintenance of the "Jewel Bags Stock Register" is up to date.
- Verify whether any Jewel Loan has been granted to the Jewel appraiser or his relatives? If yes, who has appraised the Jewels pledged in such loan? Give details of such loans?
- Verify whether the branch has sent periodical statements connected with the issue of Jewel /gold Loan to HO?
- Confirm that the branch has maintained overdue Jewel Loans/gold loan register, and follow up action is taken.



- Ensure that the stipulated margin is maintained and furnish a list of over advanced loans. Branch should be collecting the deficit in margin to maintain the necessary margin.
- Verify the Jewel Loan/gold loan register and report whether borrower's discharge has been obtained at the time of redemption?
- On repayment of the loan, whether the branch is taking proper care to obtain signature of the borrower for taking delivery of Jewels pledged and officer delivering the Jewels verifies the signature of the borrowers and signs for having delivered the Jewels?
- Verify whether any death claims are pending against pledged items and comment?
- Verify whether timely action is taken on Jewel /gold pledged, pertaining to the overdue loan. Comment if loan amount is still outstanding even after adjusting sale/auction proceeds in defaulter's accounts.
- Verify whether action in irregular loans such as sending registered notices, auction notices etc., are initiated by the Bank/Branch. Whether all procedures have been followed for conducting the auction and auction proceeds are properly accounted as per procedure.
- In case gold is offered as security for undertaking any productive activity attracting concessional terms of finance (like KCC, etc.), branch has to satisfy itself as to the genuineness by obtaining a documentary proof to that effect to be kept along the loan application. Ensure that applicable interest rates and margin are being followed according to the guidelines stipulated. Verify and comment.
- Verify Jewel Loan/gold loan appraiser's file and ensure that a condition has been stipulated that the appraiser is solely responsible for the purity, gross and net weight of the Jewels/gold.
- Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers periodically.
- Verify, the renewal of contract of the appraiser?
- Verify Payments made to the appraiser and other charges (processing fee, documentation charges etc) that are mentioned in the terms and condition as per the loan documents and also verify that the same are reflecting in the customer's account.
- Verify TDS on the payment to the appraiser with respect to the provision of the income tax act 1961
- Verify Loan application/ pledge form have been properly filled and signed by the Pledger.
- Verify that the branch officer has cross checked the gold rate on the day the loan is getting appraised.
- Ensure the periodic checking of the weighing machine and the stock of the acid (testing materials)

7.10. SALARIED EMPLOYEES

- Verify whether the loan has been sanctioned as per credit rating, /CIBIL score or/ and the loan policy of the bank.
- Verify whether the applicant has been admitted as nominal member?
- Verify whether the applicant has executed an undertaking to the effect that he will not borrow from any financial institutions/co-operative society against his salary until the loan is fully discharged?
- Verify the take-home salary of the applicant and guarantors, which should not be less than 33 per cent of gross salary or as decided by the bank.
- Ensure that the applicant is maintaining Savings Bank Account with the Bank. The borrower may also be persuaded to get his salary credited direct in his/her bank account.
- Verify the applicant's and guarantors remaining period of service. It should be ensured that he/she has



at least one year's left-over service left after the due date prescribed for repayment of the last instalment of loan.

- Verify whether the guarantors are having good standing.
- Verify whether the sanction of loan has been as per the terms and conditions laid down by the HO?
- Verify the documents submitted by the applicant along with the loan application (nominal membership, letter of continuity, DP note, letter of agreement, salary certificate etc.) and ensure that they are complete and in order.
- Pro-note duly executed jointly by the applicant and guarantors and duly stamped.
- In case employer does not provide irrevocable letter, there are provisions in Societies Acts of some States (Sections 39(1) to 39(3) in Punjab State Cooperative Societies Act 1961 and Sections 45(1) to 45(3) in Haryana State Cooperative Societies Act 1984) providing for that a member of a cooperative society may execute an agreement in favour of the society providing that his employer shall be competent to deduct from the salary payable to him/her and pay the same to the society the amount indicated in the agreement. On failure on the part of the employer to do so **after receipt of such a requisition in writing from the society**, the employer shall be personally responsible. Wherever such provisions exist, the auditor may ensure that such an agreement quoting the provisions in the Act is obtained from the borrower and on his/her default in repayment, the requisition, in writing, is sent to the employer. On default by the employer even after receipt of requisition from the society, legal action may be taken against the employer for recovery.
- Ensure that the repayment period is within the maximum period as stipulated by HO.
- Check the rate of interest and ensure that rate percentage is as per the regulations and interest is applied properly.
- Verify whether the instalments are being paid regularly on or before the stipulated date and in case of any belated payment, penal interest has been collected?
- Verify whether the branch is closely monitoring the recoveries, and borrowers who have committed default have been reminded regularly to clear their overdue?
- Verify whether the defaulted cases have been referred to HO for legal action/arbitration proceedings and/or requisitions, in writing, have been sent to the employers as indicated above, as the case may be, as per the norms prescribed?
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.

7.11. LOAN AGAINST MORTGAGE OF PROPERTY

- Ensure that loan on mortgage of building or any other immovable property has been granted or sanctioned for any one of the purposes mentioned in the rules/regulations governing the grant of mortgage loans.
- Ensure that loans have been sanctioned to those individuals or group of individuals who own the immovable property.
- Verify whether the loan sanctioned against building/property is within the area of operation of the Bank/Branch.
- Verify whether the amount of loan sanctioned is within the maximum limit prescribed for different types of borrowers.

- Ensure whether loans sanctioned have been restricted/limited (to say 60 percent or as per bank policy) of the estimated value of the property.
- Confirm that the documents obtained by the branch are in order and enforceable.
- Verify HO/Branch holds the following documents for adequacy of loan application:
 - Legal opinion from the approved panel lawyer and got approved from Bank's legal cell/section wherever required.
 - List of title deeds
 - Original property documents recited in the legal opinion
 - Blue print plan copy
 - Photograph of the Building/immovable property
 - Valuation report given by two officers of the Bank who surveyed the property along with approved valuer.
 - Property/Water Tax payment receipts
 - Age of building
 - Comprehensive Insurance Policy standing in the joint names of the Bank/borrower and covering all-risks.
 - KYC papers with at least two documents for ID and address proof of borrower.
 - Loan agreement with required stamping, signature of borrower/borrowers and witnesses.
 - Agreement of creation of equitable mortgage.
 - Mortgage register with loan details, property details, with proper signature of borrowers and witness thereon, with date and place.
 - Encumbrance certificate/broken period encumbrance certificate.
- Ensure that the value of the site has been assessed as per the prescribed norms and inspecting team has reviewed the CERSAI portal regarding registration within stipulated time.
- Verify whether the bank has accounted for the documentation charges, processing charges if any to avoid revenue leakage.
- Verify whether the relevant documents are properly filled in/completed with date and executed by the mortgagors/all joint holders of the property/borrowers.
- Whether the branch has incorporated all the clauses as per the guidelines/circulars issued from time to time in this regard.
- Verify whether the legal adviser (Lawyer) has scrutinized the documents and Encumbrance Certificate for 13 years and confirm that legal opinion has certified that the property is free from encumbrances and the mortgagor has clear marketable title to the property to be mortgaged.
- Ensure that the borrower has produced further encumbrance certificate of the property for verification after such registration and before getting disbursement of the loan.
- Ensure that the borrower has given his acceptance/consent to retain all the original documents with the Bank pertaining to the property as advised by the legal advisor till the loan is cleared in full.
- Confirm that the Head-Office/Branch has complied with the provisions of Urban Land Ceiling Act or any other similar Acts of the Govt.
- Verify whether the branch has obtained E.C., Tax receipts periodically and any alteration of property has been mentioned in the E.C.



- Verify whether the HO/Branch has inspected the mortgaged property periodically and maintained record for the visits.
- Ensure that the period of repayment of the loan is not beyond the period prescribed by the bank. Ensure that the borrower's repaying capacity has been properly assessed i.e. his/her monthly income is adequate to repay the monthly instalments towards principal and interest and also ensure that the repayment instalment should be within his repaying capacity.
- Ensure that the borrower has been admitted as nominal/associate member before sanction of the Loan.
- Verify the loan application and ensure that the borrowers have furnished additional document viz., building permit, plan, estimate of construction etc., as required under the loans scheme in the event of availing the loan for extension/repair/renovation of building.
- Ensure that HO/Branch has obtained a letter of undertaking from the borrower stating that the borrower will not alter or alienate the property mortgaged to the bank in any form without the prior permission of the bank.
- Ensure that HO/Branch is closely monitoring and follow up action is being taken promptly to avoid loan becoming overdue/NPA.
- In the event of overdue/NPA loans, verify whether the HO/Branch has initiated step to regularise the bad loans.
- Verify any legal restrictions for sale of property?
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.
- Ensure adherence to sanction of limits, terms and conditions, documentation, etc.as prescribed by H.O. time to time.

7.12. HOUSING LOAN

- Verify whether the member who desires to obtain a loan under Housing Loan Scheme has submitted the application in the prescribed form along with the following documents:-
 - Title Deed in original together with Parent Deed.
 - Encumbrance certificate for 13 years till date.
 - Opinion of Bank's Legal Advisor to prove the Title to the property.
 - Site plan and building plan approved by the Competent Authority viz., Town Planning Authority in case of construction/outright purchase of house/flat and upgradation where addition to the living space is involved.
 - Age proof of the borrower.
 - Estimates for cost of construction; certificate by the approved Engineer.
 - Estimated value of the House/Flat certified by the approved Engineer along with documentary proof for the life of the building.
 - Salary certificate from his employer / other income proof as prescribed.
 - Original Agreement with flat promoter in the case of purchase of flat.
 - Second Encumbrance Certificate from the date of issue of first encumbrance certificate.
 - Verify whether the update photo, address KYC of borrower has been obtained and check it?
 - Verify whether the insurance of borrower is needed as per bank policy, if yes please check the insurance policy with details.

- Confirm that the documents obtained by the HO/Branch are in order and enforceable.
- Verify whether the Building/Flat proposed to be purchased by the borrower has been inspected and report is kept, and confirm that the report does not contain adverse details?
- Verify whether the lawyer has scrutinized the documents and E.C .of the last 13 years and confirm that legal opinion has certified that the proposed seller has clear marketable title to the property to be sold?
- Verify whether any affidavit-cum–undertaking has been obtained from the person applying for such credit facility to the effect that he/she shall not violate the sanctioned plan and construction shall be strictly as per the sanctioned plan?
- Verify whether the loans are sanctioned directly to individuals who are above 18 years of age and within the maximum age as fixed by the bank?
- Ensure that the borrower has been admitted as the nominal/associate member before sanction of loan.
- Ensure that the loan has been sanctioned for the construction of house on plots under layouts approved by appropriate authority.
- Ensure that the house purchased by the borrower under the scheme is in good tenantable condition and normal useful age and remain in such condition at least for a minimum period of 20 years from the date of purchase?
- Ensure that the quantum of loan sanctioned is within the limits prescribed for different purposes.
- Ensure that the property offered as security for loan stands in the name of applicant and unencumbered.
- If the property is in joint names, parties concerned should have given consent and join in execution of documents. Verify the same and give comments.
- Ensure whether the loan eligibility in favour of each borrower has been properly assessed and sanctioned as per norms prescribed?
- Ensure that the borrower has satisfied/fulfilled all conditions stipulated by the HO viz., a) not more than one loan has been granted, b) the borrowers have a regular and adequate source of income and c) left-over service of at least 5 years after the due date prescribed for repayment of the last instalment of loan.
- Ensure that the borrower has mortgaged the plot and the house to be constructed in favour of the Bank.
- Ensure that in case of purchase of Flat, the undivided share in the land and the Flat has been mortgaged by the borrower.
- Ensure that the Mortgage Deed is signed by the borrower and two witnesses.
- Ensure that the Original Deed is with the HO/Notified Branch as per the policy of the Bank.
- Ensure that Evaluation Fees has been collected from the borrower as per bank policy.
- Ensure that HO/Branch has obtained an affidavit -cum-undertaking to the effect that the built up property has been constructed as per the sanctioned plan and/or building bye-laws of the respective state authority.
- Ensure that the disbursement of loan has been done in instalments as per percentage of loan amount prescribed for each stage of construction.
- Ensure that in the event of acquiring a House/Flat, the payments have been made directly to the sellers.
- Ensure that in the event of construction of new house and/or upgradation/repair of the existing House, whether the loan amount has been disbursed in instalments depending upon the level of construction and utilisation of the previous instalment ensured before releasing the next instalment.



- Ensure that the construction of the House/Flat or upgradation in the existing house has been carried out exactly in accordance with the approved plan, specifications estimates on the basis of which the amount of loan has been computed and sanctioned.
- Ensure that the repayment schedule has been fixed as per the income stream of the borrower, but not exceeding the period fixed by the bank.
- Verify whether there are any cases of default and in such cases penal interest, stipulated under the scheme has been collected over and above the normal rate of interest?
- Verify that interest charged on the loans is as per the rate fixed by the bank.
- Ensure that the construction has been completed within the stipulated time from the date of first instalment of the loan is paid to the borrower.
- Verify whether the annual inspection is being carried out in respect of Houses constructed by availing loan from the Branch/HO to ensure that the Houses are maintained well?
- Ensure that the original documents of title to the plot and property under mortgage have been obtained from the mortgagor and kept in safe custody along with mortgage deed.
- Whether the House/Flat constructed or purchased and House/Flat in which upgradation has been made out of the loan sanctioned by the Bank has been insured in the joint names of the borrower and the Bank with the Insurance Company against Fire, Flood, Cyclone and Earthquake, etc.?
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.
- Ensure that the housing loan granted is within the limit of RBI/NABARD guidelines. Presently the individual limit is Rs. 75.00 lakhs for the StCBs/DCCB having net worth equal to or more than Rs.100 crore, and Rs.50.00 lakhs for those having net worth of less than Rs.100 crore.

7.13. LOAN FOR PURCHASE OF CONSUMER DURABLES/HOUSEHOLD NEEDS, INCLUDING COMPUTER etc.

- Verify whether the loans for purchase of consumer durables under the Bank's scheme have been sanctioned only after obtaining signature of two guarantors who satisfy the prescribed eligibility norms.
- Ensure that loans are sanctioned to persons as per the policy of the bank.
- Verify whether the Borrower and Guarantors have been admitted as nominal members before sanctioning of the loan?
- Verify the articles enlisted in the invoice, submitted along with the loan application are eligible for purchase under the Bank's scheme and also verify whether the invoices are obtained from the Dealers/Co-op. Super Markets.
- Verify whether the applicant is eligible as per the scheme formulated by the bank.
- Verify the Guarantors' net worth and ensure that he/she has repaying capacity in case of default by the borrower.
- Verify whether the following documents have been furnished:-
 - Certificate issued by the employer duly signed by the competent Authority.
 - Pro-note executed by the Applicant and Guarantors jointly.
 - Hypothecation Deed/Agreement duly executed by the Applicant.
 - Pro-forma Invoice from the Dealer/Co-op. Super Market.



- Other than the salaried employees, viz., Entrepreneurs and Professionals have to submit copy of Income Tax Returns/assessment order for the past 3years or any other proof of their income
- Ensure that all documents are in the custody of persons authorized for the purpose.
- Verify whether the loan has been sanctioned by competent authority.
- Verify whether the eligibility criterion has been arrived on the basis of salary/income of the applicant?
- Verify whether the applicant has remitted margin money as stipulated under the Scheme.
- Verify whether the repaying capacity of the Borrower has been properly assessed to fix the loan instalments to be repaid under MI.
- Verify whether the payment has been made directly to supplier/manufacturer out of the loan sanctioned to the applicant.
- Verify whether the loan repayment period under EMI has been restricted within the period stipulated by the bank.
- Verify whether the EMI has been arrived after charging interest at the rate prescribed.
- Verify whether the repayments made under the scheme are regular and is there any overdue payments (made after due date)? In such cases, whether the Bank has collected penal interest as prescribed?
- In cases where default persists continuously for 3 months, whether the Bank has exercised the right to recall the loan and sent notice to take possession of the articles purchased with the Bank's advance.
- Verify whether the goods have been properly insured by the borrower, as prescribed.
- Verify whether the overdue recovery procedure has been followed to regularize the over dues as prescribed.
- Verify whether the Bank/Branch has initiated action to file arbitration proceedings, in cases where the loan recoveries are not forthcoming even after giving sufficient time to regularize.
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.

7.14. ADVANCES AGAINST INLAND BILLS/CHEQUES PURCHASED/DISCOUNTED

- Ensure that Discount facility has been extended to customers only against the Bills/Cheques issued by the Government Departments, reputed companies and Bank Drafts.
- Verify cases where Bills have been purchased/discounted in excess of the limits and ensure that the excess have been promptly reported to the higher authorities.
- Verify whether the Cheques/Bills discounted or purchased are being dispatched promptly as required. In case of Bills accompanied by RR and other title deeds, are they invariably sent by secured mode so as to take care of loss in transit?
- Verify whether the bill payable on demand is collected as early as possible.
- Verify whether the usance bill was sent for acceptance, wherever required.
- Verify whether the proceeds of the bill were collected on date of maturity and adjusted in appropriate account.
- In case of Return/Dishonour of Bills/Cheques, whether notice of dishonour has been served and the amount of Dishonoured Bills/Cheques being recovered with interest promptly and a distinct note is made against the bills in the concerned register?



- Verify whether the Branch is following the practice of debiting returned bills to cash credit/overdraft accounts by overdrawing these accounts or to current accounts causing debit balance.
- Verify whether the consignments of the returned bills are got rebooked, if they remain unadjusted.
- Verify whether any cheque discounted returned item is being time-barred/pending recovery. Full details are necessary for fixing up accountability.
- Verify whether the cheques discounted are not for accommodation. If so, identify the cases and steps taken by the branch.
- Verify whether immediate credit facility is segregated from general discounting. Whether self-drawn cheques are discounted under this arrangement.
- Verify whether discount/purchase charges have been collected in addition to commission charges for collecting bills (local and outstation)/ cheques as prescribed by the Bank from time to time.
- Verify whether the following documents have been collected from the parties to whom a bills purchase limit is granted:-
 - Application for Sanction of Bills/Cheques
 - Stamped Bills Purchase Agreement
 - Demand Promissory Note
 - Securities such as FD Receipts, NSC Certificate, Title Deeds, etc.
- Verify whether the person has been admitted as nominal/associate member before extending this facility.
- Ensure that this facility has been extended to a customer who is maintaining an account in his own name to the satisfaction of the Bank at least for a period of one year or such other period as prescribed by the bank.
- Verify whether this facility is extended to customers within the ceiling permitted.
- Verify whether the Interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.

7.15. ADVANCES AGAINST LIFE INSURANCE POLICIES

- Confirm that Life Insurance Policies assigned to the Bank are in the names of borrowers/parties to the borrowing transactions and assignments are duly registered with LIC.
- Ensure that the Life Insurance Policies are not under the Married Women's Property Act 1974, Children Endowment, and Children Deferred Policies etc.
- Whether the age is admitted in life Insurance Policies and is inscribed on the face of the Policy?
- Whether the Branch has maintained the prescribed margin?
- Whether the premium, on all the assigned policies is paid up to date and the receipts are properly held?
- Whether premium paid promptly?
- Ensure that loan or advances have been granted to customers of good standing against Endowment Life Insurance Policy.
- Ensure that the following precautions have been taken/observed while granting advances against Insurance Policies:
 - Insurance must be inforce.
 - Premium on the Policies have been paid up to date.



- Latest premium receipt has been obtained and kept in record.
- The original policy duly stamped and signed by the Issuing Authority should be obtained.
- If the duplicate policy is produced by the borrower, it should be confirmed from LIC before the grant of advance.
- Policy should be free from encumbrances.
- A nomination will be cancelled by a subsequent transfer or assignment.
- Verify whether it contains any clause which restricts its assignment.
- Nominal membership of borrower.
- Verify whether any Advance/Loan has been granted against the following policies since they are not eligible for advance:
 - A Policy in which a minor is recited as a Nominee.
 - Policy which has been assigned to MINOR.
 - Children Endowment or Children Deferred Policies.
 - A Policy taken by a Partnership concern.
 - A Policy which restricts its assignment.
- Verify whether the terms and conditions prescribed under the scheme have been followed while fixing the limit in relation to %age of the surrender value.
- Verify whether the advance is granted only after policy is assigned in favour of the Bank and duly attested/witnessed by a person other than the relative of the borrower.
- Verify whether the notice of assignment and the policy have been sent to LIC for registration and collected it back.
- There should be a condition/clause in agreement that the assured should pay all the future premium and in case of default, the advance will be treated as overdue and recalled. Further, in case the bank is required to pay premium, the bank shall be entitled to recover the same together with interest and other charges, as per the bank's policy, from the borrower.
- Verify the repaid Loan and Advances and ensure that in such cases, policies have been reassigned in favour of the policy holder only.
- In case the policy matures during the currency of the loan, verify whether the Bank has sent completed claim voucher together with the policy duly discharged to LIC to receive the amount.
- Upon receipt of the amount, whether the Bank has adjusted the same to Loan account?
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.

7.16. TEMPORARYOVERDRAFT (TOD)

- Verify whether the overdraft has been sanctioned to a valued customer with regular and satisfactory operations?
- In case the T.O.D. has been allowed to staff members of the bank, ensure that it is as per bank's policy.
- Verify the letter of request submitted by the customer with a specific request to sanction temporary accommodation.
- Ensure, that the customer who availed T.O.D. facility has been admitted as nominal/associate member of the Bank before extending the facility?



- Whether the customer has executed pro-note for the amount required as temporary accommodation?
- Ensure that a fresh pro-note has been obtained as and when temporary overdraft is renewed?
- Ensure that the temporary overdraft has been sanctioned only by the Officer/Executive who is competent to sanction T.O.D.
- Verify whether the outstanding in the T.O.D. accounts are within the delegated limits prescribed by Head Office from time to time to different category of Officers/Executives?
- Verify that the temporary accommodation availed by the customers are regularized by making remittances within the stipulated time limit.
- Verify whether the interest has been charged to the account holders who have availed the facility of temporary accommodation as per the guidelines issued by HO from time to time?
- In the event of overdue accounts, ensure whether the penal interest has been charged as per the regulations prescribed over and above the regular rate of interest.
- Verify whether the HO/Branch has insisted the borrower to provide security by way of assigning LIC Policy, NSC, FD receipts etc. If so, whether proper lien has been marked in the Deposit ledgers with appropriate authority?
- Verify the T.O.D. accounts and ensure that outstanding in the account has not exceeded the T.O.D limit fixed in favour of each customer, even after charging interest to the account at monthly rates.
- Ensure that HO/Branch has followed the time gap limitation as specified under this facility while renewing/sanctioning T.O.D. for second and subsequent times.
- Ensure that the classification of over dues has been done properly as per guidelines issued and prompt action has been initiated against defaulters to clear the outstanding by issuing Demand notices/Final Demand notices within the time frame work prescribed.
- In the event, outstanding is not cleared even after final demand notice has been issued, ensure whether HO/Branch has initiated legal action by referring the matter to Legal Department at HO in respect of all overdue loans.
- Ensure that right to recall the advance condition clause has been incorporated in the terms and conditions to sanction T.O.D. and communicated the same to the customer.
- Ensure that temporary overdraft register has been updated with all details viz., name of the customer to whom T.O.D. limit is sanctioned, date of availment, amount availed, operative period of the limit, etc.
- Verify whether the periodical return on the loans sanctioned has been sent by the Branch to the HO.

7.17. EDUCATION LOAN

- Verify the purpose and ensure that the purpose mentioned in the application is in line with the purpose for which the scheme has been designed.
- Verify the course mentioned in the application to obtain loan under the scheme and ensure whether it is under the enlistment of courses eligible for sanction?
- Verify whether the college/polytechnic/ institution in which the borrower has admitted his son/daughter/ward has been approved and recognized by the State Government University/ UGC as well as the degree/diploma to be awarded is recognized by the university and any other agency, namely, AICTE/ Government?
- Whether proper appraisal has been made to assess the repaying capacity of the borrower to pay loan



instalments as per schedule?

- Verify whether the Bank/Branch has obtained the certificate from the college, Institute or University as the case may be confirming the studentship, the course admitted, duration of the course, the approximate expenditure towards the entire course with annual break-up?
- Verify the loan amount sanctioned is as per the provisions of the scheme viz., percentage of the total cost, maximum amount prescribed for each course, etc.
- Verify the security aspect for the loan disbursed and ensure that the deeds executed by sureties are as per the stipulations made under the scheme.
- Verify the valuation certificate issued by the competent authority and ensure that the property value is equal to the loan amount, if the security offered is property.
- Verify the period and procedure fixed for repayment and ensure that it is as per the laid down regulations.
- Verify the agreement executed and confirm that it is in order.
- Verify the interest charged/collected from the borrower whether it is as per the procedure prescribed; and if any deviation is noticed, call for explanation and record the same.
- The maximum eligibility for loan is Rs.10 lakh for studies in India and Rs.20 lakh for studies abroad is 20.00 lacs under stipulated guidelines of RBI. It should be as per guidelines revised from time to time.
- Verify whether any rebate in interest has been provided under any scheme of GOI/State Government to students and, if so, verify whether the same has been extended?
- Verify whether proper follow up action has been initiated in default/overdue cases?
- Ensure that the Education Loan is sanctioned as per RBI instructions. (Student's eligibility, items of expenses considered for loan, margin etc.)
- Verify whether the interest and penal interest have been collected as per the terms and conditions from the borrowers, periodically.

These are some indicative list of retail advances. The auditor may also comment on other types of advances if being sanctioned/extended by the bank as per guidelines of RBI/NABARD/RCS etc. at the time of audit.

7.18. GENERAL OBSERVATIONS

- Verify whether the loans are sanctioned as per the eligibility of the borrower and surety within the prescribed limit
- Verify whether the borrower/Sureties are enrolled as nominal/associate members.
- Verify whether unit/sectoral norms prescribed by NABARD under CMA were observed for financing individuals.
- Verify whether the sanction letter is issued to the borrower and acknowledge is in place and whether the sureties were obtained as per the bank's policy.
- Verify whether the required processing fee & admission fee is collected as per policy.
- Verify whether CIBIL score is 750/700(or as decided by bank) and above. If Score is less, whether relaxation from the competent authority was obtained. Verify whether all the required documents are obtained as per the policy.
- Verify whether the Borrower, Sureties and the BM have signed at all the required places.
- Verify whether the ROI is correctly marked in the documents and as well as in the system.



- Verify adequacy of post-dated Cheques obtained as per the bank's policy.
- To comment on the coverage of over dues under legal action under all types of loans disbursed by the branch.
- Verify and comment on up-to-date insurance coverage with regard to vehicle loans, housing loans & all other loans, wherever applicable.
- Verify the signatures of borrower, co-applicant and sureties obtained across and below the Revenue stamp, wherever required, on DP/TP note.
- Verify whether the debt acknowledgement is obtained from the borrower/Co-applicant, from time to time as per bank's policy
- Verify whether any loans are sanctioned to the staff members at the branches and, if so, whether they were in order as per bank's policy
- Verify whether action under Sec.138 of N.I. Act is initiated when repayment post-dated cheque is returned unpaid on presentation for insufficiency of funds in the account.
- Verify any other unsecured loan issued to the same applicant. If yes, whether it was genuinely needed and it was sanctioned for a short duration.
- Verify the cross/multiple sureties are obtained while issuing retail loans.
- Verify the accounts with closed status and having outstanding amounts.
- Verify whether Processing fee/admission fee, if any, are collected properly.



CHAPTER 8

ADVANCES OF ST CROP LOAN/WORKING CAPITAL FOR AH & FISHERIES/WORKING CAPITAL OF SOCIETIES/ MT/ MT (CONVERSION)/ LT LOAN

The cooperative banks are mainly providing crop loans to the farmers under three/two tier system of cooperative credit in India. Under the advances of ST crop loan, MT loan, and LT loan internal auditor should examine the various important factors as follows:

8.1-STCrop Loan

Whether the branch followed the systems and procedures as prescribed for financing societies for SAO with particular reference to the following:

- Whether Scale of Finance (SOF) fixed as per guidelines on production oriented system of lending issued by NABARD? Whether the SOF fixed as a range showing minimum and maximum amount that can be financed for a particular crop in the particular location?
- Adoption of SOF fixed by the branches/PACS. Whether the SOF fixed by District Level Technical Committee was used as indicative and whether the range of variation was reasonable?
- Proper maintenance of register of rights in lands of members by PACS, posting it up-to-date, annual verification of entries therein with revenue records, verification of cropping pattern of borrowing members indicated in the normal credit limit (NCL) statement, comparing the same with the land records for avoiding inflated/ghost acreage for crops carrying higher scales of finance, etc.
- Preparation and submission by the societies of NCL statement and drawl applications
- Whether all the borrowers of crop loans were issued KCC?
- Whether the drawls of KCC were allowed by branch or by PACS only. If farmers were allowed to operate KCC at branch, whether 'mirror' account was maintained in PACS. The efficacy of the system, including the margin sharing may be examined and commented upon.
- Were there any restrictions by the Bank/Societies in the disbursement of cash component? Whether farmers allowed to take kind component in cash subject to production of vouchers?
- Whether there was undue delay in sanction/disbursement of loans to members of societies and making payment/adjustment at the bank's level in respect of the fertilizers and other inputs supplied by marketing societies/other agencies to the PACS on behalf of borrowing members?
- Whether any disparity in the scales of finance and actual disbursements-Specific reasons may be ascertained and commented in cases where the banks had higher scales of finance but disbursements were made at a very low-level.
- If the share croppers/tenants/oral lessees etc., were financed for SAO, whether they were financed on the same scales of finance as fixed for owner cultivators? If not, the basis adopted/steps taken by the bank for financing such cultivators.
- Examine the system of financing Joint Liability Groups (JLG) and bring out the deficiencies observed.
- Norms of security prescribed/followed by the bank of financing members of societies for SAO. Limit for issue of crop loan for SAO and its adequacy vis-à-vis the requirements of the cultivators in the area according to the scales of finance fixed by the bank.



- If the scheme of linking of credit with marketing had been introduced by the bank in its area of operation, effectiveness or otherwise of its working (with relevant figures of recoveries effected through linking arrangements, etc., and concrete suggestions for improvement, if the arrangement is not effective).
- Action taken by banks in implementing the various production programmes sponsored by GOI/State Government.
- Whether separate credit limits were sanctioned to PACS for financing cultivation of oilseeds covered under OPP, pulses under NPDP and DTP for financing Tribal?
- Whether separate Demand collection balance (DCB) register was maintained for cultivation of oil seeds covered under OPP/NPDP/DTP? If not, reasons thereof.
- Whether the norms for identifying small farmers are those fixed by NABARD? If not, the actual norms followed by the branch/PACS.
- Whether RCS had imposed any restrictions on financing societies? If so, details thereof. Whether such restrictions affected the flow of credit to new and non-defaulting members of PACS?
- In the case of ineligible PACS, arrangements made for ensuring adequate flow of credit to new and non-defaulting members.
- Whether RCS had fixed any recovery norms for financing PACS and whether such norms had come in the way of flow of credit to new and non-defaulting members?
- Examine the crop insurance scheme covering the following aspects:
 - Name of block where the scheme is in operation and name of the scheme
 - Crops covered
 - Farmers covered – No. of farmers to whom loans were disbursed
 - Area (in hectares) covered crop-wise
 - Amount of loans disbursed crop-wise
 - Sum insured
 - Insurance charges recovered
 - Amount of subsidy to be obtained/obtained in the case of small and marginal farmers
 - Whether insurance premium deducted out of loans has been passed on to the Insurance Companies in time.
 - Number of farmers and the amount of claim, if any, filed with the insurance company.
 - On receipt of claim amount whether the branch has passed on the amounts to the concerned PACS giving full details of the notified area/crop to which the claim relates and the percentage of the sum insured or loan which has been reimbursed
 - On receipt of claim amount, whether PACS had worked out the actual amount of claim relating to each of the loan accounts covered by the claim and credited the amounts to the respective accounts?
- Examine as to how the insurance claim received has been adjusted at bank and PACS level. Whether the adjustments were in conformity with the objectives of the scheme/instructions issued by National Bank/GOI?
- Verify Interest Subvention Scheme of Govt. of India in reference to:
 - Whether the bank had ensured that the interest charged on crop loans by the societies to the ultimate borrowers was as per the interest subvention scheme of GOI.
 - Whether the branch has compiled the claims for interest subvention correctly and discrepancies, if any, observed.

- Verify whether SAO credit limits and additional limits applications of all DCCBs for the current financial year are as per NABARD policy guidelines and verify all the necessary documents along with the Board Resolutions and comment there on as follows:
 - Comment on the Scrutiny of Credit Limit Applications obtained from the DCCBs
 - Verify Realistic Lending Programme (RLP) for the current financial year
 - Verify whether the disbursements are as per the targets fixed by bank for Kharif and Rabi seasons.
 - Comment on guidelines along with necessary documentation.
 - Verify agenda and proceedings of SLIC/ SLTC meetings during the period under Audit.
 - Verify the Monthly NODC statements obtained from the DCCBs and furnishing of NODC to NABARD by 20th of succeeding month.
 - Verify Interest Subvention & prompt repayment Incentive scheme claims to NABARD.
 - Verify TP notes for the disbursement of loans during the Financial Year
 - Comment on the Scrutiny of the drawl applications as per bank policy Guidelines
 - Verify due date register and daily transaction register.
- Verify Confirmation of balance certificates received from DCCBs and also the balance confirmation certificate sent to NABARD on borrowings on half year and year-end basis.
- Verify the Maximum/Reserve borrowing power of the Bank.
- Verify safe custody of documents related to drawl applications.
- Verify application of interest on half yearly basis on fixed dates i.e., 30th September and 31st March for ST loans.
- Verify application of interest on monthly/quarterly/half yearly as applicable on different loan products.
- Comment on the maintenance of daily transaction register of ST and IF operations. Comment on the due date register and recovery position.
- Verify the maintenance of rate-wise NABARD borrowings outstanding for tallying the interest demand of NABARD from time to time.
- Comment on the Monitoring of over dues in ST and IF Lending if any and action taken against them.

8.2.KCC Scheme for working capital for animal husbandry and fisheries

- Working capital finance for animal husbandry and fisheries is also covered under KCC Scheme and farmers availing such assistance are issued KCCs.
- Such borrowers are also eligible for interest subvention and prompt repayment incentives.
- The norms for fixing the working capital requirements for various activities are decided by the DLTC which also decides scales of finance for various crops. Has the bank/branch adopted and followed such norms
- Verify if the bank has framed any policy and issued guidelines to the branches for ensuring financial assistance to such borrowers. If yes, the features of the policy and suggestions, if any, for improvement therein.
- Verify the manner in which such borrowers are financed by the bank/branch and the scope for coverage of such potential borrowers. In case limits are sanctioned to dairy/fisheries society, whether the drawals of funds by the society are promptly used for on-lending to borrowers. Also verify the NODC cover and comment on imbalance, if any.



- Verify whether the bank/branch has financed such borrowers as per the scheme and based on the norms fixed by the DLTC.
- Verify whether the benefit of interest subvention and prompt repayment incentive has been passed on to the borrowers in time and as per the Scheme.
- Verify whether interest subvention and prompt repayment incentive claims have been lodged in time and received by the bank/branch.

8.3. Working capital requirements of societies

- Policy followed for sanction of cash credit limits to PACS, Marketing Societies, processing societies etc. for meeting their working capital requirements.
- Security and margin – whether as per the norms fixed by RBI/NABARD from time to time?
- Instructions issued by HO for custody of the goods pledged in case of loans against pledge
- HO instructions regarding insurance of stocks and adequacy
- Compliance with the directions of RBI /NABARD on financing for procurement of sensitive commodities
- Whether the loans/limits sanctioned to a single society is as per the norms. Comment on violations/ observations, if any, and the action being taken to bring the same within limits as per the guidelines/ instructions.

8.4- MT (Conversion) Loan

- Whenever natural calamity occurs, steps taken by the bank to provide relief to the borrowers of cooperative credit system such as approaching the State Government for declaration of Anwari and issue of land revenue certificate from the district authorities, issue of instructions to the PACS for conversion of ST (SAO) loans into Medium Term (Conversion), issue of guidelines to the PACS, etc.
- Examine whether the bank had granted conversion of ST (SAO) loans into Medium Term (Conversion) Loans and the amount converted during the period covered by the inspection.
- Examine the balance in the ACSF and the amount utilised by the bank for conversion during the year. In case the balance in the ACSF was not sufficient, how the bank met its share?
- Whether the bank had adhered to the criteria and procedures laid down by the RBI/ NABARD for granting conversion facilities to the PACS?
- Whether any 'overdue' loans were converted?
- Whether the bank had ensured that the benefit of conversion had been granted in time to the ultimate borrowers at the society level?
- Whether the security obtained for conversion loans was in accordance with the norms prescribed by the RBI / NABARD?
- Whether the bank had met required share (25%) in conversion? If not, how the share was met?
- Whether the bank had ensured that the farmers, for whom conversion was allowed, had been granted fresh loan by the PACS concerned?

8.5. Other Medium Term loans

Whether the bank had framed policy and laid down procedures for grant of MT loans for various purposes under farm and non-farm sector. The purposes for which MT loans are generally advanced and adequacy of standard outlays laid down (as per unit cost / per acre basis) in respect of any item of investment under farm sector.

- The manner of working out repaying capacity of borrowers for different types of investment credit.
- In fixing the repayment schedule, whether the bank had taken into account the repaying capacity of the borrower?
- Whether the economic life of the asset created was taken into account for fixing the repayment schedule and moratorium/gestation period allowed, wherever needed.
- Whether economics of the projects was worked out and pre-sanction appraisal was carried out, including borrower's appraisal?
- Whether security obtained for various medium term loans were as per the norms fixed by the RBI from time to time?
- Method followed for valuation of land and its reasonableness.
- Whether the due dates were fixed in accordance with the cash inflow with the borrower?
- Whether utilization/end-use of the credit was monitored and records available for visits carried out by the field staff?
- Whether insurance of assets acquired was insisted and whether available during the pendency of the loan?

8.6. LT LOANS

The internal auditor should examine that the long term loans have been sanctioned and disbursed as per the policy of the bank and are as per the guidelines issued by NABARD/RBI. Auditor should also verify whether the loans have been disbursed under LTRCF scheme and guidelines have been strictly followed.

8.6.1. POLICY

- Verify allocation of the eligibility criteria for DCCBs as per bank policy
- Verify the maintenance of policy files along with the Board resolutions.
- Comment on the preparation of LT Loaning programme on quarterly basis.

8.6.2. Operations

- Verify LT loaning allocations to DCCBs as per bank policy guidelines.
- Verify the loan agreements received from the DCCBs.
- Verify drawl applications along with necessary documents received from the DCCBs, as per the policy.
- Verify NPA classification statement of each quarter.
- Verify daily transaction register of LT operations
- Comment on Monitoring of overdues in LT Lending.
- Verify the Calculation of share capital requirement on LT lending.
- Verify whether the ratification of limits is approved by the Board and
- Verify whether the sanction letters were forwarded to the DCCBs with in due date.
- Verify the allocation of credit limit to various units and whether they are as per CMA exposure norms.
- Verify the Pending legal cases if any in different Courts of Law and comment on the latest status of pending cases.
- Verify the maintenance of policy files along with the Board resolutions.
- Verify Documents register
- Comment on the repayment of principal and interest instalments.



CHAPTER 9

LEGAL ASPECTS OF ADVANCES

9.1 Laws applicable to the cooperative banks

There are numerous laws that apply to the cooperative banks, right from its registration to working, documentation, etc. The IAs should be well versed with the provisions in such laws/Acts, as amended from time to time. Some of such important laws/Acts are as under:

- The State Cooperative Societies Act/Multi-State Cooperative Societies Act, under which the bank is registered.
- The Banking Regulation Act, 1949 (AACS) governing its operations as a banking Institution.
- The Prevention of Money-Laundering Act 2002 requiring reporting of particular transactions to FIU-India
- The Negotiable Instruments Act, 1881 dealing with the negotiable instruments (Promissory Note, Bill of Exchange and Cheque)
- The Indian Contract Act, 1872 dealing with the agreements, contracts, lien, pledge, indemnity and guarantee.
- Securitisation and Reconstruction of Financial Assets & Enforcement of Securities Interest Act, 2002 defining 'hypothecation' and dealing with requirements of registration of securities for their enforcement under the Act
- The Transfer of Property Act, 1882 dealing with assignments, mortgage of immovable property and various types of mortgages
- The Insurance Act, 1938 dealing with assignment of insurance policies
- The Limitation Act, 1963 dealing with the period prescribed for seeking legal remedies for various types of transactions, time-barred documents, etc.
- The Indian Stamp Act, 1899 dealing with stamping of various types of documents
- The Indian Registration Act, 1908 dealing with the registration of documents, mandatory and voluntary.
- The Deposit Insurance and Credit Guarantee Corporation Act, 1961 dealing with insurance in deposit accounts, payment of insurance premium, etc.
- The Income Tax Act, 1961 requiring the banks to report specific type of transactions
- The Indian Evidence Act 1972 dealing with documents and proof of evidence.

In addition, the IAs should be through with rules framed under these Acts, besides being well-versed with various regulatory/ supervisory directions/instructions/guidelines by RBI/NABARD and various other higher authorities, so as to ensure all statutory and regulatory compliances.

9.2-Sanction of loan

While inspection and audit of advances, the auditor should examine the various legal aspects of loan documentation mainly as follows:

- Whether proper loan application was received indicating therein the purpose of loan, amount of loan required, together with other details as required under the bank's policy, duly signed by borrower(s)/



authorised signatory(ies) and duly addressed to the bank enclosing therewith all the required documents. Availability of loan application in bank's records is one of the prime requirements.

- Whether due diligence measures (required documents obtained) have been adopted for establishing an account based relationship/opening account of individuals, joint family, sole proprietary firms, legal entities (company, partnership firm, trust, unincorporated association and a body of individuals, judicial persons) and identification of beneficial owner in case of legal person, company, trust, etc. as per KYC/ALM Policy?
- To ensure that the borrower is competent to enter into a legal contract.
- In respect of a partnership firm, a copy of the Partnership Deed is to be obtained and held on record and ensure that the amounts borrowed by the firm are for the purpose of carrying on the firm's business as stated in the deed.
- In respect of credit facilities to Companies, the following points have to be examined:
- Whether the company is a Private Limited Company or a Public Limited Company?
- Whether the Company has submitted the following: -
 - Certificate of Incorporation,
 - Memorandum and Articles of Association.
 - List of Directors and Managers.
 - Names of the persons authorised to operate the Bank account.
 - Names of the persons authorised to execute the documents.
 - Names of the person in whose presence the common seal of the company will have to be affixed to the documents.
 - Names of the persons authorized to deposit the title deeds.
- Whether the credit facilities sought are within the borrowing powers of the company as restricted by its Memorandum or Section 180 (1) (c) and 180(2) of the Companies Act, 2013?
- Whether the borrowing is for the purpose of achieving the objectives of the company as stated in the Memorandum? Otherwise, the contract will be unenforceable at law and ultra vires.
- Whether the Branch holds, on record, a resolution passed by the Board of Directors certifying that the borrowings, including the proposed borrowings by the company are within the limits specified by the Memorandum/Companies Act or the limit sanctioned by the shareholders at the General Body Meeting?
- In case, a Company has offered its guarantee, whether the Company is expressly authorized by its Memorandum to stand a guarantor and the guarantee has been offered only after a resolution was passed by the shareholders and also a specific resolution was passed by the Board of Directors?
- Whether in respect of advances to Societies, the bye-laws have been studied, borrowing powers have been ascertained and resolutions by the Managing Committee have been passed?
- Whether a No-objection letter ceding second charge has been obtained from the First Charge holder?
- Whether a letter ceding Pari Passu charge has been obtained from other financial institutions?
- Whether the borrower(s)/guarantors have duly acknowledged the sanction letter and copy thereof is held by the Branch along with the document?
- Whether, in respect of advances to Companies, the terms of sanction conveyed by the Bank have been accepted by the Company by means of a resolution passed by the Board of Directors?



- Whether all the documents have been adequately stamped and properly cancelled prior to the execution of the document?
- Whether the documents requiring compulsory registration under the Indian Registration Act and/or Indian Companies Act have been duly registered with the competent authorities.
- Whether search at the office of the Registrar of Companies is done to rule out any prior charges over the assets/properties charged/mortgaged to the Bank?
- Whether Search of the Register of Charges maintained by the Company in terms of [Section 85 of the Companies Act, 2013](#) is carried out to cross-check the particulars of the prior charges registered with the Registrar of the Companies under [section 77 of the Companies Act 2013](#) and also to ascertain the particulars other charges like pledge etc.?
- When immovable property is offered as security, whether search is carried out at the Registrar of Assurances to rule out any prior mortgages/charges?
- Whether Encumbrance Certificate is obtained?
- Whether clearance from the legal advisor is obtained before creating mortgage and the property physically inspected by the branch functionaries?
- Whether mortgage is properly created? In respect of simple mortgage, obtention of mortgage deed duly attested by two witnesses to be ensured.
- Whether in respect of Equitable Mortgage, deposit of only Original Title Deeds by the owner of the property or by his authorized agent, creation of mortgage at a Notified Centre, entry of particulars in the Title Deeds Register and confirmation letter from the Mortgagor dated subsequent to the date of deposit having deposited the Title Deeds by means of a Registered Post were ensured?

The following points are to be adhered to by the bank while obtaining the documents :

- That no amount is released until all the requisite documents are properly executed by all the parties concerned, including the guarantor.
- That the documents are executed in the presence of the Branch Manager or any other Officer of the Bank so as to be able to identify the borrower(s)/guarantor(s) personally
- That all the blanks filled up are authenticated by the borrower under his initials.
- That each document and schedule attached thereto are complete in one sitting and in the same handwriting.
- That all types of cuttings, deletions, additions, alternations, modifications etc., are authenticated by the borrower under his full signature.
- That the documents are executed in the Branch premises and that the date and place of execution is mentioned by the borrower under his full signature.
- That in case of an illiterate borrower, the contents of the documents are explained to him in a language that he could understand.
- That the borrower signs in full and in the same style throughout all the documents.
- That if a borrower signs from left hand, a small note is annexed to the document recording that the borrower has signed in left hand.
- That the borrower's full signature is obtained in each page and also across the fold of the document in such a manner that the signature runs on both the pages.
- That the borrower's full signature is obtained at the end of each document and also at the end of each schedule attached thereto.



- That in case there is a change in the ink or pen, a suitable endorsement is recorded at the same point in the document under the full signature of the executants.
- In case of documents to be executed by companies, it is essential to ensure that the seal is affixed as required by the Article of Association.
- That the documents taken are entered in the Documents Execution Register, where very necessary.
- That the documents are executed by the borrowers in proper manner appropriate to their status/capacity.
- That, in respect of Partnership Firm, all the partners have signed all the documents, and that all the partners have also signed individual guarantee agreement.
- That the date on the Promissory Note and the date on other documents is the same and that the documents are taken on the Bank's standard forms, wherever available and never on Photostat copies.

9.3- Examination of Post sanction/disbursement follow up checks.

The auditor should verify that the post sanction follow ups are being carried out by the bank mainly on the following:

- Whether as a post-sanction follow-up in respect of simple mortgage, Mortgage Deed is registered with the Registrar of Assurances within four months from the date of its execution?
- Whether, in respect of Company advances, charge is created with the Registrar of Companies under Section 77 of the Companies Act 2013 together with the instrument, if any, creating or evidencing the charge within 30 days of creation of charge.
- Whether the Branch is adequately insured all the assets including the collateral security charged to the bank and that the policy is in the joint names of the Borrower and the bank?
- Whether the Insurance Policies are taken with "Bank Clause" wherever the policies are taken solely in the name of the borrower?
- Whether the Branch has obtained periodical Search Reports from the Office of the Registrar of Companies and/or Registrar of Assurances after release of the amount during the time of review or renewal?
- Whether the Branch has obtained Revival Letter/Balance confirmation at periodical intervals?
- Maintenance of documents register, dual custody of documents and periodical physical verification of documents needs to be ensured
- Whether revival letters are obtained before the expiry of limitation period as revival letters obtained after expiry of the limitation period will not revive the documents?
- Whether revival letters were obtained even in case of term loans within three years from the date of execution to keep the borrower's personal liability in tact so that the bank can also proceed against other personal assets of the borrower?
- Whether revival letters are obtained from both the borrowers and the guarantors or their duly authorised agents to extent limitation against both of them?
- Whether, in case of Joint borrowers, revival letters are obtained from all the joint borrowers, to extend the limitation against each one of them?
- Whether in case of more than one guarantor, revival letters are obtained from all the guarantors, to extend the limitation against each one of them.



- Whether in case of time-barred documents, the Branch has obtained fresh documents and DP Note for the balance outstanding as on the date of execution of fresh set of documents with fresh guarantee deed from the old guarantor, if possible, or from a new guarantor as the case maybe?
- Whether the Branch has obtained agreements on a proper stamp paper from the legal heirs of the deceased borrower/guarantor to keep the documents alive?
- Whether the Branch is maintaining the record of due dates of documents for timely obtention of revival letters so that the documents do not get time-barred and the bank's interest is not jeopardized?
- Whether the pay-in-slips (credit vouchers) paid into the bank as part payment before expiry of the limitation period were duly signed by the borrower by his authorized agent in order to extend the period of limitation?
- Whether the adhesive stamps are duly cancelled by the Branch Manager to ensure that they cannot be used again?
- Whether the contents of the documents are typed on the reverse side of the Non-judicial stamp papers?
- Whether the revenue stamps affixed on a DP note are properly cancelled by signing across the stamp by the executants failing which the document becomes invalid?
- Whether attestations are obtained for all mortgages from two respectable persons and their addresses recorded along with their signatures?
- Whether the stamp papers are purchased by the executants in their own name?
- Whether the date of document is always subsequent to the date of purchase of the stamp paper (or date of embossing of adhesive stamps)?
- Whether the suits are filed in a court which has proper territorial and pecuniary jurisdiction?
- Whether all suit filed accounts are being properly followed-up with the advocates.
- Whether in respect of Mortgage suits, application for Final Decree have been filed wherever courts have granted Preliminary Decree within the limitation period?
- Whether the Branch has filed EPs in respect of all decreed accounts?

9.4-Examination of CMA

Further NABARD vide circular dated 6 May 2022 has issued instructions for submission of CMA statements on ENSURE portal of NABARD. The auditor should verify the compliance of the same. The main instructions are:

- CMA-I and CMA-II returns have been combined into a single return viz. CMA-1 and has been uploaded in ENSURE Portal.
- The violations to be reported in CMA-1 return include individual violations, unit-wise violations, sector-wise violations, violations in loans for housing (both individual and sector) and marketing federations.
- All the banks will submit the information on CMA return on ENSURE Portal only. Bank will not forward the copies of the return in either soft or hard form to NABARD. The auditor should assure it.
- The timeline for submission of CMA-1 return in ENSURE Portal is 15 days from the end of the quarter as follows:



Quarter ended	Due date
June	15 July
September	15 October
December	15 January
March	15 April

The exposure norms of CMA for cooperative banks have been issued by NABARD circular no Dos 68 dated 12-05-2008. The exposure norms for cooperative banks are:

Inspection Rating	Unit-wise (% to capital funds)	Sector-wise (% to LR)
A	60	50
B	50	40
C	45	35
D	40	30

- The exposure limit for individual category borrowers will be Rs. 60 lakhs for banks having 'A' rating, Rs.40 lakh for banks having 'B' rating and Rs.25 Lakh having 'C' rating or 'D' rating as per latest inspection report of NABARD. However maximum quantum of housing loan can be granted to a borrower by bank will be governed by the prescribed limit of RS. 75 lakhs (for the banks having net worth equal to or more than 100 crore) and Rs.50 lakhs (for the banks having net worth less than 100 crores) as per RBI guidelines. The internal auditor should ensure the compliance of exposure norms.
- Borrowers for whom credit limits are allocated directly by RBI for the purpose like food credit limits will be outside from the purview of exposure limits.
- The norms will not apply to the loan to PACS and other credit society and agricultural advances.
- Capital fund means –paid up capital and free reserves. Reserve by way of revaluation of fixed assets will not be included.
- Lendable resources means –Sum of share capital, Reserve including provision and excluding the balance under ACSF, Deposits and borrowing less sum of optimum liquid assets (35% of DTL), fixed assets, accumulated losses and any other commitments except loans and advances.
- Financing in excess of exposure limit NABARD prior permission is must.
- Credit to bigger borrower should be based on evaluation of credit risk, commercial judgement and market information.



CHAPTER 10

SHARE CAPITAL AND FREE RESERVES

10.1- Share capital

Under this head the auditor should examine about the raising of share capital by the cooperative banks and comment;

- Increase /decrease in share capital-reason thereof with the previous year position.
- Issue of share certificate to shareholders.
- Paid up share capital is as per bye laws of bank or not.
- Share capital composition like from State Govt.,DCCBs, Societies(primary/regional/apex)
- Share capital contribution received/repayment made during the year,
- Arrear of share capital (if any)
- Any rules/byelaws amendment for share capital.
- In case state government had availed assistance from NABARD under NRC(LTO) fund for share capital contribution to cooperative credit institutions, whether there was any delay in transfer of funds to the societies.
- Whether all the societies in the area of operation of the bank were affiliated to bank, if not, reasons for that.
- Comments on the adjustment of share capital, if any, towards dues, is as per provisions of Act, Rules and Bye laws.
- Whether the appropriation of profits was done in accordance with the provisions of Act/Rules and Bye-laws and investment of various Funds, like ACS Fund, etc. outside the business of the bank, wherever necessary, was in conformity with said regulations
- In case any reserve were drawn upon after the previous inspection/audit the circumstances which justified their withdrawal and whether such withdrawal was done as required under the Act/Rules/Byelaws.

Regarding raising of share capital, RBI vide circular no RBI/2022-23/31 DOR.CAP.REC.22/09.18.201/2022-23 dated 19-4-2022 has permitted the StCBs and DCCBs to issue shares and debentures under certain norms. The auditor should examine it very carefully specially follows;

- Whether the bank has raised share capital by issuing shares and debentures.
- Whether the prior approval has been obtained from RBI.
- Examine, whether the equity shares and additional shares have been issued to the existing members within the area of operation.
- Examine whether the preference shares have been issued to the existing members as well as non-members within the area of operation.
- Examine whether the Bonds and Debentures have been issued to the members as well as non-members within the area of operation.
- Examine issue of preferential shares are as per permission of RBI as follows;
 - Perpetual non-cumulative preference shares eligible for inclusion in Tier I capital.
 - Perpetual cumulative preference shares eligible for inclusion in Tier II capital.



- Redeemable non-cumulative preference shares eligible for inclusion in Tier II capital.
- Redeemable cumulative preference shares eligible for inclusion in Tier II capital.
- Examine issue of Bonds/Debentures (debt instruments) are as per permission of RBI as follows;
 - Perpetual debt instruments eligible for inclusion in Tier I capital.
 - Long term subordinate bonds eligible for inclusion in Tier II capital.

Examine whether the instructions of RBI have been followed while raising resources through the above instruments.

10.2- Free Reserves

The internal auditor should examine and comment on any increase /decrease in the amount of following funds in comparison with the previous year and indicate the reasons thereof:

- Statutory Reserve
- Building fund
- Agriculture credit stabilization fund
- Dividend equalization fund
- Provision for standard assets
- Creation of any special reserve as per any provision in any Act

Whether investments towards Reserve Fund and other Funds have been properly earmarked by the Board of Directors.

10.3-Capital to Risk weighted Assets Ratio (CRAR)

Comments on calculation of CRAR, whether it has been worked out as per RBI/NABARD guidelines. If there is any deficiency, it should be examined and corrected. Procedure for calculating CRAR should be as follows:-

- Examine each item of asset.
- Assign risk weight.
- Multiply with respective risk weight.
- Convert the amounts of off balance sheet items to risk weighted assets by multiplying with the relevant credit conversion factor.
- Arrive at the aggregate amount of risk weighted assets.
- Calculate the eligible capital requirement.

The guidelines on Risk weights for calculation of CRAR has been issued by RBI circular no. RPCD.RCB. BC.No.37/07.51.012/2014-15 dated 29th October 2014, and NABARD circular no.NB DOS HO POL/4799/J-1/2017-18(cir.no.46/Dos-13/2018) dated 16-03-2018. For CRAR purposes the tier I and Tier II capital should be seen as follows:

10.3.1. Tier I Capital

Tier I capital consists of shareholders' equity and retained earnings—disclosed in their financial statements—and is a primary indicator to measure a bank's financial health. These funds are generated specifically to support banks when losses are absorbed so that regular business functions do not have to be shut down. This mainly includes:



- Paid up share capital collected from regular members having voting powers
- Free Reserves
- Capital Reserve representing surplus arising out of sale proceeds of assets
- Perpetual non-cumulative preference shares.
- Perpetual debt instruments.
- Any surplus (net) in profit and loss account i.e. balance after appropriation towards dividend payable, educator funds whose utilisation is defined and asset loss, if any, etc. Contributions received from associate/nominal members where the bye-laws permit allotment of shares to such members and provided there are restrictions on withdrawal of such shares as applicable to regular members
- Contribution/non-refundable admission fees collected from the nominal and associate members which are held separately as 'Reserves' under appropriate head since these are not refundable.
- Outstanding amount in Special Reserve created under Section 36(1) (viii) of the Income Tax Act, 1961 if the bank has created Deferred Tax Liability (DTL) on this Reserve.
- (Note: Amount of intangible assets, accumulated losses, deficit in NPA provisions, income wrongly recognised on NPAs, provision required for liability devolved on bank, etc. shall be deducted from Tier I capital)
- Tier I capital ratio is calculated by dividing the bank's Tier I capital by its total risk-weighted assets (RWA). RWA measures a bank's exposure to credit risk from the loans it underwrites.

10.3.2. Tier II Capital

The composition of Tier II capital includes:

- Undisclosed Reserves
- Revaluation Reserves (at a discount of 55%, i.e. up to 45% of the amount in Revaluation Reserve)
- General Provisions and Loss Reserves which are not attributed to any identified potential loss, like general provisions for standard assets and provisions for NPAs in excess of regulatory requirements (admissible amount is subject to maximum of 1.25% of RWAs)
- Perpetual cumulative preference shares.
- Redeemable non-cumulative preference shares.
- Redeemable cumulative preference shares.
- Long term subordinate debts
- Balance, if any, in Investment Fluctuation Reserve.

(Note: The aggregate of Tier II capital will be limited to a maximum of 100% of Tier I capital)

The auditor should examine:

- Whether Tier I Tier II capital has been worked out properly as per norms.
- Whether risk weighted assets worked out properly.
- Whether margin money has been deducted properly.
- Whether provisions have been made properly.
- Whether calculation is correct.
- Any other points whatever the auditor may think to check.



CHAPTER 11

DEPOSITS AND BORROWINGS

11.1-DEPOSITS

The raising of resources through collection of deposit from public is one of main functions of a bank and auditor should examine this portfolio very carefully on the various aspects as per the guidelines of RBI/NABARD/Bank policy, as follows:

11.1.1. Operational Aspects.

- Whether Rate of interest as per guidelines or paying additional interest?
- Whether the cheque book stock is updated in computers in the custody of officer and issue register in order? Who is the custodian?
- Verify that the accounts have been opened by the depositors or duly authorised persons?
- Verify that proper account opening forms have been obtained for all the deposit accounts and properly scrutinized by the branch as per KYC norms?
- Internal audit Team to check all Account Opening Forms for non-individual cases (as there may be few accounts other than individual cases) and test check individual cases w.r.t all applicable KYC documents and comment upon them.
- Whether branch has made proper enquiries about the genuineness of the account holder?
- Are proper resolutions authorizing the persons to open and operate the accounts obtained and filed in the branch/bank? Are the changes from time to time recorded and filed properly? Specimen signature files are kept in the custody of any officers.
- Are the Specimen signature and photos scanned?
- Whether the nominations are obtained for all types of accounts?
- In case of minor account, see that the proof of date of birth is obtained and instructions of RBI have been followed?
- Verify whether the proof of date of birth is obtained for paying additional interest to the senior citizens under all types of deposit?
- In case of staff deposits, whether the declaration has been obtained that the money kept in the account belongs to staff member.
- Are inoperative accounts, dormant accounts properly watched by the officers? Whether the specimen signature (inoperative) cards are kept in the custody of authorised official?
- Are the rules regarding withdrawals from the CA/SB accounts (with cheque book facilities) followed?
- Are any RD, FD paid before due dates? Was interest paid as per rules?
- Whether the branch has submitted the details of all types of unclaimed deposit accounts to HO at the end of the year?
- If the term deposit is not renewed, whether the same is transferred to matured deposit account on the someday?
- Whether the print outs of due date diaries are taken out and filed and updated monthly/quarterly as per HO circular?



- Whether matured deposits are paid/renewed as per latest RBI guidelines?
- Are the standing instructions relating to joint deposits, company deposits, minors' deposits etc., noted in the application and in computer?
- Is the interest calculation on all types of deposits properly done and checked? Is monthly interest in FD's paid at discounted rate as per norms prescribed by RBI?
- Comment on any term deposit exceeding the cash payment limit, if paid over the counter?
- Verify any death claim received during the inspection period, whether settled early and as per rules properly.
- Whether any complaint lodged by depositors to the branch is properly dealt with?
- To verify if confirmation of balance is obtained by the depositors. Whether any differences observed?
- Whether penalty is imposed for non-maintenance of minimum balance, if required as per bank's policy.
- Whether the branch has transferred all the unclaimed matured deposits of more than 10 years u/s 26 of BR Act.
- Whether proper procedure was followed for allowing operations in inoperative and unclaimed deposits accounts?
- Whether the bank/branch had sought any refund from RBI after transfer of amount to DEAF in respect of unclaimed deposits and whether the same was in order as per RBI guidelines.
- Whether there was any debit balance in savings/current deposit account? If so, whether the same was duly authorised as per bank's policy.
- Verify whether TDS, as applicable, was property deducted and remitted with the IT authorities in time?
- Whether the branch had provided the following minimum facilities, free of charge, in BSBDA accounts:
 - Deposit of cash at bank branch as well as ATMs/CDMs
 - Receipt/credit of money through any electronic channel or by means of deposit/collection of cheques drawn by Central/State Government and their agencies
 - No limit on number and value of deposits that can be made in a month
 - Minimum of four withdrawals in a month, including ATM withdrawal
 - ATM Card or ATM-cum-Debit Card
- Examine the procedure for ensuring compliance with standing instructions of account holders and comment on violations, if any.

11.1.2. Adherence to KYC/CKYC Norms

- Verify the adherence of KYC/PMLA/CFT Policy as per latest guidelines in Master Directions issued by RBI on 04.05.2023 by new as well as existing customers. Give the particulars of violations, if any. Check whether Official Valid Documents and other documents were obtained as per guidelines?
- Whether guidelines in case of 'Simplified measures' for proof of address for small accounts were followed? Whether operations in such accounts were allowed as per RBI directions?
- Whether customers categorized as low, medium and high risk as per KYC Policy? Further, whether review and updation of status is undertaken as per RBI guidelines?
- Effective and strict implementation of Customer Acceptance Policy, Customer Identification Procedure and Customer Due Diligence. Whether branch is taking utmost care for identifying Suspicious Transactions?



- Verify whether bank account is linked with Aadhaar number in respect of those account holders who were receiving any benefit or subsidy under any scheme notified under Section 7 of Aadhaar Act, 2016 (18 of 2016)
- Whether periodic updating of KYC has been carried out at least once in every two years for high risk customers, once in eight years for medium risk customers and once in every ten years for low risk customers?
- Whether simplified norms have been followed for Self Help Groups?
- Whether record management and its preservation has been done as per KYC Guidelines?
- Examine the system being followed for keeping watch over the transactions/activities required to be reported to FIU-India by way of CTRs (both types - Individual transactions as also integrally connected transactions), CCR, NTR, CBWTR and STR, comment on its effectiveness for ensuring compliance and whether the required reports were being sent in time.
- Whether branch has taken adequate precautions to any money laundering and financing of terrorism threats that may arise from new or developing technologies and ensured that appropriate KYC procedure issued from time to time are duly applied? And whether branch escalating transaction monitoring alerts to HO?
- Whether branch is issuing letter of thanks or sending cheque book to verify the correctness of the address.
- Confirm that branch does not have any account in the name of individuals/entities appearing in the lists of individuals and entities, suspected of having terrorist links, which are approved periodically by UNSC as per Section 51 A of UAPA Act, 1967 and followed the procedure laid down in UAPA Notification dated 27 August 2009.
- Confirm that branch is following mandatory quoting of PAN as per Rule 114 B of the Income Tax Act (modification from 1 January 2016)
- Confirm that the branch has obtained Permanent Account Number (PAN), or form No.60/61 for all types of customers like individuals, firm, Company, Trust, Association, Society etc. and for accepting a term deposit above Rs.50,000/- .In case of renewal matured term deposits also confirm that PAN/or declaration in Form no.60/61 is obtained.
- Examine branch strictly following the procedures & guidelines for remittance of funds by way of DD or any other modes or values, cash deposits, sale of gold coins, etc. of value of Rs 50,000/- and above to customers & walk-in-customers.
- Comment on the awareness level of KYC/E-KYC/AML/CFT guidelines of the staff working in the branch? Whether branch manager is ensuring capacity building of staff in the branch relating to requirements under KYC/AML/CFT policy?
- Verify whether the branch is making independent confirmation of the address of the account holder?
- Verify whether branch follows instructions with regard to obtaining of photographs for opening accounts?
- Verify whether operational instructions, cheque series, address and other particulars have been noted in the Ledger/Register?
- Whether closed account opening forms are removed and filed separately?
- Confirm that the branch is destroying the unused cheque books/leaves of closed accounts, and endorsement to this effect is made in the respective ledger folios.



- Verify whether the customer's standing instructions are carried out properly? Verify whether the incidental charges are collected for non-maintenance of minimum balance?
- Verify whether the branch is charging the incidental charges half yearly in case of current accounts?
- Verify whether any of bank employees operating third party account on power of Attorney without prior permission from Competent Authority.
- Comment on the issue of cheque books and verify whether: -
 - Confirmation has been obtained in case the cheque books are issued through third persons.
 - Issue of cheque books, is properly regulated and the signature on the requisition slip is verified before issuing them.
 - In case cheque books are issued against other than requisitions slip, proper care is exercised.
 - Issue of cheque book has been recorded properly in the system.
 - Personalized cheque book is sent with Regd. Post and/or got acknowledged properly.
 - Comment on maintenance of the stop payment recording in the system.
- Comment on maintenance, preservation, and removal of the signature cards, signature in system and verification of drawer's signature on cheques before passing and affixing the seal thereon to the effect.
- Comment that the deduction of income tax on interest paid to non-resident accounts and domestic deposits, wherever applicable, is ensured as per the guidelines issued.
- The Inspectors /auditor should, at random, check the interest paid on various deposits periodically or on maturity and confirm that the rate applied and the calculations made are in order.
- Verify the control exercised over inoperative current accounts, and savings bank accounts; whether such accounts are periodically transferred to separate ledgers and necessary control is exercised as per the guidelines.
- Whether the transactions above Rs. 10 lakh & above are reported to the Controlling Office/ Head Office on a fortnightly basis.
- Whether any counterfeit currency was detected and if so, whether it has been reported to HO promptly?

11.1.3. Current Accounts

- Verify whether appropriate account opening forms with all requirements are obtained?
- Confirm whether PAN or form No.60/61, in addition to an OVD, is obtained while opening new current account?
- Check the issue of balance confirmation letter to current account holder at random (to the extent of say 5% to 10% of the outstanding accounts).
- Furnish details regarding overdrafts, if any, allowed in excess of the discretionary powers, allowing of frequent overdrafts to certain parties etc.
- Verify whether the overdraft allowed are noted in the overdrawn register, duly signed by the sanctioning authority. Whether approval obtained/ sought for overdrafts in excess of the discretionary powers?
- Verify operations in newly opened accounts and comment on unusual transactions.
- Confirm that the branch is following the instructions to exercise caution in allowing operations/opening new accounts to prevent frauds/hawala transactions, money laundering and such other unlawful activities.
- Confirm collection of service charges/incidental charges and service-tax, wherever applicable.
- Verify whether interest is charged on the debit balances in accounts.



11.1.4. Savings Bank Accounts

- Verify whether appropriate account opening forms **with all requirements** are obtained?
- Verify in case of minor accounts, whether the date of birth have been obtained and recorded in the ledger.
- Confirm whether PAN or form No. 60/61, in addition to an OVD, was obtained while opening the account and whether the branch has opened the accounts in the names of Proprietorship/ Partnership/ Limited Companies/ Associations. Payment of interest, are not permitted for Government Department/ Bodies, payment of interest is permitted, provided the funds received in the account are not through Budget allocation .Verify for violations of guidelines, if any.Verify whether the branch had opened SB account in the name of entities not eligible to open such accounts as per instructions of RBI.
- Verify whether the ledgers having inoperative accounts and their specimen signature cards are held under the custody/lock and key of the authorized officer.
- Confirm that the withdrawals from the inoperative accounts are permitted by the Branch Manager/ Authorized persons only. Test check cash withdrawals with the specimen signatures to ensure that the money has been withdrawn by authorized persons only.
- Verify whether inoperative interest earning accounts have been identified as per guidelines?
- Verify the issue of confirmation letters to about 1% of total number of accounts.
- Verify whether branch is ensuring maintenance of minimum balance in all accounts and levying service charges/service tax for non-maintenance of minimum balance, as per bank's policy.
- Verify operations in newly opened accounts and comment on adherence to KYC norms and/unusual AML transactions.
- Examine the Savings Banks Accounts of employees and report if there are any unusual transactions in the conduct of the account.
- Whether nomination was indicated in the passbook?
- Examine whether interest is calculated on the daily balance basis as per the RBI instructions
- Verify accounts opened and closed within a short span of time, i.e., accounts with quick mortality.
- Scrutiny of staff accounts to detect any abnormal transaction.

11.1.5. Fixed/Term/Recurring Deposits and Cash Certificates

- Confirm whether PAN/ Form No. 60/61 is obtained while accepting a term deposit above Rs. 50,000/-, in addition to an OVD.
- Confirm that the maturity value has been verified before payment, to ensure payment of correct amount due to the depositor.
- Verify whether the branch has diarized the maturity dates of the term deposits. Are the depositors intimated of the maturity dates in advance?
- Verify whether instalments were being received regularly in recurring deposits and, on default, the branch was levying penalty as per bank's policy.
- Verify whether the branch was following instructions of depositors, like payment of interest on monthly/quarterly, etc. basis or on maturity of the deposit and credit of maturity proceeds in SB account or reinvestment on maturity, etc.



- Is the branch transferring the term deposits to Matured Deposit accounts on the respective due dates? Or customer's instructions for auto renewal have been received in time, and accordingly the action is being taken by branch.
- Whether the interest rates recorded are correct and the application of interest is done correctly?
- Whether the accrued interest on cash certificates is recorded in the register?
- Confirm that the renewal of Overdue Term Deposits is made as per the guidelines issued from time to time.
- Verify whether the branch has taken effective steps for the renewal of the long pending items in Matured Deposit accounts or for transferring them to Dormant Deposit account?
- Verify whether the branch is deducting income tax at source on interest on term deposits and the tax is remitted promptly in cases where 15G/15H form is not submitted?
- Verify whether the form 15G/15H accepted are being forwarded to the Income Tax Authority duly filled for every financial year, as per requirement of the IT department.
- Verify whether the required returns were being filed by the bank/branch with IT authorities and in time.

11.1.6. Achievement of Deposit Targets and other operational aspects

- Examine the achievement in mobilizing deposits vis-à-vis target fixed during the last 2 years and also progress made by the branch in the current year. Composition of deposit portfolio, cost of deposits, etc.
- Comment on the interest rate wise position of branch deposits and suggest measures for smooth switchover so as to reduce the cost of funds.
- Discuss and comment on the performance, keeping in view the potentialities in the area of operation, customer service offered by the branch and the motivating role played by the Branch / HO in securing involvement of the staff members in this endeavour, etc.
- Details of deposit mobilization campaigns conducted during the year under audit. Examine if there is any particular area not explored by the branch in Deposit mobilisation.
- Proportion of High cost/Low cost/Zero cost deposits to the total deposits of the bank/branch.
- Efforts made by the bank/branch to tap deposits from local bodies - Quasi Government, institutions, charitable institutions, clubs/association etc.
- Whether the rates of interest allowed by the bank on various types of deposits are in conformity with the relative directives issued by RBI/NABARD/HO, etc.
- Whether the account opening forms and specimen signature cards duly authenticated were filed separately and maintained in custody?
- Whether the bank issued balance confirmation letters/statement of accounts to the current account holders regularly? Action taken on countermanding payment of cheques by the bank.
- Procedure followed by the bank in regard to cheques causing overdraft in current accounts – whether as per bank's policy or any violations?
- Whether the bank insisted on production of pass books by depositors when draws were allowed through withdrawal forms?
- Whether the paid fixed deposits receipts were discharged properly?
- Ensure that while paying/ receiving cash, the KYC norms are strictly adhered to?
- Maintenance of due date diary of fixed and short-term deposits accounts.



- Issue of notices to the depositors well in advance, soliciting their instructions.
- Efforts made by the bank to ensure that the borrowing societies invested their Reserve Fund with the bank.
- Whether the bank was preparing the returns correctly and sending them to DICGC promptly?
- Whether the bank had worked out assessable deposits and the premium to be paid to DICGC correctly and whether the premium had been paid in time?
- If target is not achieved, what are the attempts made by the branch/bank to achieve the target? Any service or programmes like customers meet etc. rearranged?
- Any staff member involved with the field work of contacting depositors? What are the efforts made by the Branch Manager, involvement of other officers and clerks?
- What are the suggestions of the Inspecting Officer to increase deposits in this Branch/ Bank?
- Are all types of deposit accounts viz., SB, CA, RD & Term Deposit, etc., are balanced monthly and verified by the officers? Whether balancing of accounts pending? Reasons for this pendency, test check some balanced accounts, examined and commented.
- In case the bank/branch had engaged deposit mobilising agents, whether the instructions issued by RBI/NABARD were being followed? What are the checks and balances to ensure that the agent issued proper receipt to the depositors and the amount collected by him/her is daily deposited in the bank/branch for credit to the accounts of respective depositors? Any violations or loopholes observed?

11. 1.7. Depositor's education and awareness fund (DEAF Account)

The Reserve Bank of India has mandated banks to identify deposit accounts where there has been no customer-initiated transaction for a period of more than 10 years. As per the regulation, banks are required to transfer credit balance in such accounts to Depositors Education and Awareness Fund (DEAF) as per the time schedule decided by RBI. Under section 26 of BR Act the statement ending the calendar year must be sent within one month and the amount must be transferred up to 31 march. The internal audit team should examine this carefully and make comment in the report.

11.1.8. Death Claims

To check & verify all death claims settled during the period of inspection / audit and examine whether claims are duly supported by all requisite documents as per RBI and HO guidelines and also authorised by the competent authority and examine:

- Whether nomination has been available in the account.
- In case of nomination, examine all the required documents have been obtained at the time of opening of account.
- If there is no nomination in the account, proper legal heir certificate of successor as well as indemnity has been obtained.
- In case of WILL/PROBATE what precautions have been taken by bank?
- What precautions have been taken for the delivery of articles in safe deposit lockers?
- In case the locker has been broken, whether the procedure and norms have been followed properly?
- Verify procedure in place for settlement of claims of deceased customers and payment of TDR against lost receipts and obtention of indemnities, etc.



11.1.9. Dormant Accounts

- Confirm that all items outstanding for more than 3 years under unclaimed deposits, matured deposits and balances in inoperative accounts remaining dormant for more than 3 years are transferred to Dormant Deposit account at the Branch.
- To verify each case of dormancy where any account has been moved out of dormancy and check whether all latest KYC documents have been obtained and proper application has been obtained from the account holder and payments from the dormant accounts has been authorized by the Manager/ Authorized officer?
- Verify that balancing of dormant deposit accounts is extracted by referring to individual account, and alternate set of balancing books is maintained and balance is extracted by the staff members other than the staff handling the ledger accounts of Dormant Deposit Head.
- Confirm that balancing extracted is tallied with balance in the General Ledger maintained for Dormant Deposits. Scrutinize the Dormant Deposits Repaid Accounts register and comment on the lapses/ deviations noticed, if any.
- Verify revival of dormant accounts and accounts with minimum activities.

11.1.10. Window Dressing

- Examine whether large amount of deposits accepted and cheques kept in clearing unrealized on last day of the financial year.
- Whether overdraft account allowed in one account and one deposit account, credited?
- Whether security value overstated?
- Whether unsecured advance account shown as secured.
- Examine whether fresh loan is advanced to liquidate previous overdue/NPA loan account.
- In case, inspectors come across clear case of “Window Dressing” at the year end, a detailed note on the same may be prepared with remarks of the Manager.
- Check withdrawals allowed in the last day(s) of the financial year against unutilised limits in cash credit accounts which were repaid in the beginning of the following year.

IA Team to check all divergent trends at each 4 quarter ends and during first few working days of next quarters to check and comment on possible window dressing in deposits as well as in loans. The team to specifically comment on existence of window dressing.

11.1.11. PRESERVATION OF RECORDS

In terms of Sub-Section 2(a) of Section 12 of The Prevention of Money Laundering (Amendment) Act, 2009 (PMLA, 2009), the records referred to in clause (a) of Sub-Section (1) of Section 12 shall be maintained for a period of ten years from the date of transaction between the clients and the banking company. Compliance of this requirement may be examined by the IAs.

11.2-BORROWINGS

The internal auditor should verify the position of borrowing as;

- Borrowing from various higher financing agencies and/or other banks
- Whether the banks total borrowings were within the overall ceiling (maximum borrowing power) stipulated by the bye laws and or fixed by the AGM/competent authority, whichever is less. Indicate violation if any.

- Verify the borrowings interest rates.
- Maintenance of borrowing records in register.
- Due date diary for repayments
- Check the compliance of NODC
- Cost of borrowing
- Instance of default in repayment of borrowing if any.
- Is there is any violation of terms and condition of borrowings, should be indicated
- The auditor should also examine the borrowing documents, whether they carefully filled and proper documentation has been made.
- Receipt of documents, whichever required, after repayment.

11.3-Other Liabilities

Under the head other liabilities, the internal auditor should examine the following;

- Interest payable on deposits and borrowings. Auditor should comment whether interest provision worked out correctly or any inadequate provision has been made.
- Age wise position of sundry creditors
- Unclaimed dividend
- Other contingent liabilities, like examination of guarantee/LoC issued by the bank on behalf of its constituents i.e. individual and affiliated societies. Volume of guarantee is within the prescribed limits, if exceeds any time, should be indicated.
- Bills payable-whether there are material movements in the older balances. The reasonableness of such transactions should be verified.
- Inter –office/branch Adjustments (which is in credit balance)-Whether the bank is reconciling their transactions on a daily basis and keeping a track on un-reconciled transactions?
- Whether the old credit entries are scrutinised and the entries are checked? Auditor should confirm whether the same should remain in branch books or should be transferred to Head Office as per the policy of the bank.
- Interest Accrued- Whether the interest accruing on all deposits, (payment is due or not), is treated as a liability.
- Others(Including provisions)- Auditor should review various items at branch level and H.O.level like-collection of income tax on behalf of the Government, collection from DICGC,Provision for frauds, Insurance claims received in respect of Frauds, Provision for gratuity, Provision for family pension, Provision for audit fees, Unamortized interest income on bills purchased.

11.4-Contingent Liability

Contingent liabilities are possible obligations where existence will be confirmed by uncertain future events, not wholly within the control of bank. Therefore auditor should examine the contingent liability of the bank thoroughly. The indicative checklist for the contingent liabilities may be as under:

- Claims against the bank not acknowledged as debts.
- Liability on partly paid investments.
- Liability on account of outstanding forward exchange contracts.



- Provision for pending legal cases/legal suits.
- Provisions for pending investigations.
- Provisions for product warrantees given.
- Provisions against letter of credit/letter of comfort/guarantee.

The auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified and properly valued. The auditor should, generally follow the audit procedures given below:

- The auditor should ensure that there exists a system whereby the non-fund based facilities or additional /ad hoc credit facilities to parties are extended only to their regular constituents etc.
- Ascertain whether there are adequate internal controls to ensure that transactions giving rise to contingent liabilities are executed only by persons authorised to do so and in accordance with the laid down procedures.
- The auditor should also ensure that in case of LCs for import of goods and co-acceptances, the payment to the overseas suppliers is made on the basis of shipping documents and after ensuring that the said documents are in strict conformity with the terms of LCs.
- Ascertain whether the accounting system of the bank provides for maintenance of adequate records in respect of such obligations and whether the internal controls ensure that contingent liabilities are properly identified and recorded.
- Performs substantive audit tests to establish the completeness of the recorded obligations. Such tests include confirmation procedures as well as examination of relevant records in appropriate cases.
- Review the reasonableness of the year end amount of contingent liabilities in the light of previous experience and knowledge of the current year's activities.
- Review whether comfort letters issued by the bank has been considered for disclosure of contingent liabilities.
- Obtain representation from the management that:
 - All contingent liabilities have been disclosed.
 - The disclosed contingent liabilities do not include any contingencies which are likely to result in a loss/ expense and which, therefore, require creation of a provision in the financial statements.
 - The estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including any possibility of any reimbursement.
 - Such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities.
- Verify whether bank has extended any non-fund facility or additional/ ad hoc credit facilities to other than its regular customers. In such cases, auditor should ensure concurrence of existing bankers of such borrowers and enquire regarding financial position of those customers.
- In case of claims against the bank not acknowledged as debts, the auditor should examine the relevant evidence such as:
 - Correspondence with lawyers/ others, claimants, workers/ officers and workmen's/ officers' unions.
- The auditor should also review the minutes of meetings of board of directors/ committees of board of directors, contracts, agreements and arrangements, list of pending legal cases and correspondence relating to taxes, and duties etc. to identify claims against the bank.

- The auditor should ascertain from the management the status of claims outstanding as at the end of the year. A review of subsequent events would also provide evidence about completeness and valuation of claims.
- In case of guarantees given on behalf of constituents, the auditor should ascertain whether there are adequate internal controls over issuance of guarantees, such as:
 - whether guarantees are issued under proper sanctions,
 - Whether adherence to limits sanctioned for guarantees is ensured,
 - Whether margins are taken from customers before issuance of guarantees as per the prescribed procedures etc.
 - Whether there are adequate controls over unused guarantee forms,
 - Whether unused forms are kept under the custody of a responsible official,
 - Whether a proper record is kept of forms issued,
 - Whether stock of forms are periodically verified and reconciled with the book records etc.
 - The auditor should examine the guarantee register to seek evidence whether the prescribed procedure of marking off the expired guarantees is being followed or not.
 - The auditor should check the relevant guarantee registers with Balance Sheet and Profit & Loss Account, the list of outstanding guarantees to obtain assurance that all outstanding guarantees are included in the amount disclosed in this behalf.
 - The auditor should also examine that expired guarantees are not included in this head. He should verify guarantees with the copies of the letters of guarantee issued by the bank and with the counter guarantees received from the customers. He should also verify the securities held as margin.
 - The auditor should obtain a written confirmation from the management that all obligations in respect of guarantees have been duly recorded and that there are no guarantees issued up to the year-end which are yet to be recorded and there are no guarantees as at the year-end which are invoked but not paid by the bank.
- In case of the letter of credit (LCs),
 - The auditor should evaluate the adequacy of internal controls over issuance of letters of credit and over custody of unused LC forms in the same manner as in the case of guarantees.
 - The auditor should verify the balance of letters of credit from the register maintained by the bank. The register indicates the amount of the letters of credits and payments made under them.
 - The auditor may examine the guarantees of the customers and copies of the letters of credit issued. The security obtained for issuing letters of credit should also be verified.
- In respect of disputed tax demands:
 - The auditor should examine whether there is a positive evidence or action on the part of the bank to show that it has not accepted the demand for payment of tax or duty.
 - In determining whether a provision is required, the auditor should among other procedures, make appropriate inquiries of management, review minutes of the meetings of the board of directors and correspondence with the entity's lawyers/ tax consultants and obtain appropriate management representations.

CHAPTER 12

Examination of Profit and loss account

The Third Schedule to the Banking Regulation Act, 1949(AACS) requires the disclosure of the following in Profit and Loss Account:-

12.1 -Income

12.1.1 Interest earned

- Interest/Discount on Advances/Bills: This includes interest and discount on all types of loans and advances like cash credit, demand loan, overdraft, export loans, term loans, domestic and foreign bills purchased and discounted (including those rediscounted), overdue interest and interest subsidy, if any, relating to such advances/bills. The amount to be included under this head is net of the share of participating banks under inter-bank participation schemes on risk-sharing basis.
- Income on Investment: This includes all income derived from the investment portfolio by way of interest and dividend, except income earned by way of dividend, etc., from subsidiaries and joint ventures abroad in India. Interest and dividend on Investments is usually accounted for at the Head Office.
- Interest on Balances with RBI and Other Inter-Bank Funds: This includes interest on balances with Reserve Bank and other banks, call loans, money market placements, etc.
- Others: This includes any other interest/discount income not included in the above heads. Interest on advances given by the bank to staff member in its capacity as employer rather than as banker should be included under this head.

12.1.2- Other Income

- Commission, Exchange and Brokerage: This item comprises of the following:
 - Commission on bills for collection
 - Commission/exchange on remittances, RTGS/NEFT etc.
 - Locker rent
 - Commission on Government business.
 - Commission on other permitted agency business including consultancy and other services.
 - Brokerage on Securities.
 - Fee on insurance referral.
 - Commission on referral of mutual fund clients.
- Profit on sale of Investments
- Profit on revaluation of Investment
- Profit on sale of Land, Building and Other Assets
- Profit on Exchange Transaction
- Income earned by way of Dividends, etc.
- Miscellaneous Income: This head generally includes following items of income:
 - Recoveries from the constituents for godown rents;
 - Income from bank's properties;



- Security charges;
- Insurance charges recoverable from customers, etc.;
- Rent received if any.

12.1.3-Audit procedure of an audit of income

The auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertain to the bank, that there is no unrecorded income, and that income is recorded in proper amounts and is allocated to the proper period. In view of the mandatory requirement of recognition of income, the recognition of revenue will have to be subjected to examination vis-à-vis the guidelines.

12.1.3.1-Interest Earned

- The auditor should check whether, in terms of income recognition guidelines issued by the RBI has been followed by the bank properly and also to ensure that the bank has either reversed or made provision in respect of interest accrued and credited to income account, in respect of an advance (including bills purchased and discounted) that becomes NPA as at the close of any year.
- The auditor may assess the overall reasonableness of the figure of interest earned by working out the ratio of interest earned on different types of assets to the average quantum of the respective assets during the year.
- The auditor should, on sample basis, check the rates of interest, etc. (with sanctions and agreements) as well as the calculation of interest to satisfy himself that:-
 - Interest has been charged on all the performing accounts upto the date of the balance sheet;
 - Interest rates charged are in accordance with the bank's internal regulations, directives of the RBI/ NABARD and agreements with the respective borrowers. The security of interest rates charged is particularly important in the case of advances made on floating interest rate basis;
 - Discount on bills outstanding on the date of the balance sheet has been properly apportioned between the current year and the following years;
 - Interest on inter-branch balances has been provided at the rates prescribed by the head office; and
 - Any interest subsidy received (or receivable) from RBI in respect of advances made at concessional rates of interest is correctly computed.
 - The auditor should check the Accounting procedure followed by the bank in regard to accrued overdue interest in respect of Loans and advances and Investments, and satisfy himself that it is as per Law.
 - The auditor should also satisfy himself that interest on nonperforming assets has not been recognised unless realized.
 - In case of accounts under Corporate Debt Restructuring (CDR) scheme, the auditor should see whether the income on project under implementation which has been classified as standard has been accounted for on accrual basis pursuant to the RBI's income recognition norms. It is not permitted to recognise income on accrual basis from projects under implementation which have been classified as 'sub-standard' asset. Banks may recognise income in such accounts only on realisation on cash basis.
 - The auditor should check that Bank books income on accrual basis on securities of corporate bodies/ public sector undertakings in respect of which the payment of interest and repayment of principal



have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.

- The auditor should check that Bank has booked interest income from all other performing investments on accrual basis provided interest rates on these instruments are pre-determined.
- Discount earned on discounted instruments like commercial papers, zero coupon bonds should be booked on accrual basis. The discount may either be accrued equally over the remaining period to maturity or by following the constant yield method. Auditor needs to check that discount income is properly accounted for.
- The auditor needs to check that Interest income from non-performing investments has been booked on realization only.
- Checking should be done to ensure that Income from units of mutual funds should be booked on cash basis only.
- Dividend received should be checked with reference to counterfoils of dividend warrants. As per AS 9, "Revenue Recognition", dividends should be recognised when the right to receive payment is established, i.e., dividend has been declared by the corporate body at its Annual General Meeting and its owner's right to receive payment is established.

12.1.3.2-Other Income:

- The auditor may check the items of commission, exchange and brokerage on a test basis. The auditor should examine whether the commission on non-funded business (e.g., letter of credit, guarantees and bills for collection) has been properly apportioned between the current year and the following year
- The auditor should also check whether any fees or commission earned by the bank as a result of re-negotiation or rescheduling of outstanding debts has, in terms of the income recognition guidelines issued by the RBI, has been recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit. Balance Sheet and Profit & Loss Account. The auditor can check authority for disposal of:
 - Fixed assets, if any, sold during the year under audit; and
 - Ensure that proper accounting entries have been made in connection with profit or loss on sale of fixed assets.
- The auditor should check all income earned by way of foreign exchange. Commission and charges on foreign exchange transactions except interest are to be included under the head "Profit on Exchange Transaction". In addition the auditor should apply the following checks:
 - The auditor should check that the year-end outstanding entries are translated at appropriate rates of exchange as communicated by the Controlling authority, for recording profit/ loss on exchange transactions.
 - The auditor should check large transactions on test check basis to ensure that these are recorded in compliance with the directions of the controlling authority
 - The auditor should check the transactions recorded in the past Balance sheet period to ensure that no material items have been ignored up to the year end.
 - The auditor should enquire into unusually large entries involving huge gain/losses for the year.
 - The notes and instructions for compliance of profit and loss account, issued by the Reserve Bank, requires that in case any item under the head "Miscellaneous Income" exceeds one percent of the total income, particulars thereof may be given in the notes.



- The auditor can ascertain whether any premises or part thereof is let out, and, if, so, whether rent recoveries are recorded upto the yearend at the rates as applicable.
- Fees on insurance referral are fast emerging as a major source of income for bank. In terms of the RBI circular on para banking activities, banks are permitted to undertake insurance business as agents of insurance companies on fee basis without any risk participation. The Auditor should carefully examine the agreement entered into by the bank and the concerned insurance company to see the basis for calculation of the said fee, time when the referral fees becomes due to the bank. etc.

12.2- Expenditure

12.2.1- Interest Expenses.

- Interest on Deposits: This includes interest paid/ payable on all types of deposits including deposits from banks and other institutions and also brokerage paid by the bank on deposits.
- Interest on RBI/NABARD /Inter Bank borrowings: This includes interest/ discount on all borrowings and re-finance from the RBI/NABARD and other banks.
- Others: This includes discount/interest on all borrowings/ re-finance from financial institutions. All other payments like interest on participation certificates, panel interest paid, etc. may also be included here.

12.2.2- Operating Expenses

- Payment to and provision for employees
- Rent, Taxes and Lighting
- Printing and Stationary
- Advertisement and Publicity
- Depreciation on Bank's Property
- Directors' Fees, Allowances and Expenses
- Auditors' Fees and Expenses
- Law charges
- Postage, Telegram, Telephone, etc
- Repairs and Maintenance
- Insurance
- Other Expenditure

12.2.3- Provisions and Contingencies:

This item represents the aggregate of the provisions made mainly in respect of the following:

- Non-performing assets
- Taxation
- Diminution in the value of investments
- Provision for Contingencies

12.2.3-Audit procedure of audit of expenditure:

The auditor is primarily concerned with obtaining reasonable assurance that the recorded expenditure arose from transactions, which took place during the relevant period and pertain to the bank, that there is no unrecorded expenditure, and that expenditure is recorded in proper amounts and is relating to the relevant period.



12.2.3.1-Interest Expenses

The auditor should follow, on a sample basis, check the calculation of interest. The auditor should satisfy himself that:

- Interest has been provided on all deposits and borrowings up to the date of the balance sheet; verify whether there is any excess or short credit of material amount.
- Interest rates are in accordance with the bank's internal regulations, of the RBI directives, and agreements with the respective depositors;
- In case of Fixed Deposits it should be ensured that the interest rate in the accounting system are in accordance with the interest rate mentioned in the Fixed Deposits Receipt/Certificate.
- Interest on Saving Bank Account should be checked on a sample basis.
- Interest has been provided on all deposits and borrowings up to the date of the balance sheet; verify whether there is any excess or short credit of material amount.
- Discount on bills outstanding on the date of the balance sheet has been properly apportioned between the current year and the following year;
- Payment of brokerage and deposits collected is properly authorised.

12.2.3.2-Operating Expenses:

- The auditor should check the calculation of **salaries and allowances**, etc. on a sample basis with reference to relevant agreements/ awards. He may also assess the reasonableness of expenditure on salaries, allowances, etc. by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.
- Regarding **Rent, Taxes** and Lighting the auditor should check the following on a sample basis:
 - Verify rent paid and check whether adjustments have been made for the full year on account of rent at the rates as applicable and as per agreement in force.
 - Examine that rent does not include House Rent Allowance to employees.
 - Check whether municipal rates/ taxes are duly paid/ adjusted for the year under audit.
 - Enquire whether any disputed liability exists on this account upon the year-end.
 - Expenditure incurred by the bank for advertisement and publicity, including printing charges of publicity material should be verified by the auditors with the documents.
- Regarding **depreciation** on bank's property, the auditor should;
 - Ascertain the exact procedure followed by the bank for calculation of depreciation.
 - Check Head Office instructions as regards adjustments of depreciation on the fixed assets of the branch.
 - Check whether depreciation on fixed assets has been adjusted at the rates and in the manner required by H.O.
 - Report unadjusted depreciation on assets acquired but not capitalized.
 - Ascertain the exact procedure followed.
- The auditor should verify that the **legal charges** payable by the bank in respect of all legal disputes/ cases currently being pursued at various courts of law, etc are accounted for in the accounts. For this purpose, the auditor may go through the list of contingent liability prepared by the bank as at the year end to verify the disputes/ cases which the bank is contesting.



- The auditor should check that the payment made to Directors/ Key management personnel on account of Directors Fees, Allowance and Expenses are in accordance with the terms of contract, and it should be ensured that the payment has been duly approved as well authenticated by the authority concern.
- The auditor should verify the expenditure made on account of Printing & Stationary, Law Charges, Repairs & Maintenance, Postage, Telegrams, Telephones, Insurance, Auditors' Fees & Expenses and Balance Sheet and Profit & Loss Account other Miscellaneous expenses with reference to documents evidencing/ vouchers, purchase/debit note received along with proper authentication of payment made.
- The auditor should check that all expenses other than those included in any of the other heads, like, license fees, donation, subscriptions to papers, periodicals, entertainment expenses, traveling expenses, etc. have been properly accounted for and any abnormal increase should be reported in note.
- The auditor should ensure that the operating expenses for the entire year have been booked under P&L Account, either by way of payment or by way of provision.

12.2.3.3-Provision and Contingencies:

- The auditor should verify that the provisions in respect of NPA (Non-Performing Assets) and NPI (Non Performing Investment) should be verified with the regulatory requirements to ensure full provisioning
- The auditor should check that interest is not charged in NPA accounts.
- The auditor should ensure that all interest charged in NPA accounts from the date it became NPA is reversed when it is actually classified as NPA.
- The auditor should check that an account is not upgraded as performing assets. PA from NPA until all unrealized interest including interest not charged and instalment/principal due has been cleared.
- The auditor should thoroughly check that cases where deposit has been adjusted to create a credit entry to ensure that account does not become NPA.
- The auditor should check whether there is any diminution in the value of Investment during the financial year and also ensure that the same has been accounted for in the Book of Accounts properly.
- The auditor should check the provision made for Income Tax payable with reference to the computation of taxable Income should also get satisfied with the accounting treatment made in this regard.
- The other provisions for expenditure, taxes etc. are to be examined by the auditors with the circumstances warranting the provisioning and the adequacy of the same.
- The auditor should ensure whether there is any claims have been made by any Government Department or any demand has been raised by any office or department against the bank which has not been provided for in the books as a liability e.g., Municipal Taxes, Stamp duty on lease deed etc.
- The auditor should check whether there are any suits filed against the bank at Consumer Court or any other court which might require provisioning.

Therefore the internal auditor should examine the profit and loss account mainly;

- Whether the bank's profit and loss account have been inflated in any manner, for instance by charging interest on NPAs on accrual basis or by not duly accounting the depreciation on dead stock/fixed assets or by carrying irrecoverable items or not making adequate provisions for NPA, losses due to frauds/misappropriations/ embezzlements, etc., Tax provisions are made adequately
- Interest payable on deposits and borrowings, including penal interest on borrowing are being accounted on accrual basis or not.



- Whether the bank has derived any substantial income or suffered any loss from nonbanking business such as purchase/sale/revaluation of investments, premises, other assets etc.
- Whether the cost of management in relation to gross income and to working capital was high? If so what steps have been taken to reduce it?
- Comment on the increase/decrease in income from loans and advances and investment.
- Comment on miscellaneous income and expenditure if any.
- Transfer price mechanism (TPM) being followed by the bank to arrive at the branch profitability.
- Risk cost whether it has been taken into account while fixing the interest rate for loans.
- Overdue interest position etc.
- Provision for gratuity, bonus, income tax, prepaid insurance etc.
- Method of appropriation followed by the bank is within permissible limit as per banks bye laws.
- Appropriation of profits Vis-a Vis the provisions of the cooperative societies Act/Rules/Bye laws
- All the items of income & expenditure should be examined by the IA while scrutinising the P&L A/c of the branch.
- The ratio analysis of various income and expenditure items of the bank/branch should be undertaken, compared with the past and recommendations should be made for improvement in profitability.

CHAPTER 13

INTERNAL CHECKS AND CONTROL

The auditor should examine various aspect of internal checks and control as follows;

13.1-General Maintenance of system of internal checks and control:

- Whether there is system of biometric attendance with the staff code. Attendance to be checked and corroborated with the leave record. Leave record to be checked. Muster roll or attendance sheet of part time/contractual workers, if any, to be checked.
- Whether in biometric system, the late entering arrangement is there.
- Whether indication of auto leave is there in the software of the biometric system for late comers beyond permissible limit.
- Whether provision of attendance in Salary software is linked with the biometric attendance. It should be checked and corroborated with the attendance register and leave record.
- Whether salary bills are sanctioned and authorised by the competent authority?
- Maintenance of Visit Register to monitor visits of staff to PACS, field visits for recovery, etc.
- Maintenance of HO instructions file and availability to the concerned staff.
- Is grievance redressal system is there in the software. Please check various keys for the execution.
- Maintenance of complaint register has been prepared for VIP/general complaints.
- Whether proper time line is maintained for grievance redressal. In case of delay what actions are being taken?
- Whether staff data is maintained on the system. Please randomly check some records.
- Whether personal data of the staff maintained properly? Please check for any unauthorised access.
- General quality of maintenance of various supporting registers/ledgers and also other important registers/ledgers and deficiencies/shortcomings.
- Adequacy of the system for detecting and reporting various types of transactions/activities to IT authorities, FIU, etc. under the Income Tax Act, PMLA and KYC directions of RBI.
- Whether cheque returned, stop payment of cheques, cheque book issue etc. are properly recorded in the system.
- System of internal checks and control and to bring out shortcomings therein with particular reference to the following aspects ;
- Custody and periodical verification, by a responsible official of investments, securities, bills, parcels, vouchers, blank cheque books, unused stock of fixed deposit receipts/ cash certificates/ draft forms, pass books, go down keys, etc.
- Whether day book is being generated/ticked on a daily basis with the vouchers
- Maker and checkers authorisation from vouchers on daily basis. How the maker/checker system is being observed in one-man branches, the adequacy thereof and recommendations, if any.
- Whether surprise checking of accounts is made by persons other than those, working on system.
- Checking of G/L and there sub accounts by surprise (at least once a quarter);



- Long outstanding items' pending adjustment / reconciliation in the suspense/sundry registers and bank accounts reconciliation register, reconciliation of inter-branch accounts, settlement of clearing transactions, suspense accounts, premises and stationery accounts.
- Pending entries that have not been responded for unduly long periods i.e. for over 3 months. Give full details such as number of cases, amount involved, and period-wise classification of pending amount with complete list of individual items involving large amounts.
- Detailed scrutiny of the suspense account and give specific instructions for early reversal of entries in a time bound manner.
- System evolved/developed for recording the details of off-balance sheet transactions.
- Regularity or otherwise in submission of various statutory and non- statutory returns to the RBI/NA-BARD/HO/Regional Office. Chronic deficiencies, including false reporting and delay in reporting, etc. should be pointed out return-wise with adequate details.
- Comment on the adequacy or otherwise of various returns prescribed/obtained by the HO/RO from the branches so as to have an effective control over the working of branches.
- Examine whether proper inventory of dead stock articles & stationery maintained? Annual verification report to be examined and commented?
- Examine old entries outstanding in respect of inter-bank accounts
- Whether interest subvention and prompt repayment incentive claims under KCC Scheme prepared/ lodged by the bank/branch is correct?
- Whether branch has covered KCC holders under PAIS(personal accident insurance scheme) on their consent?
- Whether branch has covered all eligible crops grown by KCC holders under RKBY/PMFBY/WBCIS?
- Whether branch is obtaining declaration from staff members with regard to their bonafide deposit for availing additional rate of interest?
- Whether performance/ financial/ other guarantee executed by the branch in accordance with the norms and sanctioned by the competent authority?
- Comment on whether the duties of the staff are clearly defined and periodically reviewed and rotated? Whether the duties of staff are so organized that the work of an employee does not go unchecked and that he does not have absolute control over any financial operations of an important nature?
- Comment on the working of the extension counter attached with the branch, if any.
- Whether concurrent audit is in place.If so, compliance of observations.
- Comments on the status of disposal of complaints.

13.2-Internal checks of sections of H.O.

The internal auditor while auditing of various sections of head office should examine:

13. 2.1. Banking – Investments Front office

- Verify cash flow statement and investment transactions during the period under audit and comment on the funds' management by the Section.
- Verify investment proceedings which reflects the date-wise investments made in various categories. Comment on the maintenance of call deposit register and ST deposit register.



- Verify/Comment on the Investment Committee meetings
- Verify whether the surplus amount is invested as per the trading committee/investment committee proceedings.
- Verify and comment on the maintenance of SLR/Non-SLR investments, whether maintained as per the guidelines during the period under Audit.
- Verify whether prescribed CRR is maintained for the fortnights in the Period under audit. The CRR to be maintained is on average balance basis as prescribed (presently average should be 4.5% or above) and also verify whether CRR maintained is within the trigger limit of NDTL or as prescribed by the Risk Management Policy of the bank.
- Verify whether the investments in various categories viz. ST, SLR, Non-SLR and Call deposits are within the exposure norms fixed by the Bank.
- Verify Shares with other institutions.
- Verify whether the interest on deposits of 2 quarters and above is calculated with quarterly compounding for complete quarters and where the terminal quarter incomplete interest is calculated for the actual number of days.
- Verify whether the investments in Mutual Funds if any is within the ceiling limit fixed and as per guidelines.
- Comment on the shifting of securities from permanent to current category and vice-versa.

13.2.2. Banking- Mid office and Back office

- Verify Call Deposits with system report
- Verify ST deposits and Term deposit with system report.
- Verify all the transactions carried out on day-to-day basis with scrolls and also comment on the checking of scroll with vouchers.
- Verify the calculation and applying interest rates on Short Term deposits G-Sec, T-Bills, etc. for end of every month.
- Verify the applying of interest on investment in consortium financing for food procurement
- Verify whether Notes on Review of Investments is submitted to RBI and NABARD as per the time schedule.
- Verify amortization of Government securities in permanent category
- Verify whether the Accounting of receipt of coupon interest on Government Securities on due dates is being done properly.
- Verify valuation of securities under current category on quarterly basis and verify whether depreciation if any is provided for.
- Verify whether valuation is done as per RBI guidelines on shifting of securities from Permanent to Current category and vice-versa and provision for depreciation, if any, is made.
- Verify whether the ST deposit receipts and other Investment documents are in joint custody and verify whether joint custody register is maintained and signed by the custodians.
- Verify whether the ST deposit receipts and other Investment documents are in joint custody and verify whether joint custody register is maintained and signed by the custodians.



13.2.3. Banking-General

- Verify DICGC Premium payments, coverage.
- Verify whether daily scroll prints pertaining to RTGS, NEFT, and DBT are being taken and verify whether amounts of RTGS, NEFTs DBTs are checked with the Scroll and tallied on daily basis.
- Verify whether Budget Vis – a Vis expenditure of Branches, HO and CTI is reviewed periodically.
- Verify the Income Tax Pending cases if any and comment on the Pending cases.
- Verify the payment of monthly TDS and filing of quarterly returns of TDS.
- Verify the correctness on payment of GST and filing of GST returns.
- Verify whether Advance Tax is paid to the Income Tax department as per the requirements.

13.2.4. Banking CLPC (centralised loan processing centre.)

- Verify all the retail loan accounts viz., Housing loans, Real Estate Mortgage Loans (REML), Education loans, SME loans, Personal loans, SHG loans and Petty Traders Loans along with all required documents are issued as per the Respective policies for the loans issued during the period under audit.
- Verify whether CIBIL score is 650/700 as per bank policy and above. In case if score is less, whether relaxation from the competent authority was obtained. Verify all the CIBIL transactions whether the borrower has eligibility.
- Verify legal opinion and valuer's opinion and valuation for the respective loan accounts.
- Verify sanction letters and disbursement schedule
- Verify the Scrutiny Report of loan applications and Site Visit report.
- Verify loan eligibility of the applicant and the sureties with reference to pay-slips and Bank statement furnished by them.
- Verify whether post-dated cheques are collected for the retail loans as per the Loan Policy.
- Verify whether sufficient number of sureties are obtained as per the policy.
- Verify required processing fee & admission fee collected and NSC register maintained.
- Verify whether the required documents obtained as per check-list.
- Verify signatures of Borrower, Sureties and manager obtained at all required places.
- Verify the Clearance certificate issued for Staff/Other customers on closure of loans during the period under audit.
- Verify and comment on the record keeping i.e., filing of all loan applications and maintenance of registers.
- Comment on the maintenance of cheques for all retail loans and verify whether they are in proper serial order and also comment on the due date register.
- Comment on the coverage of over dues under legal action within the period of limitation in respect of Demand loans to individuals, Housing Loans, Mortgage Loans, Personal Loans, SME Loans, Educational Loans, Schematic Lending for Urban SHG Schematic Lending for Petty Traders Loans, and any Other Loans that may be introduced from time to time.
- Examine if any documents had become time-barred. If yes, the reasons therefor and recommendations for obtaining fresh documents.
- Verify and comment on up-to-date insurance coverage with regard to vehicle loans, housing loans & other loans wherever applicable.



- Verify loan eligibility of the applicant and the sureties with reference to pay-slips and Bank statement furnished by them.
- Comment on the verification and scrutiny reports in respect of all types of loans
- Verify NPA statements, classification of NPAs and period wise overdues.
- Verify and comment on the retail loans issued to the bank staff during the period under Audit.
- Verify Correctness of DCB of all retail loans .and Verify the payments to Credit Rating agency, during the period under Audit.
- Comment on the reconciliation of loan accounts.
- Verify the maintenance of policies/Circulars issued files.
- Comment on the relaxation of loan policies to the Branch manager if any.
- Comment on the maintenance of registers such as Surety, Document and loan sanction registers.
- Verify Correctness of data submitted to Central Govt. through portal
- Verify correctness in preparation of data/ reports.
- Verify promptness in submission of returns/ reports to regulatory agencies
- Comment on the NPA management strategy on various loans/ advances issued.
- Comment on new loan products designed and the procedure followed to design the new loan products.
- Comment on new products innovated for Business development during the period of Audit

13.2.5. Banking – Stationery:

- Verify whether due procedure was followed viz., calling for quotations etc.if required before finalization of suppliers.
- Verify stock position with respect to stock register / stock report
- Verify all invoices along with payments during the period under Audit.
- Verify the stocks with receipts.
- Verify whether approval was taken for all payments as required as per the delegation of powers.
- Verify whether the expenditure incurred is within the budget allotted to the department.
- Verify quotations from reputed printers for printing and supply of books& forms and sanction of bills, payment to the suppliers concerned.
- Comment on the maintenance of stock register (i.e., Opening, Purchases, Consumption, and Closing stock).
- Verify the stationery items provided to the Branches and to the departments against the indents raised were properly recorded or not.

13.2.6.Safe, Fixture,Furniture and Vehicle etc.

- Whether registers for various fixed assets, furniture& fixtures, vehicles, etc. were properly maintained and updated and whether the General Ledger balances tallied with the balances in such registers?
- Whether depreciation is charged as per extant instructions?
- Where there are certain dead stock assets which are unserviceable/unworkable? In that case, make recommendation for writing of such assets as per bank's rules.
- Whether bills for purchase of such assets have been properly verified and sanctioned by the competent authority?



- Whether annual verification of fixed assets, furniture & fixtures, etc. is carried out?
- Whether building, safe, furniture and fixture etc. are insured as per HO guidelines?

13.2.7. Central account -Suspense Accounts / Sundry Assets

- Illustrative list of such accounts –suspense, sundry debtors, advances against travelling allowance, difference in cash, difference in books, advance payment to merchant establishments, advance against expenditure/purchase of asset
- Whether any long outstanding entries pending for adjustment? Reasons for delay in non-adjustment to be recorded in the report.
- Details of long outstanding entries to be examined w.r.t. its origin and destination.
- All heavy entries outstanding/ pending for adjustment, irrespective of age, to be checked w.r.t. its origin and destination.
- Whether any unauthorized advance has been raised? Examine and report in detail.
- Whether any repeated entry is posted and adjusted frequently?
- Obtain the breakup of entries under this head and verify the correctness thereof.
- Scrutinize very old entries outstanding for more than six months and report on inadequate efforts in liquidating such entries.
- Whether any Pay order/ Cash Order Payable Account is there, reasons thereof.
- Whether efforts made to contact the parties who purchased the instruments and lying pending beyond three months and whether proper name and address of the purchaser has been obtained?
- Whether any manual voucher has been passed even after CBS and if any, details of such entries with source and destination to be reported, along with reasons. Please examine the status of draft payable account in CBS and note thereon.
- If there is any TOD, Justification for creation of any temporary account to be scrutinized and details to be verified and included in the report.

13.2.8. BDPI Cell-

- Verify whether resource persons are appointed as per NABARD guidelines.
- Verify whether activities are being carried out as per NABARD guidelines.
- Verify whether Project Advisory Committee (PAC) meetings conducted during the period
- Verify whether New products designed/approved and launched during the period
- Verify whether Resource Persons Remuneration reimbursement claim and other claims to NABARD are preferred / reimbursed.

13.2.9. Human Resource Development:

13.2.9.1- HRD-Admin

- Comment on the recruitment if any in bank during the period under Audit.
- Comment on the promotions in all cadres of bank during the period under Audit.
- Comment on the compassionate appointments if any during the period under Audit.
- Verify whether confirmation of employees who have completed probation is done as per the norms during the period under Audit.
- Comment on transfers made and verify whether the same were reflected in Service Registers and Comment on the updating of service register of the employees on time to time.



- Verify whether increments are affected correctly and same were entered in the service registers.
- Verify whether roster register is maintained and updated.
- Verify whether the payments made to training institutes and to trainees: are made through proper channel on approval of competent authority.
- Comment on the maintenance of Personal files and service registers.
- Verify whether Employment Exchange Returns are furnished.
- Comment on the HR committee proceedings.
- Verify whether the CRs and Annual Performance Appraisals as per the policy are obtained.

13.2.9.2- HRD-Leaves/Payments-Salaries

- Verify leave encashment of staff and LTC availment by the staff during the period under Audit.
- Verify OT wages requisitions and process of payment during the period under Audit.
- Verify calculation and payment of EX-gratia, Gratuity and Medical aid during the period under Audit.
- Verify calculation and payments of Petrol/Paper bills and other conveyances to Staff.
- Verify remittance details of Income Tax and Professional Tax during the period under Audit.
- Verify TDS returns of every quarter during the period under the Audit.
- Verify whether reimbursement of leave encashment paid to regular employees is claimed from LIC, as per the terms & conditions of policy
- Verify salary and recoveries remittance details.
- Verify remuneration/salaries to the contract employees, medical consultant and any other payments are as per contract.
- Verify whether lunch allowance to watchmen & ward staff is being paid and recorded the same in register.
- Verify and comment on the loans sanctioned to the staff and comment on the record keeping i.e., filing of all loan applications title deeds of house, Copy of Registration Certificates of vehicles, Insurance Certificates of vehicles and houses etc.
- Verify whether recovery is being effected from the salary of staff members, who have been granted loans, regularly as per terms of sanction? Comment on cases of default/non-recovery from salary.

13.2.9.3-HRD-Payments-Miscellaneous

- Verify payment of various bills i.e. Domiciliary Medical Bills, Hospitalization expenses, Annual Health check-up bills and Reimbursement claims during the period under Audit.
- Verify payments of Medical Advance, Medical Aid and Children Education Allowance during the period under Audit.
- Comment on Group Medical Floater Policy of regular and retired staff.
- Verify all staff loans viz., salary advance, Festival Advance, Housing Loans, Vehicle Loans and Insurance for outstanding loans amount of staff etc. with all required documents including title deeds, during the period under Audit.

13.2.9.4- HRD-Gratuity and Provident Fund

- Verify payment details of Audit EDLI and admin charges to regional PF office on PF and Bank Contribution Amount.



- Verify whether pension amount of staff on deputation, which is parked in Sundry Creditors account is remitted to the respective institutions. Comment on delay, if any.
- Verify the correctness of monthly statement of PF SB Account with all vouchers.
- Comment on renewal or withdrawal of matured deposits with Central, State and PSUs by PF trust.
- Comment on the process of PF loan applications and verify whether the same are filed properly.

13.2.10. Planning and Development:

- Verify Budget estimates for various Govt. Schemes pertaining to bank and Coop. Credit Structure.
- Verify sanction of reimbursement and release of Cooperative Development fund.
- Verify payment of Additional Compensation to DCCBs during the Period under Audit.
- Verify release of PAIS reimbursement of bank share to DCCBs during the period under the audit.
- Verify payments for subscriptions to various institutions viz., NAFSCOB, NCUI, IBA etc. with approval of appropriate authority.
- Comment on the CEOs Conference and HLC Meeting and verify whether the proceedings of the Meetings are communicated to the Departments concerned.
- Comment on the Correspondence with DCCBs and other institutions on the Crop Insurance Schemes and verify whether the information, particulars on insurance coverage & premium paid details etc. are forwarded to the concerned.
- Verify the preparation of Quarterly Progress Reports on DAP/MoU in respect of bank for NABARD.
- Verify whether all the Quarterly progress reports and Monthly progress reports are being scrutinized by the department.
- Comment on the preparation of Final DCB on overdue of DCCBs.
- Verify whether follow-up on the legal action taken by the DCCBs and PACs against overdues are being done monthly basis. Comment on the allotment of the Nodal Officers to DCCBs and verify whether the Nodal officer reports are being scrutinized and communicating the observations to the concern.

13.2.11. Information Technology

13.2.11.1-Infrastructure

- Comment on the Annual Maintenance of Desktops, printers, thin clients, ATMs, Antivirus and fire-walls etc.
- Verify the coverage of insurance for all the IT electronic and non-electronic equipment.
- Verify dead stock register.
- Verify the all payments to the vendors against invoices, with approval and clearance.
- Verify the assets purchased during the period under Audit were properly capitalized as per AS10 and AS 26.
- Comment on the maintenance of inventory of hardware and software of all the Branches and HO and Verify whether the movement of Hardware to Branches and HO departments were recorded properly or not.
- Verify whether disposal of scrap and other old electronic hard ware are properly recorded and also verify whether amount received are properly accounted to respective GL head.
- Verify the maintenance and Updating /renewal of Antivirus, Firewall protection.9 Comment on the maintenance and renewal of agreements executed by IT.



13.2.11.2-Information regarding various service providers.

- Verify the bill or invoices against the procurement of Hardware, Software and others during the period under Audit.
- Whether the same has been approved by the competent authority.
- Comment on the Maintenance of Fixed assets register, Intangible assets, Attendance registers, Inventory, etc.,

13.2.11.3-Core Banking Solutions

- Verify payments against the invoices raised by various vendors.
- Comment on the AMC agreements executed with various service providers.
- Comment on the reconciliation of GL heads.
- Verify the log registers of outsourced staff and on roll staff.
- Verify the invoices and license agreement relating to procurement of new software modules and whether the same has been approved by the competent authority.
- Verify whether proper record has been maintained for all the software modules.

13.2.11.4- Electronics Payments Dept. (EPD)

- Verify payments to various vendors during the period under Audit along with respective bills or invoices and verify whether the same are approved by the competent authority.
- Verify budget estimates for supervisory committee.
- Verify whether the Purchase Orders are being issued to Vendors.
- Verify the payments made to Green PIN solutions along with Bill/Invoice and approval.
- Verify the certification fee paid to vendors, like Sarvatra, NPCI and others etc.
- Verify AMC agreements and payments to the vendors.
- Verify the Point of Sales machines issued to merchants if any during the period under Audit.
- Verify the Reconciliation of Rupay cards, Mobile Banking, IMPS and other E-Channels transactions.
- Verify the Reconciliation of ATM GL heads on daily basis.
- Verify whether action is being taken for tallying of difference between GL, ATM Cash and ATM receipt on daily basis.
- Verify whether ATM charges are being deducted from the customers on Annual basis and also verify the calculation of deduction of charges including GST.
- Verify whether call log book is being maintained to record the status of companies received from customers, branches and other departments.
- Comment on the resolving of card fraud reported by the branches if any.
- Verify the maintenance of stock register of ATM cards (ie. Opening, received, issued and closing stock of cards.)
- Verify the maintenance of files, records, vouchers, scrolls and board resolutions.

13.2.12. Clearing and RTGS/NEFT

13.2.12.1-Clearing

- Verify the Inter Bank Clearing Transactions.
- Comment on the verification of Outward Return Clearing and InwardReturn Clearing entries on daily basis.



- Verify the originating of vouchers related to the above.
- Verify the Maintenance and entry of scrolls.
- Verify the preparation of Vouchers pertaining to outward return cheques and interbank cheques.
- Verify the Payments made to NPCI, and to others if any.
- Verify the Bills or invoices along with the approval of competent authority for purchases made during the period under Audit.
- Comment on the Tallying of RBI statements on daily basis.
- Verify the tallying of all GL heads
- Verify whether the returns are submitted correctly to the NPCI.

13.2.12.2. RTGS/ NEFT

- Verify whether the staff are responding to Inward Messages of NEFT, RTGS received from time to time.
- Comment on the tallying of the NEFT and RTGS transactions with the aggregate on daily basis.
- Verify the commission pay outs received from NPCI against the inward and outward transactions.
- Comment on the attending and resolving of queries raised by branch staff.
- Comment on the verification of ECS mandates.
- Comments on the uploading of DBT, ACH returns files and DBT mapper files on daily basis.
- Verify the monthly charges of NEFT/RTGS.
- Comment on the Maintenance of Scrolls

13.2.13. Cooperative Training Institute

- Verify payments to various vendors and honorarium to guest faculty during the period under Audit.
- Comment whether the course calendar approved by standing committee.
- Verify the quarterly claims and quarterly progress reports for reimbursement of expenditure incurred by CTI from respective NABARD RO
- Verify the registers of courses conducted, number of participants attended, number of training days, names of the course coordinator, etc. were properly updated.
- Verify the budget estimates for every program conducted by CTI and whether approved by standing committee.
- Verify the final bills submitted to the outside institutes and verify whether the claims are settled.
- Verify various payments viz., housekeeping, gardening, electricity, telephone, wages, mess bills, vehicle, cable, Broadband etc. along with concern invoices/bills during the period under Audit and also verify whether the same was approved by the competent authorities.
- Verify reconciliation statements of CTI with other banks if any.
- Verify furniture, depreciation, sundry debtors and rent receivables Register.
- Verify the registers of courses conducted, number of participants attended, number of training days, names of the course coordinator, etc. were properly updated.
- Comments on the maintenance of stock register (ie. Opening, purchase, consumption and closing stock.)
- Verify the remittance of Income Tax and GST collected, if any
- Verify the assets purchased during the period under Audit were properly



- Capitalized as per AS10.
- Verify payments of allowances viz., Monthly Petrol, News Paper and Washing allowance to regular staff.
- Verify the bills and invoices for purchase of bags, files, scribbling pads, pens and other stationary items and for printing of course materials.
- Verify payment of conveyance to Faculty Members.
- Comment on the recreation activities. And verify the purchases of recreation equipment along with the Invoices/Bills and approvals.
- Verify whether the Insurances of vehicle and building are renewed.
- Verify various P&L heads like Misc. Exp, purchases, donations etc.
- Comment on maintenance of library.
- Verify whether purchase of books and donation books were recorded separately.
- Verify books in the library as per the record/books issue register.
- Verify efforts of CTI for increase in CPEC membership
- Comment on the status of faculty members for CTFC COURSE and General.
- Verify the Book keeping and Maintenance of Policy files and other records.
- Verify the Maintenance of Registers i.e., Dispatch, File movement and any other registers pertaining to the department concern or CTI.
- Comment on the preparation of Budget estimates and verify whether the expenditure is as per Budget sanctioned.
- Verify Bills or invoices along with the purchases if any in the Department concern and in CTI during the period under Audit.
- Verify the miscellaneous expenditures during the period under Audit along with the Bills.
- Verify the deduction and remittance of TDS and GST against the payments if any are being done properly.
- Verify fixed assets of HO premises and CTI on yearly basis.

The auditors may also cover any other areas or points uncovered in the methodology and scope of assignment if they deem necessary.

13.3-General Observations

- Verify overnight excess cash balance maintained continuously for some days and above during the period of Audit.
- Verify whether DDs above Rs.50,000/- are issued to non-account holders
- Verify whether the instruments are issued by taking all the precautionary measures and verify whether any BC/DD is issued by collecting less/no commission
- Verify whether ATM card charges are being collected at the time of issue
- Verification of exchange and lodgement of second set of keys of branch as per head office circular.
- Verification of transactions under Sundry Debtors, Sundry Creditors, Clearing House, Cheque return, OBC and all other suspense accounts as in the trail balance



- Verify whether Security obtained against Bank Guarantee is satisfactory?(i.e., BG issued against 100% deposit pledged or any other security/ guarantee acceptable to the bank based on risk perception of the customer) and verify Whether Commission is collected properly as per the H.O instructions
- Verify exceeded the Budget allotted for the Year / Half Year
- Scrutinize all death claim settlements vis-à-vis the policy of the Bank
- Verify whether the defects, particularly pertaining to non - compliance of KYC and PMLA directions and other statutory and regulatory requirements, pointed out in the observations of the previous report are rectified by the Branch/HO Dept. /CTI.
- Verify the GL codes on CBS along with the accounts details as per software of the Bank and whether the branches are sending certificate to the Head Office confirming the up-to-date accuracy of the same.

Auditor should also verify the maintenance of important registers on system with their code such as;

- Reserve Cash Register
- ATM Cash Register
- Due date Register
- Key Movement Register
- Daily Locker visit Register
- Locker rent Register
- Stock register (Security items)
- Loan documents register
- Receipt/ Dispatch (Inward/ Outward) Register
- Visitors Register
- Charge Handing Over Register
- Share capital register
- Nominal Membership Register
- Recovery Monitoring Register
- Cheque book issue Register
- Gold Ornaments Safe Custody Register
- Cheque Return Acknowledgement Register
- Inventory Register
- BC/DD issue Register
- Remittance Register
- Complaint Register
- Inoperative to Operative Accounts Register
- Transactions made by non-account customers
- The register of collection of commission on Bankers Cheque /Demand Draft / Issued and other services rendered as per the circular issued by Head Office to avoid Income Leakage.
- Any other register prescribed by the bank

The auditors may also to cover any other areas or points uncovered in the methodology and scope of assignment if they deem necessary.



CHAPTER 14

MANAGEMENT INFORMATION SYSTEM

Management information system (MIS) is an important tool to keep track on the activities being undertaken and in solving problems and making decisions. It can be very effective and accurate for arriving at decisions at micro as well as macro level related to advancement, investment, deposit mobilization, compliance with KYC policy, reporting CRR, SLR, CTR, CFT, off-site returns, ALM, NPA management, cash management, reduction of cost of funds, management of transaction cost, updating profile of customers, risk management, monitoring compliance of terms and conditions of loans and advances, sound functioning and health of indebted co-operative societies, monitoring business performance, reporting to RBI, NABARD, Govt. of India, RCS, IT authorities, FIU-India, etc. In the absence of a proper MIS, the decision making process gets hampered and the bank may be failing in various compliances, resulting in financial burden/loss to the bank, which may include imposition of penalty on the bank.

Most of the statements are nowadays computer generated. Record of such returns/statements needs to be maintained properly at branch level for which branches are required to maintain printouts of all the returns and statements. Further, there is a need to maintain the record of indebted co-operative societies for ongoing monitoring, for which a software / portal is required. The record of societies should be available not only to the branch but also to District Manager and HO for purpose of inspection and monitoring the recovery of over dues, etc.

14.1-Examination of MIS by Audit Team

The audit team will test check the branch reporting system of MIS to HO as well as returns submitted by HO to RBI/NABARD. Under the branch MIS, Main observations may be;

- Conduct test check and ensure that the data furnished under various returns are accurate and reliable.
- Compliance of policies, laid down procedures, observance of KYC/AML/CFT and prudential norms
- Compliance with various provisions of Income Tax Act, 1961, deduction of TDS on payment/accrual of interest on term deposits from eligible depositors and obtaining 15H/15G forms from them and submission to Income Tax Department regularly etc.
- Calculation of GST in accordance with relevant instructions and remittance to HO as per guidelines of the bank.
- Data collected should be relevant to the problem/issue to be solved for which MIS has been designed. The data should be complete and correct in all respects and should be sent in time.
- Whether the staff is well acquainted with the MIS requirements at various levels?
- Comment whether the hardware, software and other materials acquired are able to take care of the installation and implementation of the MIS designed/proposed?
- Verify whether the forms designed by the bank for a specific MIS are adequate and serve the purpose.
- Examine that the MIS helps the Management in formal review, formulation of an action plan, and follow up of the decision taken? Suggestions may be given.
- Whether day book (cash, transfer and clearing journal) is being generated and tallied / ticked with vouchers on daily basis? Whether record of the day book is being maintained in the branch properly?
- Whether control balance reports are being generated on a monthly basis and verified that GL balances are tallied with the respective subsidiary ledger balances?
- Whether statement of irregular accounts generated on monthly basis? Examine if irregular accounts are being properly maintained in order to avoid the same adding towards NPA.



14.2-Statutory Returns

The audit team will also examine that the various statutory returns of RBI/NABARD are being send in time. Some illustrative returns with timelines are follows;

Name of return	Period
ATM deployment	Quarterly
Card statistics	Monthly
Prepaid payment instrument statistics	Monthly
PPI customers grievances	Quarterly
Mobile banking transactions	Monthly
Balance sheet	Annual
RBI note refund rules	Quarterly
Details of counterfeit bank note	Monthly
Restriction of holding shares	31 st march
Form I(SLR)	Monthly
Form II (unsecured loans and advances.)	Monthly
Form VIII(unclaimed deposits)	31 st December
Form IX(assets liability)	Monthly
Non-banking assets	31 st march
Form B(CRR)	Fortnightly
Sectoral deposits	Half yearly (June and December)
PSU investment	Quarterly
Form IX special	31 st march annually
Return on internet banking	Monthly/quarterly
Annual certificate of statutory auditor	Annual within one month of completion.
Branch opening /closing	Last day of quarter.
OSC 1 statement of assets liability	Quarterly
OSC2 statement of earning	-do-
OSC3 statement of sector wise advance	-do-
OSC4 statement of asset Quality	-do-
OSC5 statement of NPA/OTS write off	-do-
OSC6 statement of management	Yearly
OSC7 statement of CRAR	Quarterly
OSC8 statement of bank profile	Yearly
OSC9 Demand collection balance	Yearly (30 June)
OSC10 statement of qualitative indicators	Quarterly
FMS1Actual/suspected fraud, during reporting period.	Event based
FMS2fraud outstanding and new cases	Quarterly
FMS3progress of disposal of fraud cases	Quarterly
FMS4report on Dacoits/robbery in Qtr.	Quarterly
FMS4(a) Immediate report of dacoits/robbery occurred	Event based
VINFRA-vulnerability index of frauds	Yearly
DICGC RETURNS	Half yearly
D1 return form	

The due dates are as per guidelines from time to time. Presently NABARD returns OSS and FMS should be sent on the last day of next month of the scheduled quarter/year except event based reports. Event based reports should be reported immediately. The auditor should examine all these factors.



CHAPTER 15

INFORMATION SYSTEM (IS) AUDIT

15.1. INFORMATION SYSTEM (IS)

The general objective of Information System Audit is to provide management a reasonable assurance that the computerised information systems in the Bank is operating properly and efficiently. Formerly known as Electronic Data Processing (EDP) audit, an IT audit is the process of collecting and evaluating evidence of an organizations information system, practices and operations. Obtained evidence evaluation can ensure whether the organizations information systems safeguards assets, maintains data integrity and is operating effectively and efficiently to achieve the organizations goals or objectives. IT audits are also known as automated data processing (ADP) audits and computer audits. An information technology (IT) audit or information systems (IS) audit is an examination of the controls within an entity's Information Technology Infrastructure.

The detail guidelines of IS audit for StCBs and DCCBs have been issued by NABARD vide reference no DOS.H.O.POL/3634/J-1/2014-15 circular no 33/DOS-01/2015 dated 25.02.2015 and DOS.H.O.POL/1794/J-1/2019-20 circular no 134/DOS-13/2019 dated 21.05.2019.

15.1.1- Objectives of IS audit

Being the migration of banking system into IT environment, it is necessary for every bank to prepare IT policy and Information system audit. Information system audit is the process of collecting and evaluating evidence to determine whether the information system safeguards assets, maintain data integrity, achieves organizational goals effectively and efficiently keeping in view the IT policy of bank. The main objective of IS audit is:

- To ensure that data integrity and financial integrity across various systems is maintained.
- To assess the impact on customers due to system changes/procedural changes proposed. To evaluate impact on business due to various changes in systems.
- To ensure that all system changes/developments are in alignment with business and IT strategic objectives.
- To have timely triggers on various IS/technical risks.
- To ensure compliance of Information Technology (IT) Act 2000, Information Technology (Amendment) Act-2008 and other Information System related guidelines.
- To follow risk based approach in all areas.
- To ensure that the Information system on which bank heavily depends is available for the business at all times when required.
- To ensure that the system are well protected against all types of losses and disasters.
- To ensure that the information system are disclosed only to authorised persons to see and use it.
- To ensure that The information provided by the system is always accurate, reliable and timely
- To ensure that the adequate measures have been taken by the management to ensure that no unauthorised modification can be made to the data or the software in the system.
- Investment on Information Systems/ Technology is aligned to the Business requirement of the organization.



- Bank's resources and assets are properly accounted for and safeguarded and optimally utilized for the purpose of conducting business.
- Financial, operating, accounting and other data generated within the Bank and/or used for management purposes is accurate and reliable.
- The integrity, reliability, confidentiality and continuous availability of Information Systems is secured.
- The application of Risk management procedures and methodologies and the functioning of internal control are effective.
- Bank's policies, procedures and manuals in relation to the above are adequate and complied with the governance, operations and various functions and activities of the Bank in those areas described in scopes are performed efficiently and effectively.
- Obtain an assurance that document a general understanding of the Information Systems environment in which the entity's financial applications operate.

15.1.2-Scope of IS audit

The IS audit aims to provide reasonable assurances on test basis regarding the adequacy of the controls used in the governance over IS resources and covers all the major and common types of audit, viz. Systems Audit, Application audits Compliance audits, Security audits, Performance audits, etc. The indicative scope of IS audit consist of as under:

- The scope of IS Audit applies to all the operating systems, applications, network devices and relational database management systems(RDBMS) that are deployed across various locations of the Bank including the Head Office, Data Centre, Disaster Recovery Centre, ATM Switch, ATMs and Outsourced locations, Regional Office and Branches.
- The scope of IS Audit will also include the adequacy and effectiveness of internal control system(s) for the use and protection of the information and the Information systems, as under:
 - Data—in terms of its representativeness of business and its integrity.
 - Application System—in terms of its functionality, controls and change management.
 - Technology—in terms of standardization, risks, investments and returns.
 - Facilities—in terms of infrastructure, maintenance and security.
 - People—in terms of establishing segregation of duties and organizational structure, adequacy and competence.

IS Audit like any other Audit function, is an independent function by itself. IS Audit is an independent tool to evaluate whether the process are getting executed as per set norms, internal controls are maintained and the risk mechanisms are in place. To ensure independence for the IS Auditors, it shall be ensured that:

- IS Auditors have access to information, personnel, locations and systems relevant to the performance of audit
- IS Auditors have complete right to examine/evaluate all manual/system related records, documents and any other evidence covered under organizational activities from employees and outsourced persons and organizations at all levels.
- IS Auditors have the right to conduct independent data inspection and analysis

15.1.3. Outsourcing of IS audit

IS audit should be conducted by a qualified auditor/ audit firm. Banks which have an independent Inspection & Audit Department should constitute an IS audit cell as part of their Inspection and Audit De-



partment to carryout IS audit in branches / offices having computerised operations. However, the banks, which do not have an independent Inspection & Audit Department, should create a dedicated group of persons, who, when required, can perform functions of an IS Auditor. The overall control and supervision of these IS Audit Cells should be vested in the Audit Committee.

Bank may also decide to outsource external professional service providers for want of expertise. There shall be a formal document of engagement of external auditors defining the activity in its totality including commercial terms/conditions, within the framework of the Bank's outsourcing policy with the approval of Audit Commit of Board depending upon the merit of the case. The external auditors shall be accountable to the Internal Audit Department in all such cases. Whenever External Auditor is engaged for IS Audit purpose through the Audit Department, following aspects need to be covered for effective communication:

- Describe the outsourced service, its scope, its availability, risk assessment and timeliness of delivery.
- Describe problems and possible resolutions for them.
- Providing adequate and readily accessible facilities for effective communication.
- Determining the relationship between the service offered and the needs of the Auditee.

The Qualification of IS auditor, Periodicity of IS audit and Accountability of auditor should be clearly mentioned in the document for outsourcing of IS audit. It should also contain the Compliance and closure of audit. The auditor should be preferably certified internal auditor who are well versed with the system audit both on system parameters as also from the perspective of compliance to income recognition, asset classification, and provisioning guidelines. Qualification of IS auditor should be as per bank policy according to the latest guidelines of RBI/NABARD.

15.1.4. Audit Report

The information systems auditor is to provide a report in an appropriate form, upon completion of audit work. The audit report is to state the scope, objectives, period of coverage and the nature and extent of the audit work performed. The report is to state the findings, conclusions and recommendations with respect to improvement in data integrity, system effectiveness and system efficiency.

The compliance and closures of IS audit process may be as follows:

- The auditee shall be required to send comments/ compliance to GM/ Incharge (I&A) within a month from the date of issue of the final audit report.
- The report, along with compliance, if received, shall be placed before the Audit Committee of Board.
- The compliance shall normally be completed within 3 months from the date of the report.
- Any area remaining to be complied shall be addressed within a defined time frame, and such timeline shall form part of the audit compliance.

The audit cycle shall be deemed to be closed by the GM/ Incharge (I&A) after verification by the auditor concerned that all major observations have been complied with.

15.2. Suggested check list for the guidance of Auditor

15.2.1-Access to the system

- Verify whether the Computer System is protected against unauthorized and unlimited attempts of booting/access?
- Verify whether the Operating System/Application is protected against unauthorized and unlimited attempts/trial of access?



- Verify whether the Operating System/Application generates the access log?
- Verify the computer room have adequate physical barriers to prevent unauthorized access to the system console / server?
- Whether combination locks, security badges or other means used to restrict access to the computer server room, back-up storage library and documentation library?
- Whether combination locks, security badges or other devices changed periodically?
- Whether detective equipment has been installed to monitor access to the computer server room, (or e.g. cameras with time and date stamp in case of ATM-Unit)?
- Whether the location of off-line storage of data, transaction journals and critical reports are safeguarded against unauthorized access?

15.2.2- User-ID / Password Maintenance:

- Verify whether a user ID register is maintained and the custody of the register with the authorised person?
- Verify whether passwords are changed periodically and at stipulated intervals?
- Verify whether the system forces the user to change password, periodically?
- Verify whether the same passwords can be repeated?
- Verify whether the user ID of employees/ officers transferred/ resigned/ retired etc. are deleted /de-activated?
- Verify whether Officers and Operators use their own user ID and password for operations?
- Verify whether separate user ID and passwords are being provided to different category of officials?
- Verify whether any digital certificate/ smart card/ access card was issued to the branch staff. If so, verify whether the same has been returned to the branch under proper noting, upon transfer/resignation etc., of the employee. Also comment on the safe-keeping of such items and receipts/return of the same to Head Office.
- Verify whether password administration facilities in Operating System (OS) and in Application packages are in vogue?
- Verify whether a security package in use, or any other security facilities in O.S. and App. Packages is being explored?
- Whether suitable security software installed and updated regularly in all systems for protecting software systems against virus, spyware, spam ware and other malicious programs?
- Whether various levels of passwords established for different transaction types, files and programmes?
- Whether various levels of passwords required based on the usability, confidentiality and significance of information?
- Are all modifications to authorization tables and access privileges recorded and reviewed?
- Are all Systems / Database logs validated by the Solution/Service provider at periodical intervals?
- Are users prohibited from selecting passwords that contain their names, or the passwords, which are very easy to guess?
- If the Data Bank Administrator (DBA)/password administrator assigns passwords first time, are delivery procedures appropriate to assure that an employee's password is not intercepted?
- Does that employee change the password immediately after he receives from the DBA?



15.2.3-Day Begin Operations

- Verify whether the check-sum of day-begin and balances (in case of SB) are printed during day-begin and tallied with previous day's day-end check-sum & balance.
- Verify it with the net banking balance on random basis.
- Verify whether the computer system maintain a log of access activity?
- Verify whether the invalid access attempts reported to, and investigated by management, DBA, and Computer Auditors?
- Verify whether the system capable of distinguishing activity source by terminal identification?
- Verify whether the system capable of identifying authorized individuals by multi-level passwords?
- Verify whether all entries by personnel restricted or secured areas recorded?

15.2.4-Operational Review:

- Verify that all software licenses are available and only authorised software is being used.
- Verify whether the operator logs out of the system while leaving the seat?
- Verify whether proper access controls are in place for computer hardware, software, media, records etc. Also comment on exercise of proper control on computer service personnel and any third party involved in data-entry/networking/telecommunication etc., services?
- Verify whether unusable media and computer printouts of waste nature are destroyed in a secure and safe manner?

15.2.5- Computer Environmental Review:

- Verify whether the UPS is used only for the Computer Systems and Networking Equipment. Verify, if any other power consuming equipment is connected to the UPS?
- Verify whether the batteries of UPS are properly kept in a rack?
- Verify whether AMC/Warranty is valid in respect of-UPS/Batteries. Computer System (Servers, PCs, Nodes), Printer sets, Networking Equipment, e.g. Modems, Switches, Routers etc., if any.
- Does the vendor's representative visit installations periodically for preventive maintenance of UPS/Batteries, Computer Systems & Printers, Networking Equipment? Date of Last visit, in each case may be commented upon.
- Verify the Visit register/Call reports and note the details of serious breakdowns, if any.
- Whether fire extinguishers are provided? If yes, whether fire extinguishers provided are suitable for computer installation?
- Verify whether operating staff is aware of usage of fire extinguishers?
- Verify whether fire extinguishers are being serviced and tested periodically?
- Verify whether the manual of instructions for operations of all the applications is supplied by HO and is available for ready reference.
- Verify whether the procedure manual for Computer Applications is provided? Also, verify that OS, Drivers and Application software CDs/Floppies are properly recorded and kept safely.
- Verify whether any computer hardware is available in the branch, which are not installed or is not in use? If yes, the reasons there for.
- Verify that the branch ensures creating separate back-up and proper deletion of its data from the Hard Disk(s), before a computer is shifted to other branch, or is taken by the vendor for repairs/replacement of part thereof.



- Verify whether all branch staff are trained in operations of branch systems /applications?
- Verify whether the usage of systems facilities, Networking, Internet, email is proper and justified?
- Ensure that all hardware and software-maintenance is:
 - Identified
 - Authorized
 - Recorded
 - Reviewed
 - Monitored

15.2.6-Standing Instructions

Verify whether:

- Validation for closed/ stopped/ frozen/ dormant account is provided.
- Standing instructions are executed.
- Provision for addition/ deletion/ modification of standing instructions is provided.
- Authority for addition/ deletion/ modification or execution of standing instructions is provided.
- Audit trails are produced for all the above operations.
- Standing instructions due on a holiday are executed on the prior working day. Whether service charges for standing instructions are collected and modified as per revised guidelines, if any.
- Service charges for standing instructions are entered while entering standing instructions?

15.2.7-Transaction Processing

- Verify whether interest on debit balance in CA is debited as prescribed by the bank.
- Verify whether all the slips/ vouchers entered on the system bear the transaction number generated by the system with due initials of clerical / supervisory staff for having entered /checked?

15.2.8-GL Operations

- Verify whether day book postings, day book, GL, reported are duly verified and authenticated?
- Verify whether any on-line help is available for the required codes?
- Verify whether the correction of any error/data required authorization?
- Verify whether system prints the day book after matching automatically before the day ends?
- Verify whether the matched Day Book report is being checked and authenticated by Officer /Manager?
- Verify whether system prints any GL matched reports?
- Verify whether GL matched report generated by the system is checked and authenticated?
- Verify whether it prints GL automatically or is there an option to print it / view it on screen whenever required?
- Verify whether special functions at various intervals (weekly/fortnightly/monthly/quarterly/half-yearly/yearly) are taken care of by the package automatically/?

15.2.9-Interest Calculations

- Verify whether products can be changed? If yes, whether any authorization is registered and audit trail produced. Verify audit trail for product change.
- Verify whether rate of interest on OD is modified as per circulars issued from time to time?



- Verify whether the interest to be applied in different modules is correct, for variety of accounts and for the duration of interest application?
- Verify whether the branch keeps proper record of the interest calculations on monthly/ quarterly / half-yearly/ yearly basis?

15.2.10-Clearing Module

Verify whether the software provides for clearing module? If yes, verify whether the following aspects are taken care of:

- Warning for the operator before day-end procedure in case the clearing module is not executed?
- In case of execution of clearing module, any report is produced in respect of number of instruments and amount posted?
- Verify whether clearing credits are accorded regularly?
- Verify whether charges for clearing returns are debited manually?
- Verify whether interest/charges for passing cheques against clearing are debited regularly

15.2.11-Levying of Incidental Service Charges, etc.

Verify whether incidental charges, service charges etc., are levied as per the latest circulars

15.2.12-Cheque Management:

- Verify whether stop payment option is provided for a single cheque or group of cheques?
- Verify whether validation is performed for closed/dormant/frozen accounts?
- Verify whether cheque books issued are entered in the system regularly? (Scrutinize the exceptional transactions report).

15.2.13-Reports:

- Verify whether detailed sub-day book is printed daily at day-end?
- Verify whether balances are printed daily?
- Verify whether day-end reports like exception reports, MIS report, access log, User-ID report, parameter changes, sensitive GL head reports (in CBS branches) etc. are printed and authenticated/signed by the Branch Head/authorized person and are filed separately?
- Verify whether ledger printing and statement of accounts options are provided?
- Verify whether ledger extracts are taken regularly and stored, as per the Bank's latest guidelines or printouts are taken and preserved after binding (SB, CA/ OD ,Loan)?
- Verify whether branch tallies "All OK" statement on a daily basis and total of all accounts of the individual modules tallies with GL Verify whether parking GL is nil in case of CBS Branches.
- Reports (Day Book / GL Package) Friday Statement, Daily HO summary, Fortnightly/monthly statements.

15.2.14-Demand Draft /Blank cheque-access

Whether Demand Draft module is still implemented? If yes, observe the following:-

- Access Controls- If access to programs and data is primarily controlled through passwords and whether procedures are adequate?
- Audit Trail Facility -Does the computer system maintain a log of access activity?



- Security and Recovery -Do the plans and procedures exist in a controlled manner to prevent a short-term or partial failure and are the same documented? Are concerned officers aware of the same?
- Are the documents issued (internally to the concerned employee/s) on the basis of run schedules only?
- Are the documents kept locked in a secure location when unattended?
- Are records of supply of the forms maintained?
- Are records of ACCESS TO supplies of the forms maintained?
- Are the documents periodically inventoried?
- Are the documents pre-printed?
- Are the documents pre-numbered or sequentially numbered and accounted for?

15.2.15-Verification of IT-related Registers

- Standing instructions register
- Stop payment register
- Cheque book issue register
- Cheque return register

15.2.16-Back-Up

- Verify whether regular back-ups are taken and preserved, Daily after day begins and before the day ends.
- Verify Adhoc Backup on HDD / Floppies /DAT etc. (Adhoc back-up need not be preserved, but to be kept safely).
- Verify whether these back-ups have been tested for restoration at any point of time (preferably immediately after completion of the back-up and before proceeding ahead for any other operation)?
- Verify whether daily back-up is taken on separate media, marked for the day?
- Verify whether the back-ups are stored separately in other premises as a measure of disaster recovery?
- Verify that latest back-up is stored, off-site?

15.3. NETWORK/CYBER SECURITY

15.3.1-General

Network security is a set of management Control and Procedures specifically implemented to ensure the protection and integrity of data in an information system network environment. The auditor should examine whether the bank has certified information system auditor or not and the proper cyber security system of bank is properly maintained.

15.3.2-Objectives of Network Security

- The information transmitted from a point in a Network is received at the destination where it is intended to reach and nowhere else.
- Information received at any point in the Network is exactly the same in content as the data transmitted and nothing more has been added or changed or deleted.
- All the components of the network like terminals, controllers, modems, Routers firewalls intrusion detection systems nodes data links and communication lines are adjustable only to authorized personnel.
- The sender of the information can verify that its receipt was by and only by the authorized recipient.



- Controls for non-repudiation of transactions (Financial or Non-Financials) should be available. It should not be possible for sender of transaction to deny having sent it or the receiver of a transaction to deny having received it. This is a fundamental control to ensure that the contracts are acceptable and enforced in the Court of Law when entered into over the internet.
- The receipt of information can verify the person from whom the communication appears to come is really the person who has sent it.

15.3.3- Categories of Network Controls

Although no two networks are identical in nature, certain basic controls are applied regardless of the simplicity or complexity of Network. These controls can be categorized as follows:

- Physical access control
- Logical access controls
- Organisational control
- Personnel controls
- Operational controls
- Application development controls
- Work station controls
- Data transmission protection
- Fire wall, Routers, Intrusion detection system.

Implementation of logical access controls requires working out good administrative procedures by:

- Identifying resources to be protected.
- Identifying each individual in the organization with a unique user identification.
- Providing authentication capability to verify that a user is really the one authorised to use the system. This can be established by an individual user represented by something only the user knows e.g. Password.
- Something only the user has e.g. a magnetic card or token
- Something only the user is e.g. a signature or finger print or retinal scan.

15.3.4-Intense Network

The following are some of the areas where the cooperative Banking is on to intense networking:

- ATM Networks and on line connectivity.
- Mobile ATM
- Networking of branches and Any Branch Banking
- Internet Banking
- Mobile van and mobile banking
- Credit Card, Debit Card and smart cards.
- Point of sale terminals
- Swift
- Structural Financial messages.

15.3.5-Fire Walls

One of the recognized method of Network security is the use of fire walls. It is a device combination of Hardware and Software that controls access between Networks. This has special features such as routers with special access controls etc. The following are the properties of fire wall.

- All traffic from inside to outside and vice versa must pass through fire wall.
- Only authorized traffic as defined by the information system security policy be allowed to pass through fire wall.
- The fire wall is itself immune to perpetration.

15.3.6. Auditor's scope for examination of cyber security system

As the banks especially the cooperative banks obviously a high profile target, the data gathered by the banks about their customers both individual and businesses-is extremely valuable to hackers looking to carry out on easy phishing attack. Therefore the banks should be aware of the risks and ready to protect it.

The three most common insider threats are as follows:

- Modifying confidential or sensitive information for personal gain.
- Customer's identification to be used for business advantage.
- Sabotage of an organization's data, systems or network.

An indicative /suggestive verification by auditor in network security/cyber security audit is as under:

Inventory management of business IT assets:- the auditor should verify whether the bank has maintained an updated business and IT asset inventory register. The register should have information about the details of every IT asset, it's critically and systems which contains customer's information, and classify it according to the sensitivity.

Preventing access of unauthorised software:- the auditor should verify whether the bank has maintained and update the centralised inventory of authorised software. There should be mechanism to monitor and block the installation of unauthorised software.

Web browser setting :-Verify that the web browser setting are up to date and internet usage have been restricted to safeguard the risk involved in the interest of bank.

Network management and security: - verify whether the bank has a regular configuration check on all the network devices and change their passwords periodically with some complexity.

Wireless network:-Verify whether the bank has regular check-up of wireless networks, access points, and wireless clients access.

Anti-virus and patch management:-Verify that there is system to monitor the status of the patches of servers, OS and software which the bank officials are using. Anti-virus management should also be centralised.

Secure mail and messaging systems:-It is very important to secure emails and messaging system. Bank's vendor's email and messaging system should also be secured .Email server specific controls should be implemented and well documented. Auditor should verify all these aspects

Removable device:-The use of removable devices should be prohibited in banking domain unless authorised specifically. In case when it is authorised it should be scanned for malware, viruses and ensure erasure of data post use. The auditor should examine all these aspect

It is only indicative. The auditor can examine the cyber security audit of bank as per latest regulatory guidelines.

CHAPTER 16

DEEN DAYAL ANTYODAYA YOZNA, NATIONAL RURAL LIVELIHOOD MISSION (DAYNRLM) and JOINT LIABILITY GROUP (JLG.)

16.1-DAY (NRLM)

The Ministry of Rural development, GOI. Launched NRLM by restructuring the SGSY scheme w.e.f.1-04-2013 which again was renamed as DAY NRLM (Deendayal AntodyaYojana National Rural Livelihood Mission w.e.f.29-03-2016).It is flagship programme of GOI for poverty reduction through building strong institutions of poor, particularly women and enabling these institutions to access a range of financial services and livelihoods.

NABARD has issued revised detailed guidelines for the scheme vide Circular No.195/MCID-02/2022 dated 26.08.2022 read with Circular No.237/MCID-03/2022 dated 11.11.2022.

The internal auditor should examine in detail mainly with regard to the following important points:

16.1.1- Group formation

- SHGs under DAY-NRLM are generally formed by women. However, groups to be formed with persons with disabilities and other special categories like elders, transgenders, the groups may have both men and women in the SHGs
- Examine the method of participatory identification of poor.(PIP)
- Verify whether women SHG under NRLM consists of minimum 10 to 20 members.
- Verify if a group is having special category of persons, and/or is difficult area/remote tribal area the minimum number may be 5.
- Verify if it is a federation of SHG, whether it is registered under appropriate Act.
- Whether Panchsutra (regular meeting, regular saving, regular internal lending regular recovery, and proper book keeping.) is being followed by the group.
- Whether SHG formation is new, and whether it has received RF (revolving fund) from GOI for 3 to 6 months.
- Whether at the credit linkage the KYC of all members of SHG has been obtained. However, at the time of opening SB A/c, KYC of only office-bearers authorised to open and operate the account would be sufficient.
- Whether the B.C. (business correspondence) has been deployed by bank for opening of SHG account and whether proper guidelines have been issued to the BC.
- Whether saving account of SHG federation has been opened as saving account of 'Association of person' and KYC have been updated.
- Whether the account is operated jointly .It should not be operated singly.

16.1.2- Grading

The auditor should examine that the grading process has been compulsorily ensured at the following ways on the stages;



- **Before disbursement of RF (3-4 months after formation):** This is for eligibility of group for receiving RF. The punch sutra parameters should be seen and graded by V.O. /bank sakhi/bank mitra for the purpose.
- **Before disbursement of CIF (6-9 months after formation):** This is for eligibility of group for receiving CIF. The punch sutra parameters should be seen and graded by V.O. /bank sakhi/bank mitra for the purpose as well as MCP should also be prepared. In case there is no V.O., an informal village committee involving members from other SHG facilitated by CRP/Community cadre may be engaged.
- **Before credit linkage (1st linkage) (6 months after formation and before submission of application for credit linkage):** This is for eligibility of group for receiving bank finance. The punch sutra parameters should be seen and graded by V.O. /bank sakhi/bank mitra for the purpose as well as MCP should also be prepared. In case there is no V.O., an informal village committee involving members from other SHG facilitated by CRP/Community cadre and bank official may be engaged.
- **Before credit linkage (Subsequent linkage) (within 2 months of repayment of previous loan or before submission of application for credit linkage):** This is for eligibility of group for receiving bank finance. The punch sutra parameters should be seen and graded by V.O. /bank sakhi/bank mitra for the purpose as well as MCP and repayment to bank also be seen. In case there is no V.O., an informal village committee involving members from other SHG facilitated by CRP/Community cadre and bank official may be engaged.

16.1.3-Important Requirements of Credit linkage with bank

- SHG should be in active existence for 6 months
- Should have successfully undertaken savings and inter-lending. Grade the SHG to assess its maturity
- Bank loan sanctioned in the name of the group; no guarantee, no security, no purpose or project to be insisted
- Decision for purposes of loan to be left to SHG; gradual shift towards income generation activities

16.1.4-Assessment for credit linkage

There are various factors of assessment, including rotation of group leaders, Refresher Training Program on capacity building, skill development, universal financial inclusion, more than 75% members undertake income generating activities, member-wise activity/credit plan prepared, bank loan not divided equally among the members and need-based disbursement, informal audit of SHG is done and financial services availed by members .

16.1.5-Cash Credit/Term loan Limits.

The internal auditor will verify the sanction of CC limit/Term loan as per latest instructions /guidelines of RBI/NABARD/GOI

16.1.5.1. CCLimit

Bank may sanction minimum CC/loan of Rs. 6.00 lakhs to each eligible SHG for a period of 3 years with yearly drawing power as given hereunder. The DP may be enhanced annually based on the repayment performance.

- DP for 1st year -6 times of existing corpus or minimum Rs.1.50 lakh whichever is higher.
- DP for 2nd year -8 times of the corpus at the time of review/enhancement or minimum Rs.3.00 lakh whichever is higher.
- DP for 3rd year-Minimum Rs. 6.00 lakhs based on micro credit plan of SHG approved by federation/ agency and the previous credit history



- DP for 4th year onwards –Above Rs. 6.00 lakhs based on micro credit plan approved by federation/agency and the previous credit history

16.1.5.2. Term loan

The term loan may be sanctioned in doses as mentioned below:

- First dose-6 times of existing corpus or minimum Rs.1.50 lakh whichever is higher.
- Second dose -8 times of existing corpus or minimum Rs.3.00 lakh whichever is higher.
- Third dose- Minimum Rs. 6.00 lakhs based on micro credit plan of SHG approved by federation/agency and the previous credit history
- Fourth dose onwards - Above Rs. 6.00 lakhs based on micro credit plan approved by federation/agency and the previous credit history.

16.1.5.3. Repayment period

The repayment schedule for term loans may be as follows:

- 1st dose-24-36 months in monthly/quarterly instalments.
- 2nd dose-36-48 months in monthly/quarterly instalments.
- 3rd dose -48-60 months based on cash flow in monthly/quarterly instalments.
- From the fourth dose onwards -60-84 months based on cash flow in monthly/quarterly instalments.

16.1.6-Security and Margin

No collateral and no margin money, up to loan of Rs. 10.00 lakhs. No lien should be marked against SB A/c of SHG and no deposits should be insisted upon while sanctioning loans

For loans to SHGs above Rs.10 lakh and up to Rs.20 lakh, no collateral should be obtained, and no lien should be marked against savings bank account of SHG. However, the entire loan (irrespective of loan outstanding, even if it subsequently goes below Rs.10 lakh) would be eligible for coverage under Credit Guarantee Fund for Micro Units.

16.1.7- Interest subvention–

- The internal auditor should verify that loans up to Rs.3 lakh have been sanctioned at a concessional rate of 7% per annum so as to be eligible for interest subvention of 4.5% per annum.
- That loans above Rs.3 lakh and up to Rs.5 lakh were sanctioned at interest rate equivalent to bank's 1 year-MCLR or cost of funds or any other external benchmark based lending rate, subject to a maximum of 10% per annum, to be eligible for interest subvention of 5% per annum.
- That the amount of interest subvention has been claimed only in respect of the eligible loans and has been calculated correctly
- That the claims for interest subvention had been lodged without delay and the amount received by the bank.

16.1.8-Documents

The auditor should verify that all the required documents are obtained.

16.2. Joint Liability Groups (JLG)

The Inspection/audit Officer may examine the financing of JLGs by the Bank, keeping in view the following broad aspects:



16.2.1- Formation of proper group

Group size- A Joint Liability Group (JLG) should be an informal group comprising 4-10 individuals coming together for the purpose of availing bank loan on individual basis or through group mechanism against mutual guarantee.

16.2.2- Criteria for membership

- Members should belong to similar socio-economic status, background and environment carrying out farm or non- farm activities and agree to function as a Joint Liability Group (JLG).
- The members should be residing in the same village/ area/ neighbourhood and should know and trust each other well enough to take up joint liability for group/ individual loans.
- Members who have defaulted to any other formal Financial Institution in the past shall be debarred from the Group Membership.
- More than one person from the same family should not be included in the same JLG.

16.2.3-Group Approach

- All members of the JLG should be active enough to assume leadership of the group to ensure the activities of the JLG. The selection of an effective /able/active leader for the JLG is essential as this will ultimately benefit all the JLG members.
- JLG should hold regular meetings which must be attended by all the members regularly to discuss issues of mutual interests.
- The principles of self-help and group strength need to be emphasized. Group cohesion has to be ensured. Adequate emphasis should be placed on the roles, expectations and functions of the group/ members & the benefits of group dynamics.
- JLG can easily serve as a conduit for technology transfer, facilitating common access to market information, for training and technology dissemination in activities relating to non-farm sector, soil testing, training and assessing input/raw material requirements.
- The JLGs and evolving JLG structures are expected to build up empathy and understanding and create responsive lending mechanisms leading to greater interaction and interdependence between the members of JLGs.

16.2.4-Credit Appraisal

- Examine the Credit appraisal - is it under or over financing.
- Is Flexible credit product approach is adopted to meet credit requirements of crop production, working capital, marketing, investment credit, etc.in the agriculture and allied sectors and non-farm sector.
- Examine sanction of crop loan and working capital for AH and fisheries up to Rs. 3 lakhs per member to be eligible for interest subvention and prompt repayment incentive at the prescribed rate of interest.
- Verify other Norms - rate of interest, margin, security, coverage under crop insurance/insurance scheme for artisans, PAIS, etc. as per the regular norms of bank and/or as prescribed under various schemes.

16.2.5- Financing to JLG

There are two models for financing JLGs. The auditor should examine:

- Whether the bank has financed to group on individual basis .(Model A)
- Whether the bank has financed to the group as a unit(.Model B)



16.2.6-Financing Individuals in the Group: - (Model A)

16.2.6.1. Auditor to examine

- Each member of the JLG is eligible to avail an individual KCC.
- For Farm Sector requirements, branch would assess the credit requirement on basis of the crop to be cultivated, available cultivable land/activity. Whether it is worked out correctly.
- For Non- Farm Sector Requirements, branch would assess the credit requirement, based on product/enterprise/activity to be undertaken and the credit absorption capacity of the individual. Whether it is worked out correctly.
- Whether all members jointly executed loan document, making everyone jointly and severally liable for repayment of all loans taken by all individuals belonging to the group.
- The mutual agreement needs to ensure consensus among all members about the amount of an individual's debt liability that will be created, including liability created out of the individual KCC
- Any member opting out of group or joining the group, will necessitate execution documents afresh, to be kept on record in the Bank's branch.

16.2.7- Financing the JLG as a group: - (Model B)

16.2.7.1. Auditor to examine

- The JLG would also be eligible to seek loan for the combined credit requirements in respect of all its members.
- The JLG functions operationally as one borrowing unit.
- The credit assessment of the group could be based on the combined credit/requirement of all members of the JLG based on the available cultivable area of each member of JLG or activity to be taken, as the case be.
- All member would jointly execute loan document, and own the debt liability jointly and severally.
- The mutual agreement needs to ensure consensus among all members about the amount of individual debt liability that will be created.
- Any change in composition of the group, will lead to fresh execution of documents.

16.2.8- Credit Assessment

16.2.8.1. Auditor to examine

- Verify whether the JLG has prepared a credit plan for its individual members and an aggregate of that is submitted to the branches.
- Whether the Branch had conducted a thorough credit appraisal to avoid under or over financing.
- Whether the individual members of JLG would be eligible for bank loan after the bank verifies the individual members' credentials.

16.2.9-Purposes of credit

The finance to JLG is required to be flexible addressing the credit requirements of its members including crop production, consumption, marketing and investment credit besides other productive purposes in the agriculture and allied sectors.

16.2.10- Security

- The loans shall be advanced, under the scheme on the strength of mutual guarantee given by all members of JLG.



- Even if a member of JLG seeks credit, the whole group shall have to give the guarantee.
- No collateral security shall be insisted upon from the applicants under the scheme. The mutual guarantee offered by JLG should be kept in record.

16.2.11- Rate of interest

If the JLG is financed under a particular scheme, like KCC, etc. as specified under that Scheme, otherwise as per RBI guidelines and bank's own policy.

16.2.12- Documents

As per bank's own policy depending upon the type of activity, tenure of the loan, etc. However, inter-se/mutual guarantee of the members and in case JLG has been sponsored by an NGO, sponsorship letter are must.

CHAPTER 17

RISK BASED INTERNAL AUDIT

Presently the most of the cooperative banks have grown in size and become systemically important, prevalence of different audit system/approaches in banks has created certain inconsistencies, risk and gaps. To identifying risk, the supervisors of the bank were required to:

- Develop and maintain a forward-looking assessment of the risk profile of the banks and , proportionate to their systemic importance;
- Identify, assess and address risks emanating from banks and the banking system as a whole;
- Have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve in an orderly manner.
- During the course of inspection, all areas of risks faced by the bank, viz., Credit Risk, Market risk, operational risk etc., were examined and commented by the auditors. The copies of the comments were also endorsed to different stakeholders like State Govt. concerned RCBs, NABARD/ RBI. However, the examination was done following a traditional system of assessment, measurement and monitoring. The Working Group on Risk Based Supervision has suggested new approach of measurement and assessment of banks.

The RBIA has not yet been implemented in RCBs, but being the increasing business risk in RCBs, it would be a futuristic approach for the cooperative banks. The objectives and scope of Risk based internal audit is given below:

Objectives and Scope

- An effective Risk-Based Internal Audit (RBIA) is an audit methodology that links an organization's overall risk management framework and provides an assurance to the Board of Directors and the Senior Management on the quality and effectiveness of the organizations' internal controls, risk management and governance related systems and processes
- The internal audit function should broadly assess and contribute to the overall improvement of the organization's governance, risk management, and control processes using a systematic and disciplined approach. The function is an integral part of sound corporate governance and is considered as the third line of defence.
- Historically, the internal audit system in banks has generally been concentrating on transaction testing, testing of accuracy and reliability of accounting records and financial reports, adherence to legal and regulatory requirements, etc. However, in the changing scenario, such testing by itself might not be sufficient. Therefore, banks will have to move towards a framework which will include, in addition to selective transaction testing, an evaluation of the risk management systems and control procedures in various areas of operations. This will also help in anticipating areas of potential risks and mitigating such risks.
- While the Risk Management Function should focus on identification, measurement, monitoring, and management of risks, development of risk policies and procedures, use of risk management models, etc., RBIA should undertake an independent risk assessment for the purpose of formulating a risk-based audit plan which considers the inherent business risks emanating from an activity / location and the effectiveness of the control systems for monitoring such inherent risks.



Guiding Principles on Risk Based Internal Audit (RBIA):

- RBIA team should also carry out IS compliance audit as part of their audit routine for small & low rated branches as well as follow up work for non-compliance issues of the branch in IS audit areas.
- Conflict of interest between Audit team member and Auditee should be avoided.
- The frequency of Audits under Risk based system should be uniformly fixed at 9-12 months for extremely high/ High Risk Branches, 12-15 months for medium Risk Branches and 15-18 months of low Risk Branches.
- Risk Assessment matrix for Branches / Departments under the suggested RBIA Policy may be adopted by banks.
- Audit team should guide the branches on spot rectification of the deficiencies to the extent possible.
- It is advised that all the Audit qualifications should be rectified within 90 days of submission of Audit Report and to be closed not later than 120 days.

RATING ASSESSMENT OF BRANCHES

Evaluation of performance and functioning of a Branch based on Inspection and Audit findings through a system of rating is an important tool to assess the potential of a branch. This Rating has a bearing on the performance of Branch Manager and other officials and staff. Hence, an objective system of rating is developed, which the Inspecting Official is required to use to evaluate the performance of a branch.

Branch Ratings designed under RBIA policy and regular inspection may be adopted by the banks as below:

Regular Inspection	RBIA
Very Good	Low Risk
Good	Medium risk
Satisfactory	High risk
Unsatisfactory	Very High risk
Poor	Extremely high risk

High Risk and above / poor/unsatisfactory / satisfactory

- The audit report shall be graded as high risk where the audit findings highlight significant matters requiring urgent management action.
- Audit findings of the following nature shall result in the internal auditors grading a particular department / operation as high risk:
 - A weakness in the Internal Control system which presents a significant risk of error that may have a material impact on the financial statements of the Bank.
 - A weakness where the risk of error, though less likely, involves amounts which may have a major impact on the financial statements;
 - A weakness which puts the assets of the Bank at risk; and / or a fraud or suspicion of a fraud.

Medium Risk /Good

- The audit report shall be graded as medium risk where the audit findings highlight less significant matters requiring management action.
- Audit findings of the following nature shall result in the internal auditors grading a particular department / operation as medium risk:



- A weakness in the Internal Control system which presents a significant risk of error but will not have a material impact on the financial statements
- Constructive suggestions which might result in significant improvement in efficiency or reduction in Cost
- Improvement relating to the prevailing regulatory environment or procedures which are necessary to avoid minor or technical breaches.

Low Risk / Very Good

- The audit report shall be graded as low risk where the audit findings highlight trivial matters which require to be brought to the attention of the management but do not warrant any action.
- Audit findings of the following nature shall result in the internal auditors grading a particular department / operation as low risk:
 - Sundry omissions in complying with prescribed policies and procedures of the Bank which do not have a material impact on the internal control environment isolated errors
 - Sundry regulatory related errors which have been rectified and which are unlikely to cause criticism from the regulatory authorities, and customers.
 - General suggestions relating to efficiency of staff or activity.

Yearly Risk Assessment:

- Yearly Risk Assessment exercise shall be carried out by Inspection team, covering the branches in all Regions as of 31st March, every year.
- Bank to undertake migration analysis of branch risk rating on annual basis in order to study the reasons for abnormal variation / fall in the ratings for taking corrective steps. Detailed report to be placed before the Audit Committee of the Board for review.
- Based on the yearly risk assessment / rating so arrived, covering all the branches, annual inspection plan will be drawn for the subsequent financial year. The Annual Audit Plan is to be placed to ACB, for directions.

Performance Evaluation

Chairman should conduct periodical reviews, annually or more frequently, of the Risk Based Internal Audit undertaken by the Inspection team vis-à-vis the approved audit plan. The Audit Committee of Board (ACB) would periodically monitor the progress and assess the performance of the internal audit for reliability, accuracy and objectivity.

Though the risk factors are related with the various activities of the bank already narrated in specific chapters, but these are summarised again hereunder for alertness of audit team so as to ensure that all these areas have been thoroughly examined and commented upon, wherever necessary.

17.1-BUSINESS RISK

17.1.1. Credit Risk

(Under Business Category)

- Trend of growth in loans and advances
- Trend in priority sector advances.



- Trend of growth in off- balance sheet items.
- Exposure to sensitive sectors
- Composition of off- balance sheet exposure.
- Credit concentration
- Share (number and amount outstanding) of large loan accounts (cut-off amount to be decided by the bank) in total loans outstanding under that category.
- Trend of breaching exposure ceiling norms
- Standard category advances
- NPA Management and Recovery of NPA – NPA Movement
- Arresting of slippages (deterioration)
- Improvement in Cash Recovery
- Improvement in upgradation
- Percentage of accounts written off and amount involved
- Reduction of NPAs (including upgradation, restructuring, recovery)
- Trend of devolvement on account of off -balance sheet exposures.
- Credit Quality improvement
- Movement of assets
- Increase in standard assets
- Decrease in Doubtful / Loss assets
- Adherence to Credit Policy norms
- Adherence to exposure (credit limits with branch and elsewhere) norms (single unit, group and industry)
- Identification of borrower and verification of antecedents through market reports, status reports from the previous bankers, credit rating agency of repute, etc.
- Assessment of worth based on Personal Financial Statements (PFS) and moderation thereof, if necessary upon verification thereof through tax returns and other documentary evidences.
- Assessment of term loan and working capital needs through balance Sheet analysis, cash flows, etc.
- Security position – verification of title, search report, valuation, Payment of taxes of mortgaged property.
- Security Documents- Stamping, signatures, registration, validity, dual custody, periodical physical verification, etc.
- Adherence to provisioning requirements after taking into account value of security, worth of borrowers and guarantors.
- Adherence to Income Recognition norms.



(Under Control Category)

- Proper credit monitoring
- Credit Rating as per norms
- Review of accounts
- Review of portfolios of credit section (Trade, Industries, Retailers, Personal Loan, Agriculture, etc.)
- Adherence to prudential norms
- Quality Appraisal of Credits
- Promptness of decision process (i.e. quick disposal of loan application)
- Data checking
- Follow-up for recovery of Term Loan instalments, interest, charges, etc.
- Adherence to accounting standards, principles and practice.

17.1.2- Earning Risk

- Budgeted Profit & Actual for last 3 years
- Trend of non-interest income
- Trend in reduction of avoidable expenditure
- Application of correct rate of interest and service charges
- Interest Income
- Recovery in written-off accounts
- Interest expenses
- Yield on fund based limits
- Cost of funds
- Reduction in Staff cost
- Income leakage

17.1.3-Liquidity Risk

- Ratio of wholesale /Institutional deposits to total deposits.
- Ratio of Low Cost deposits to total deposits.
- Ratio of high cost deposits to total deposits.

17.1.4-Business Strategy & Environment Risk

- Budget and achievement for last 3 years
- Quality of customer service
- Competition (strength and weakness of competitors)
- Adequacy and compatibility of IT Systems with business needs.
- Business initiatives
- Deposits growth – Advances growth – Market share
- Sale of customer oriented products
- Analysis of market survey
- New Products/Service



17.1.5- Operational Risk

- Frequency and impact of staff rotation
- Adherence to manuals/circulars
- Frequency of execution errors in transactions
- Frequency of violation of operational controls (exceeding limits Injudicious use of discretionary powers)
- Efficacy of information flows
- Risk due to weak security at operational points
- Frequency of operational disruptions
- Validity of IT Systems (taking help from latest IS Audit report)
- Disaster Recovery and Business Continuity Plan
- IT related frauds
- Documentation for transactions (filling up of documents, stamping, registration, creation of security by way of pledge/hypothecation/ mortgages/assignment of insurance of securities etc.)
- Interaction between Legal Department and other departments like Credit etc.
- Claims from customers
- Compliance with customer confidentiality
- History of litigation with regard to operations
- Competency of staff
- Systems and Procedures
- Dual custody and periodical physical verification of documents and timely renewal
- Time barred documents
- Litigations
- Reputation
- Advising the terms of sanction
- Compliance with terms of sanction
- Execution of Security documents including Registration of charges with appropriate authorities
- Insurance of assets
- Issue of DD as per guidelines including recovery of charges
- Issue of DD against cash
- Management of Inward and Outward Bills for Collection
- Balancing of LOBC and OBC by physical verification of outstanding bills
- Checking of General Ledger, General Ledger Balance Book prints outs by Officials.
- Checking of Profit and Loss Register including vouchers of Profit and Loss more particularly Debit vouchers for signature by authorised Officials. Balancing of P&L Book
- Destruction of confidential waste, old manuals out of circulation.
- Maintenance of old record including register of old records; old record destroyed physical security of old record, etc.
- Pest Control treatment at regular interval.
- Provision of adequate number of fire extinguishers



17.2. CONTROL RISKS

17.2.1- Internal Control Risk

- Clarity/ambiguity in reporting structure and reporting lines
- Clarity of decision making process at various levels
- Appropriate delegation of powers
- Inter-bank / branch reconciliation
- Abnormal /sudden growth in the deposit level pertaining to a particular segment (genuineness of such deposits)
- Perpetration of frauds
- Control over outsourced activities (like AMC)
- Maintenance of customer secrecy as applicable
- Adequacy and timeliness of MIS and financial reporting
- IT support for business development and client service
- Perpetration of frauds due to laxity in control over IT infrastructure
- Adherence to Know Your Customer and Know Your Business procedures
- Systems for monitoring high risk accounts
- Reporting of transactions to FIU-India and IT authorities as prescribed
- Compliance with regulatory guidelines with regard to customer Identification and monitoring funds flow.
- House Keeping
- MIS – Timeliness/Quality
- Employee relations
- Management Controls Branch Leadership –Competency –Problem Solving –Attitude.
- Monitoring end use of funds through post sanction inspections.
- Monitoring the conduct of operations in the account including checking of periodical stock statements submitted by the borrowers, calculation of drawing power and recording thereof in the system. Follow-up for submission of stock statements with the borrowers.
- Conduct of stock inspections including valuation of securities
- Follow-up for recovery of interest, term loan instalments and other Charges, overdue bills purchased / discounted.
- Filing of Suits
- Execution of Decrees
- Follow-up for submission of Financial Statements and other details for review of accounts. Annual Review of accounts and management of Accounts not reviewed beyond three months.
- Valuation of properties mortgaged to the bank from time to time
- Reporting of adverse features observed during inspections
- Cancellation of expired Bank Guarantees.
- Management of problem credits i.e. steps taken for identification, Upgradation, recovery, compro-



mise, etc. Cash is kept under dual control.

- Precautions during cash in transit- bait money maintenance etc.
- Maintenance of Cash Safe Keys Pass Book.
- Maintenance of books of cash departments
- Checking of abnormal Receipts and Payments
- Checking of accounting of Inward and Outward Cash Remittances
- Observance of rules on accumulation of various types of leave.
- Obtention of leave application promptly and sanction of leave by Authorised official.
- Maintenance of leave record.
- Staff Salary checking.
- Maintenance of old record including register of old records, old record Destroyed, physical security of old record, etc.
- Monitoring access to old record room, computer back up tapes, etc.

17.2.2-Computer related Password Administration/Configuration & Monitoring risk

- Procedure surrounding the setting up of user profiles, deleting users on leave/resigned/terminated from bank's service, etc.
- Updating of user profiles as per written requests and authorisation by manager in writing.
- Allotment of system excess rights on written request and authorisation by authorised officer.
- Review of excess rights periodically (at least half yearly).
- Generation and checking of log report, excess report by system administrator and submission thereof to the Manager.
- Reporting of failed access attempts to Branch Manager and follow-up action thereon.
- Filing of computer generated reports orderly.
- Validating, previewing instructions rejected by the system Administrator and Manager.

17.2.3-Physical security risk

- Monitoring of access to the computer room.
- Computer room kept under lock and key when not occupied.
- Installation of dry type, fire extinguishers, smoke detectors, alarm, etc. in the computer room.

17.2.4-Business Continuity plan risk

- Systems back up are run automatically at the end of each day and stored off site.
- Maintenance of back up copy of super user password in a sealed envelope and stored in fire proof safe under dual control.
- Preservation of MIS reports.

17.2.5-Disaster Recovery plan risk

- Distribution of Disaster Recovery Plan amongst staff and maintenance of copy off site.
- Test checking of Disaster Recovery Plan.

17.2.6-Logical Access Security risk

- Checking of Computer Generated Reports by officials.



- Checking of Opening of Accounts including adherence to policy on 'Know Your Customer' relating to money laundering.
- Checking of Interest paid on deposits
- Follow-up for weeding out accounts where cheques are returned frequently on account of financial reasons.

17.3. Fraud Risk

- Checking of Operations in new accounts.
- Segregation of dormant accounts.
- Storage of Specimen signature cards of dormant accounts.
- Checking of transactions in staff accounts.
- Storage of pass books, cheque books, TDRs in dual custody and maintenance of Movement Passbook.
- Adherence to regulatory guidelines on Money Laundering
- Adherence to cyber security norms
- Safe custody of Test Keys and follow-up for missing variables.
- Follow-up for confirmation of Advice of Drawings of Drafts.
- Verification of signature on Mail Transfers/Credit Authorisation Notes
- Maintenance of dual control on DD and maintenance of movement pass book
- Checking of balancing of accounts/ledgers and registers.
- Reconciliation of inter-branch/inter-bank accounts
- Reconciliation and Monitoring of Suspense Debits Account for clearing the entries
- Monitoring of Sundry Deposits and Sundry Credits Account including clearing the old entries.
- Follow-up for pending IBC/OBC
- Analysis of Profit and Loss Account for various income and expenditure accounts.
- Quality and timeliness in compliance with various audit reports
- Checking of redressal of customers' complaints.
- Scrutiny of various control returns/statements submitted to Head office.
- Maintenance of sensitive stationery
- Branch security aspects.
- Renewal of Branch Lease, payment of Taxes etc.
- Correctness of the furniture & fixtures items

17.4. Compliance Risk

The Auditors should very carefully and specifically ensure that the bank is complying with all the statutory and regulatory stipulations. Non-compliance with such requirements may attract penalty putting the bank into financial as also reputational loss. These requirements will include:

- Statutory Compliance (like TDS, etc.)
- Regulatory Compliance under various provisions of BR Act, RBI Act and other important Acts to be followed by bank.



- Other Compliances (terms of sanction, compliance of previous audit Report, etc.)
- Cash ceiling limits stipulated by Head Office and bank's indemnity policy.
- Surprise checking of cash every month.
- Adherence to Master Directions – Know Your Customer (KYC) Directions 2016 (as amended from time to time)
- Adherence to regulatory guidelines on Money Laundering.
- Inter changing of set of keys for cash safe in use and kept off-site (at other banks) on regular basis.
- Rotation of staff is carried out at regular intervals.
- Destruction of confidential waste, old manuals out of circulation, old records.
- Anti-virus software is installed.
- Documentation of Business Continuity and Disaster Recovery Plan updation.
- Submission of CTRs (Cash Transaction Reports), STRs (Suspicion transactions Reports), CCRs (Counterfeit Currency Reports)
- Disposal of IT hardware and other hazardous items
- Reporting of credit information to all the Credit Information Companies as per the formats prescribed by RBI.
- Compliance with The Reserve Bank of India (Financial Statements – Presentation and Disclosures) Directions, 2021 (as amended from time to time) on disclosures in annual financial statements.
- Compliance with Guidelines on Digital Lending
- Compliance with Master Directions – Reserve Bank of India (Cooperative Banks – Interest Rate on Deposits) Directions 2016 (as amended from time to time). These directions also prescribe the entities for which cooperative banks shall not open a savings bank account.
- Compliance with Prudential Norms on Income Recognition, Asset Classification and provisioning pertaining to advances – Classification of Special Mention Account (SMA) and Non-Performing Assets (NPAs).



Chapter 18

MANAGEMENT

The STCCS has almost more one lakh personnel in different grades working across branches/offices in the country. Though operating as banking institutions, the nature of the organisation and human resource employed in cooperative banking system is distinctly different from other banks on different factors like their rural based banking, limited area of operation, employment from within state, member based customer ownership, lack of proper recruitment and promotion policy etc.

Presently the professionalism and business efficiency associated with staff is found to be lacking in the cooperative banks. All these factors form the basis for the overall poor human resource profile of the cooperative banks. Assessment of human resource requirement in cooperative banks, in both qualitative and quantitative terms, was one of the major recommendations of the Report of the committee headed by Sri R Amalorpavanathan for assessment of Human Resource of STCCS in the post CBS environment. The committee has suggested certain benchmark against which banks in different States can frame their HR policy. Under these benchmarks the committee suggested various grades of staff such as senior management (1st line of management as CGM/GM/DGM), Middle management (2nd line of management as AGM/Chief Manager), and junior management (Manager/Asstt. Manager and clerical (Multipurpose Asstt.) and subordinate cadre staff for smooth functioning of bank.

In view of the above the internal auditor should examine and comment:

- Whether the bank has framed duly HR policy as per the recommendations.
- Whether the HR policy has been executed properly.
- Whether staff working in various cadres is as per sanctioned strength, if variation pl. indicate.
- Whether rotation of duties is being done timely as per bank policy.
- Whether the second line of management is well trained to handle the operations efficiently as if to fill the gap at any time due to superannuation, transfer etc.
- Whether the recruitment and promotion policy of the bank is running properly to provide a motivation to the employees of the bank.

18.1. BOARD OF DIRECTORS

The bank is managed by the top management i.e. the board. Board of directors is a collective body of elected or appointed/nominated members (directors) which frames policies and supervises management and functioning of the bank. As the bank is a financial intermediary which deals with the funds collected from the public, an effective board is a fundamental to success of working of the bank as also to safeguard the interest of depositors.

To ensure professionalism in the Board, the banks should have at least two directors with suitable banking experience (at middle/ senior management level) or with relevant professional qualifications i.e. in areas of accountancy / banking / agriculture and development/legal/auditing etc. The banks should also have a suitable provision in their Bye-laws to ensure such Professionals on their Board. The directors of Cooperative Banks must be knowledgeable and persons of high integrity. They must function in a cohesive manner and provide leadership for the smooth and efficient management of the affairs of the bank.



Role of Board of Directors

- The Boards of Directors of Cooperative Banks have the responsibility of formulation of policies and overseeing the performance of the respective bank's operations and ensure that they function in accordance with the provisions of Acts / bye laws / guidelines of RBI/NABARD/GoI/State Government.
- The Board should exercise overall supervision and control over the functioning of the bank, leaving day to day administration to the Chief Executive Officer (CEO) of the bank.
- The Corporate Governance Index (CGI) developed by NABARD provides an overview of various facets of banks governance that need to be adhered to and to be monitored.
- It should be ensured that all circulars and other material relating to policies issued by RBI/NABARD/GoI/State Government are seen by every member of the Board and also placed before the Board for suitable action.

Code of conduct

- As part of Corporate Governance, a Code of Conduct for Directors and Senior Management needs to be laid down. Senior Management has been defined to include personnel top Executives at the level of General Managers and functional heads. Accordingly, the Bank has to lay down the Code for its Directors on the Board and Senior Management.
- This Code of Conduct attempts to set forth the guiding principles on which the Bank shall operate and conduct its daily business with its multitudinous stakeholders, government and regulatory agencies, media, and anyone else with whom it is connected. It recognizes that the Bank is a trustee and custodian of public money and in order to fulfil its fiduciary obligations and responsibilities, it has to maintain and continue to enjoy the trust and confidence of public at large. The Bank shall continue to initiate policies, which are customer centric and which promote financial prudence.
- The Code has certain expectations from the members of the board - Do's and Don'ts for the Directors on the Board of Directors of Cooperative Banks.
- The Do's and Don'ts is illustrative and not exhaustive and is not to be regarded as a substitute to the specified duties, responsibilities or rights of the Board of Directors as enunciated in the Cooperative law and / or Bye-laws of the respective banks.
- In order to ensure adherence to the code of conduct, once the standards are formulated, the same should be signed by the Directors in witness of RCS and NABARD.

Do's

Corporate Governance: The Directors should

- Be fully aware of Cooperative Societies Act, Bye-laws & Rules and regulatory prescriptions of B R Act on banking related aspects
- Attend the Board meeting regularly, participate effectively and work in a spirit of "Cooperation must succeed".
- Receive of agenda notes in advance and examine as regards to quality of content and coverage.
- Involve in formulation and adoption of various policies such as credit policy, human resource policy, procurement policy, IT policy, cyber security policy, etc. and monitoring implementation of such policies at Board meetings.
- Ensure that selection and appointment of CEO / Professional Directors as per "Fit and Proper Criteria" prescribed by RBI.



- Ensure adoption of a proper HR policy in relation to recruitment, placement, promotion, transfer and training.
- Be aware of latest developments in banking technology and strive for adoption of these technologies in their Banks
- Review functioning of various Board level / management level Committees such as audit committee, HR committee, investment committee, ALCO, risk management committee, Frauds Committee, etc.
- Strengthen internal checks and controls mechanism as regards to segregation of duties and responsibilities and fixing accountability.
- Strengthen internal audit system & vigilance mechanism and its timely reporting and follow up action thereon.
- Carefully peruse audit reports & NABARD Inspection Reports and ensure timely action and compliance.
- Review of frauds committed, timely reporting and action taken.
- Ensure observance of statutory requirements and guidelines issued by Central Govt./RBI/NABARD/ State Govt.

Business Development: The Directors should,

- Ensure framing and adoption of Loan policy and Manual.
- Review of loan portfolio and develop strategies for business diversification for improving the profitability
- Review of mobilization of resources and suggest measures for low cost resources.
- Ensure efficient management of funds and improving profitability.
- Review investment management and functioning of Investment Committee
- Review budgeting of income & expenditure, performance & profitability
- Identify new business activities inclusive of non-fund business.
- Review viability of branches with special focus on branches especially loss-making branches.
- Ensure loans sanctioned by CEO/GM to be put up to the Board.
- Create effective follow up and monitoring system for prompt and timely recovery and reduce level of NPAs and over dues.
- Analyse the trends of economy, assist in the discharge of management's responsibility to public and formulation of measures to improve customer service and be generally of constructive assistance to the bank management.
- Review arbitration cases.

Development aspects: The Directors should,

- Ensure preparation of Development Action Plans for successive financial year (Example – for 2019-20, it should be prepared and approved by Board in March 2019.) and monitoring of implementation of plan at quarterly intervals.
- Endeavour involvement of the bank in Govt. sponsored/National priority programmes also promoting SHGs, JLGs, and Farmers Clubs etc.
- Promote and participate in spreading message of financial inclusion and digital financial literacy
- Create environment for effective coordination with higher and lower tiers.



- Establish proper MIS and intensifying computerization process.
- Monitor key risk areas.
- Take steps for financial literacy and credit counselling.

Don'ts

Non-Interference: The directors should not,

- Interfere in the management functions and involve themselves in routine or everyday business of the bank
- Send instructions / directions to any individual officer/ employee of the bank in any manner.

No Sponsorship: The directors should not,

- Sponsor any loan proposal, buildings and sites for bank's premises, enlistment or empanelment of contractors, architects, doctors, lawyers, etc.
- Approach or influence for sanction of any kind of facility
- Participate in Board discussions, if a proposal in which they are directly or indirectly interested, comes up for discussions. They should disclose their interest, well in advance, to the CEO and Board.
- Sponsor any candidate for recruitment or promotion or interfere in the process of selection/appointment or in transfers of staff.
- Do anything which will interfere with and / or be subversive of maintenance of discipline, good conduct and integrity of the staff.
- Encourage the individual officer/ employee or unions approaching them in any matter.
- Conduct Bank's business with a relative or any other person or any firm, Company or Association in which the relative or other person is associated in any significant role. If such a related party transaction is unavoidable, they must fully disclose the nature of the related party transaction to the appropriate authority. Any dealings with a related party must be conducted in such a way that no preferential treatment is given to that party. In the case of any other transaction or situation giving rise to conflicts of interests, the appropriate authority should after due deliberations decide on its impact.

Maintain confidentiality: The directors should not

- Reveal any information relating to any constituent of the bank to anyone as, he is under oath of secrecy and fidelity. The directors are expected to ensure confidentiality of the bank's agenda papers / notes. The board papers may ordinarily be returned to the bank after the meeting.
- Call for papers/ files/ notes recorded by various departments for scrutiny etc. in respect of agenda items to be discussed in the meetings. All information/clarification that they may require for taking a decision should be made available by the executive.
- Display logos of distinctive design of the bank on the visiting card/ letter head though a director may indicate his directorship of the bank on his visiting card or letter head

Model indicative Agenda of Board Meetings

- Funds position, compliance with CRR/SLR, maintenance of investments in Government securities, concurrent audit report by internal auditors and its compliance
- Loans and advances
- Business Plan – Targets and Achievements



- Branch Performance etc.,
- Review of half-yearly investment of the bank
- Review of high value frauds
- Effective Information Technology (IT) and Information Security (IS)
- Cyber security framework and review of systems

18.2. SUB COMMITTEE

The board of the bank can make sub committees for the smooth functioning of the bank .However the IA team should examine that there must be following sub committees of the board in the bank for smooth functioning:

18.2.1 AUDIT COMMITTEE

Role of the Committee: The role of audit committee has already been mentioned in Chapter 1.11.1 of this manual.

Constitution of the Committee

- Audit Committee is a Sub-committee of the Board
- The audit committee need to meet at least once in a quarter
- The composition of Audit Committee may be three or four directors only, one of whom may act as the Chairman of the Committee.
- The Chairman and the CEO of the bank should not be on the Audit Committee
- Only qualified locally available Chartered Accountant be co-opted on the Audit Committee by all banks
- Wherever elected Boards have been superseded, the Audit Committee to be appointed by the Administrator should have the Chartered Accountant as the Chairman of the Committee

Reviews to be put up to the Audit Committee:

Review:

- Recommend to the full Board for shareholders' approval, the appointment, reappointment, removal, or replacement and terms of appointment of auditors, and the fee payable to them for the audit, taking into consideration any relationship between the auditors and the Bank that may impact on the independence of the auditors in carrying out the audit.
- Approve the terms of engagement of the services of the external/ statutory auditors for rendering any other professional services to the Bank and the fee therefore.
- Reviewing and examining with the management, the annual financial statements and auditor's report thereon before submission to the Board for approval, with particular reference to:
 - Any changes in accounting policies and practices
 - Major accounting entries involving estimates based on the exercise of judgement by management
 - Significant adjustments made in the financial statements arising out of audit findings
 - Compliance with the applicable accounting standards
 - Compliance with listing and other legal requirements relating to financial statements, and RBI guidelines and directives, concerning financial policies and statements
 - To review the company's statement on internal control systems prior to endorsement by the Board.



- The going concern assumption
- viii. Disclosure of any related-party transaction, i.e., transactions of the Bank with the Directors, senior executives, their relatives, or associated concerns, that may potentially conflict with the Bank's interests at large
- Modified opinion(s) in the draft audit report
- To consider suggesting adoption of Accounting Standards on voluntary basis in tune with industry best practices.
- Review of IS audit observations and compliance
- Review of the follow-up action on the Internal Inspection/ Internal Audit Reports, particularly of “unsatisfactory” branches, and large branches and also on concurrent audit observations.
- Review the bank's compliance with statutory provisions of the Banking Regulation Act 1949 (AACCS), with particular reference to Section 18, 24, 29, 31, 35A etc./ Section 42 of the RBI Act, 1934 in case of Scheduled Banks
- Review the information security audit mechanism in the bank with particular reference to Disaster Recovery System and Business Continuity Planning.
- Periodically review the progress in reconciliation of entries in Inter-bank and Inter-branch accounts and reconciliation of bank accounts. The Committee should meet at least four times annually.
- Review of Frauds and action taken to recover the amount involved, to avoid recurrence of such frauds in future.
- Review any significant disagreement among management and the accounts department or the internal audit department in connection with the preparation of the financial statements.
- Reviewing, with the management, the quarterly financial statements before submission to the Board for approval.
- To review and oversight the functioning the Whistle Blower Mechanism.
- To ensure that Senior Management is taking necessary corrective actions to address the findings and recommendations of internal auditors and external auditors in a timely manner.

Policy

- Fixing accountability for unsatisfactory compliance of inspection/ audit reports, delay in compliance and non-rectification of deficiencies.
- Ensure bank's adherence to KYC & PMLA guidelines issued by the RBI / NABARD and if any violations are observed, action taken thereon to avoid recurrence of the same.
- Recommend to the Board of Directors the selection of the Internal Auditor considering his/ her independence and effectiveness
- Periodical review of the accounting policies, systems and controls in the bank with a view to ensuring greater transparency in the bank's accounts and adequacy of accounting controls to address the risks faced or likely to be faced by the bank.
- Consider and approve, if appropriate, major changes to the bank's auditing principles and practices as suggested by the accounts department, management, or the internal audit Department/ External Auditors/ NABARD Inspection Team.
- Establish, review and update periodically a Code of Ethical Conduct and ensure that management has established a system to enforce this Code.

Compliance

- Peruse the latest Inspection Report of NABARD and status of compliance therewith.
- Compliance to Statutory Audit Report
- Divergence is observed and pointed out in the Inspection Reports which are sent to the bank. To see that the Bank/ Statutory Auditors have been ensuring proper classification of such assets while finalizing the books of accounts as at the end of next financial year.
- Review the integrity of the bank's financial reporting processes, both internal and external, especially, the correctness of NPAs and provisioning for impaired assets.
- Reviewing omission on the part of internal inspecting officials/ concurrent auditors to detect serious irregularities, which come to light later.
- Certification of physical possession of securities as reported to RBI & NABARD every quarter by Internal/ Departmental Auditors or concurrent auditors.
- Perform any other activities consistent with the guidelines of RBI/NABARD, the Bank's Bye-laws and Co-operative Societies' Act, as the Committee or the Board deems necessary or appropriate.

Calendar of Review, indicative agenda

Quarterly

- Inter-branch reconciliation
- Performance of Concurrent Audit/ Inspection Department
- Inspection reports of poorly rated branches – Progress in rectification of deficiencies.
- Review of arrears in balancing of books, clearing differences, sundry/ suspense items.
- IS audit compliances

Yearly

- Compliance with observations made by the statutory auditor.
- Compliance with observations made in NABARD's Inspection Report.

18.2.2. RISK MANAGEMENT COMMITTEE

Role of Risk Management Committee

- Risks are usually defined by the adverse impact of several distinct sources of uncertainty on profitability. The principal banking risks are credit risk, liquidity risk, interest rate risk, market risk, foreign exchange risk and solvency risk. Risk management covers all risk information systems, reporting and subsequent actions
- Improve the ability of the Bank to identify, measure, monitor and control the overall level of risks the banks are exposed to.
- Ensure a proper Loan Review Mechanism is put in place for constantly evaluating the quality of credit portfolio and to bring out qualitative improvements in credit administration
- Monitor the Bank's handling of concentration of risk and may require that the Credit Department reports to them any such exposure exceeding a specified limit or exposures to large borrowers.
- Ensure an effective liquidity management policy which spells out funding strategies, liquidity planning under alternative scenarios, prudential limits, liquidity reporting / reviewing, etc
- Establish well defined internal control systems which includes segregation of duties, clear management reporting lines and adequate operating procedures and compliance thereof



Constitution of Risk Management Committee

- Risk Management Committee may be a Sub-Committee of the Board.
- Includes the CEO and Heads of Credit, Investment, Operational Risk departments, etc.
- Head of IT Department will be a special invitee
- Banks may have sub-committees and support committees at their discretion

Indicative Agenda

- Risk Management Committee shall approve the policy, strategy and methods for risk management, by evaluating the overall risks faced by the Bank and determining the acceptable level of risks, its management and control in the best interest of the Bank. The Committee shall oversee all risk management functions in the Bank and undertake the following functions.
- Approve the policies and strategies for implementing integrated risk management system, for addressing various risks faced by the Bank.
- Oversee functions of Credit Risk Management Committee (CRMC), Asset Liability Management Committee – (ALCO), Operational Risk Management Committee (ORMC) and Information Security Committee (ISC).
- Set policies and guidelines for measurement, management and reporting of credit risk, market risk and operational risk.
- Set risk mitigation and stop-loss parameters in respect of all the three risks.
- Ensure Management Processes (including people, systems, operations, limits and controls for implementing risk management systems.
- Ensure robustness and effectiveness of financial / rating models and their appraisal systems for assessing various risks faced by the Bank.
- Reviewing and approving the Internal Capital adequacy Assessment Process.
- Approval / Review of credit rating process, fixation of exposure ceilings for various types of exposures, geographies, sectors, industries etc., and based on internal / external rating, borrower category / groups etc.
- Ensure availability of qualified and competent officers and risk managers in the Integrated Risk Management Department for ensuring effectiveness of risk management systems in the Bank.
- Decide / approve adoption of technology / appropriate and adequate MIS system needed for risk management.
- Reinforce the culture and awareness of risk management throughout the organization that would attach high priority on effective risk management and adherence to sound internal controls.
- Assess feasibility of shift to Risk Based Internal Audit (RBIA) and prepare a road map for transition.

18.2.3. ASSETS LIABILITY COMMITTEE (ALCO)

Role of Asset Liability Management Committee

- Banks are now operating in a fairly deregulated environment and are required to determine their own interest rates on their deposits and advances. The interest rates on banks' investments in Government and other permissible securities are also now market -related.
- Intense competition in business, involving both the assets and liabilities, together with increasing volatility in the domestic interest rates has brought pressure on the management of banks to maintain



an optimal balance between spread, profitability and long-term viability. Imprudent liquidity management can put banks' earnings and reputation at great risk.

- ALCO to develop a comprehensive approach towards management of banks' balance sheets and arriving at their business decisions, based on sound risk management systems with the ultimate objective of protecting the interests of depositors and stakeholders.
- Introduce an effective Asset-Liability Management (ALM) systems to address the emerging issues, particularly liquidity and interest rate risks and review the implementation on ALM system on a regular basis.
- Get the ALM policy approved by the Board
- Take steps for capacity building / knowledge management of the officers involved in ALM
- Upgrade the Management Information System for preparation and internalization of reports

Constitution of Committee

- ALCO shall be a Management level Committee
- ALCO will consist of CEO as Head, the Chief of Investment/Treasury, Credit, Planning as members.
- Head of IT will be a special invitee

Indicative Agenda

- Review of progress in implementation of the decisions made in the previous meetings.
- Ensuring adherence to the limits set by the board as well as for deciding the business strategy of the Bank (on asset and liability side) in line with Bank's budget and decided risk management objective.
- Reporting to the Board of directors on a quarterly basis on Structural Liquidity Position - both Asset and Liability, Status of deployment and resources generation program and Analysis of Interest rate sensitivity.
- To develop a view on future direction of interest rates movements and decide on funding mixes between wholesale vs retail deposits, short term vs long term deposits etc.
- Developing and recommending policies for liquidity risk and interest rate risk for approval by Board.
- Overseeing the implementation and maintenance of management information system that can effectively identify, measure, monitor and control the liquidity risk and interest rate risk.
- Ensuring adherence to the line of authority and responsibility that the board has established for managing liquidity risk and interest rate risk.
- Reviewing the management information reports and reporting to the board quarterly
- Review of Interest Rate Sensitivity Statement
- Pricing of both deposits and advances and suggest desired maturity profile and mix of the incremental assets and liabilities.
- Furnish ALM returns viz., Statement of Structural Liability (SSL) and Statement of Interest Rate Sensitivity (SIRS) at quarterly intervals through ENSRE Portal of NABARD

18.2.4. SPECIAL COMMITTEE OF BOARD FOR MONITORING OF FRAUDS

Role of the Committee

- The rising trend in incidence of frauds, dacoits, robberies, etc., in banks is a matter of concern. While the primary responsibility for preventing frauds lies with banks themselves, the RBI / NABARD has been advising banks from time to time about the major fraud prone areas and the safeguards necessary for prevention of frauds.



- Provide focus on the “Fraud Prevention and Management Function” to enable, among others, effective investigation of fraud cases and prompt as well as accurate reporting to appropriate regulatory and law enforcement authorities including NABARD.
- Delineate in a policy document on the processes for implementation of the Committee’s directions and enable a dedicated outfit of the bank to implement the directions in this regard.
- The fraud risk management, fraud monitoring and fraud investigation function must be owned by the bank’s CEO, Audit Committee of the Board and the Special Committee of the Board.
- While Audit Committee of the Board (ACB) shall monitor all the cases of frauds in general, banks are required to constitute a Special Committee of the Board for monitoring and follow up of cases of frauds (SCBF) involving amounts of Rs. 20.00 lakh and above exclusively.

Constitution of the Committee

- The Fraud monitoring Committee shall be a Board level Committee
- The Committee shall be constituted with the following members
 - President (for StCBs and DCCBs) of the bank
 - Two members from Audit Committee of the Board; and
 - Two other members from the Board (may be by rotation) excluding NABARD nominee director / observer, if any.
- The periodicity of the meetings of the Special Committee may be decided according to the number of cases involved. However, the Committee should meet and review as and when a fraud involving an amount of Rs. 20.00 lakh and above comes to light.

Indicative agenda

- Review the reported frauds, identify the reasons for delay in detection, if any,
- Quarterly review of reporting to NABARD through FMS returns
- Monitor progress of Police Investigation, and recovery position and
- Identify the systemic lacunae, if any, that facilitated perpetration of the fraud and put in place measures to plug the same;

18.2.5. INVESTMENT COMMITTEE

Role of the Committee: Though from auditor’s view, the role of audit committee has already been mentioned in Chapter 1.7 of this manual, however the main role of the investment committee is:

- To Formulate Investment Policy to facilitate, guide and provide a directional framework for all the investment activities undertaken by the Bank
- Ensure that investment decisions are taken and treasury operations are carried out in a prudent manner within the extant regulatory framework and Asset Liability Management strategies of the Bank.
- Manage the surplus and other funds of Bank, to comply with CRR and SLR requirements, to optimize the portfolio yield in a manner consistent with the liquidity, ALM strategies and business needs of the Bank, to ensure the safety of funds invested, to earn as much income as possible from treasury operations, without compromising on the safety and liquidity requirements, to manage risk, especially credit risk, interest rate risk and operational risk, to invest in Call Money, Notice Money and Term Money Market.



Constitution of the Committee

- The Investment Committee shall be a Management level Committee
- The Investment Committee shall comprise of Managing Director/Special Officer, General Manager and all Executives of the Bank.
- The committee will be headed by MD/CEO/Administrator or in his / her absence Chief Revenue Officer of the Bank.
- The Officer-in-charge of Investment Operations will be the Convener of the meeting.
- The quorum of the meeting shall be two third of members of the IC, excluding the Convener.
- The Chief Dealer shall keep minutes of the IC meetings and in his absence the officer nominated by the General Manager shall take care of preparing the minutes. The Investment Committee may invite any other functionary to attend the meeting as a Special Invitee. The composition of the committee can be changed by the Chairman of the Investment Committee.
- The committee will meet once in a month or at more frequent intervals as warranted by the situation.

Indicative Agenda

- Consider and review the investment transactions of the previous month/since the last meeting. The review will be aimed at ensuring the efficacy of the system, compliance with the regulatory guidelines and investment policy.
- Consider the compliance with regard to the internal and statutory / other audit reports.
- Assess the funds position by taking into account cash flows and projections, review the interest rate scenario and other market developments and issue investment guidelines for the ensuing month.

Beside the above committees, the board can make more sub committees of senior management like Cyber security management committee, customer's grievances management committee, staff committee, or any other committee for the smooth functioning of bank. The IA should examine and comment that the board meetings, subcommittee meetings are convening timely and the respective agenda items are placed and reviewed properly.

The rural cooperative banks are in a unique position where the very member who borrows from the bank is the shareholders too, and the members of the board are elected from amongst these shareholders largely elected through democratic process. The auditor should examine all these factors in the light of the amendments in the BR Act as well as the instructions of RBI/NABARD.

18.3. Chairman/Managing Director/Chief executive officer (MD/CEO)

The audit team must examine that the Chairman/MD/CEO has been appointed as per the statutory and/or regulatory prescriptions. The Fit and proper Criteria for appointment of Directors and CEOs of StCBs/DCCBs have been prescribed issued vide RBI (Circular No.RPCD.CO.RCBD.137/03.01.03/2011-12 dated 5 July 2011) and NABARD Circular No.NB.IDD.COOP/1351/V-52/2017-18 dated 17 January 2018.

18.4. Annual general meeting (AGM)

The bank is required to conduct a meeting of its general body at least once in a year where the annual financial statements together with auditor's report, annual report, elections of Board of Directors/ Committee Members and amendment to Bye-Laws, if required, are the important agenda items. The IA should examine whether the AGMs were conducted in time as prescribed in the State Cooperative Societies Acts.



18.5.Meetings

The auditor should examine that the meetings of board and sub committees are called regularly and agendas are placed and discussed as per suggestive agenda of NABARD circular dated 29-6-2020.

18.6 Auditors indicative check points:

- Examine the maintenance of proper HR policy and its effective execution.
- Examine whether the fit and proper criteria is being followed properly for the appointment of C
- Examine the meeting of board of directors are being held regularly and the suggestive important agenda items are placed and reviewed in the meeting.
- Examine the meeting of the sub committees of board are being held regularly and the suggestive important agenda items are placed and reviewed in the meeting.
- Examine the adherence of code of conduct directors for the board members.
- Examine whether the Annual General Meeting are conducted in time as prescribed in the respective State Cooperative Societies Acts.
- Any other point which the IA team requires to examine.

This is an indicative list. The auditor may examine any other relative aspect as per the requirement at the time of audit.



CONCLUSION

While instituting the internal inspection / audit, the attempt should be to integrate the same with other system of audit/inspections, which are being used by the banks individually. So it is necessary that the entire system of audit inspection and their follow-up is properly documented and the performance of the integrated audit system should be reviewed from time to time as per the guidelines issued by RBI/NABARD/ GOI/STATE GOVT. /RCS etc.



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- NAFSCOB internal audit manual 2013.
- Master circular on inspection and audit system in primary cooperative banks .RBI circular no RBI/2015-16/3 DCBR.CO.BPD (PCB).MC no 3/12.05.001/2015-16 date 01-07-2015
- Nabard circular No NB/IDD/08/POL-25 circular 178/IDD-01/2020/dated 29.6.2020
- RBI education loan circular no RPCD PLN FSBC no 83/06.12.05/2000-01 dated 28-04-2001
- Guidance note on Audit of StCB and DCCBs of ICAI 2012
- RBI circular on investment policy of cooperative banks no RBI 2009-10/79 dated 01/07/2009
- Internal audit policy manual of Himanchal Pradesh state cooperative bank.
- Internal audit checklist of Telangana state apex cooperative bank ltd.
- Checklist and formats of internal inspection and audit of various Stcb as Andaman Nicobar state cooperative bank, Telangana Stcb,UPstcb,HP Stcb and various Dccbs such as Dcb Lakhimpur and Moradabad in UP,Prakasham Dccb AP,and circulars of some RRBs and commercial banks etc.
- NABARD key statistics of Cooperative banks 31st march 2022
- Master Directions –
 - Know Your Customer (KYC) Master Directions, 2016 (updated as on 28-4.2023/04.05.2023)
 - RBI/DBR/2015-16 dated 25.02.2016
- Investment (SLR/Non-SLR) – Reviews
 - NABARD Circular 100/DOS-15/2008 dated 27.06.2008
 - NABARD Circular 124/DOS-15/2010 dated 24.06.2010
 - RBI/2016-1017/14 dated 14.07.2016
 - NABARD Circular 67/DOS-19/2018 dated 06.04.2018
 - RBI/2018-2019/12 dated 06.07.2018
- Internal Checks/Controls – Frauds Monitoring/Reporting
 - NABARD Circular 96/DOS-07/2011 dated 18.05.2011
 - NABARD Circular 24/DOS-01/2014 dated 06.02.2014
 - NABARD Circular 156/DOS-15/2019 dated 31.05.2019
- Internal Inspection/Audit/Concurrent Audit
NABARD Circular 48/DOS-12/2009 dated 09.03.2009
- Master Circular on BoDs and Sub-Committees of Board
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- CRR/SLR – Calculation of NDTL
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 - NABARD Circular 246/DOS-24/2019 dated 06.08.2019

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 - DFS RBIA policy guidelines \and (Tamilnadu grama bank) TGB internal audit policy2022-23.
- Formats for reporting credit information to CICs
RBI/2020-2021/106 dated 12.03.2021
- Loans to Directors – Section20 of BR Act (AACS)
RBI/2020-2021/89 dated 05.02.2021
- Compliance Function
NABARD Circular 60/DOS-10/2013 dated 20.03.2013
- Master Directions – RBI (Cooperative Banks – Interest Rate on Deposits) Directions 2016 (updated as on 16.09.2022)
RBI/2022-2023/117 dated 16.09.2022
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 - RBI/2013-2014/433 dated 07.01.2014
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- RBI circular guidelines for issue of certificate of deposits dated 1.4.2009

List of Abbreviations

ACB	Audit Committee of Board
ACSTI	Agriculture Cooperative Staff Training Institute.
ALM	Assets Liability Management
BCP	Business Continuity Plan
BR Act	Banking Regulation Act
CAMELSC	Capital Adequacy, Management, Earnings, Liquidity and System and Controls
CBS	Core Banking Solutions
CC	Cash Credit
CCR	Comprehensive Credit Report
CEO	Chief Executive Officer
CFT	Combating the Financing of Terrorism
CRR	Cash Reserve Ratio
CTI	Cooperative Training Institutes
CTR	Cash Transaction Report
DCCB	District Central Cooperative Bank
DICGC	Deposit Insurance and Credit Guarantee Corporation
DRS	Disaster Recovery System
FSS	Farmers Service Societies
GIC	General Insurance Company
IA	Internal Auditor
IRAC	Income Recognition and Assets Classification
IVP	Indira Vikas Patra
KCC	Kisan Credit Card
KVP	Kisan Vikas Patra
KYC	Know Your Customers
LAMPS	Large Sized Adivasi Multi-Purpose Societies
LT	Long Term
MBP	Maximum Borrowing Power
MD	Managing Director
MT	Medium Term
NABARD	National Bank for Agriculture and Rural Development
NAFSCOB	National Federation of State Cooperative Banks
NCL	Normal Credit Limit
NIA	Negotiable Instruments Act
NODC	Non-Overdue Cover
NPA	Non-Performing Assets



NPI	Non-Performing Investment
NRLM	National Rural Livelihood Mission
NSC	National Savings Certificates
PACS	Primary Agricultural Credit Society
PL	Profit and Loss
PMFBY	Pradhan Mantri Fasal Bima Yojna
RBI	Reserve Bank of India
RCS	Registrar Cooperative Societies
RKBY	Rashtriya Krishi Bima Yojna
RLP	Realistic Lending Programme
STCCS	Short Term Cooperative Credit Structure
SAO	Seasonal Agricultural Operation
SHG	Self-Help Group
SLIC	State Level Implementation Committee
SLR	Statutory Liquidity Ratio
SLTC	State Level Technical Committee
SOF	Scale of Finance
ST	Short Term
StCB	State Cooperative Bank
STR	Suspicious Transactions Report
TDS	Tax Deducted at Source
UPS	Uninterrupted Power Supply
WBCIS	Weather Based Crop Insurance Scheme



Bankers Institute of Rural Development (BIRD), Lucknow
LDA Colony, Sector-H, Kanpur Road, Lucknow-226012

E-mail: bird@nabard.org / cpec.bird@nabard.org
Website: www.birdlucknow.nabard.org / bird-cpec.nabard.org