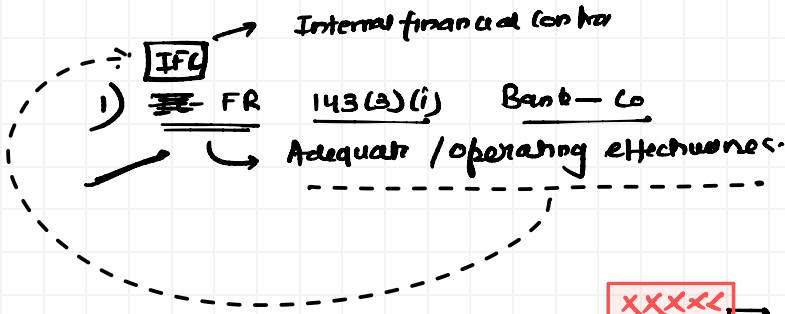
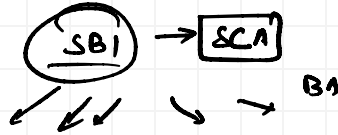


Types of Reports → Auditor — Statutory Central Auditor



← 2) LFAR - Long form Audit Report XXXXXX → LFAD

3) SLR Requirement —

4) Treasury operation →

5) { Income Recognition, Asset classification, Provisioning, Compliance } — compliance with RBI guidelines

6) Serious irregularity

7) Compliance with Recommendations of Quality & Financial Committee
Fraud IC

8) Adherence Over deposit Ratio — Ratio Area
Credit — Deposit 40%

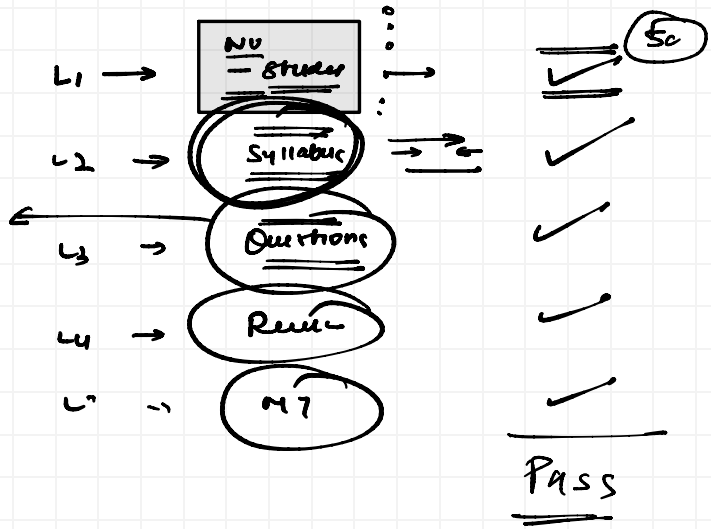
- Accounts — Bank Regulation Act, 1949 - - - - -
- 29
 - P/L B/S — Tripartite - - - - -
 - Form A — B/S
 - Form B — P/L
 - Accounting std to be followed by Bankers.

4/5 193 of

Companies Act

Section 141

Audit — Person Qualified to be Appointed as m
of Banking Co Auditor of m Co





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Power of Auditor

— Same as of a Company Auditor

Auditor's Report

Nationalised Bank → to CG

- a) **B/S** — Full and fair B/S
— True/fair view of Affairs of Bank
- b) **Transaction** — Transaction Have Been within Powers of the Bank.
- c) **Returns** — Returns from Branches/offices Adequate or Not
- d) **Profit/Loss** — Profit/Loss A/c shows **TRUE** Balance of Profit or Loss for the Period covered
- e) **Other Matters** — Any other Matters
— He considers to be brought to Notice of CG.

Report of SBI → CG — Identical to Report of Nationalised Bank.



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Format

- Auditor/ Audit Report should comply with SA
- No. of Unaudited Branches should be given with Quantification of
 - Advances, Deposits, Interest income, Interest exp.

LFAR

- Terms of eng require Auditor to Furnish LFAR
 - To be furnished by 30/6 every year
 - Proper planning for timely submission
- LFAR
+
Matter
RBJ



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Reporting to RBI

Iss

- RBI ^{Issued} Circular — for implementation of Recommendation of Committee on legal aspect of Bank frauds

Applicable on all Scheduled Commercial Banks
Excluding RRBs

Circular also provides for Liability of Auditing Profession

- Auditor Must Report suspicious Activities (fraud, act of excess Power) to the Regulator.
Deliberate failure → liable for Action Auditor must take

- Consider SA 250 —

Consideration of Laws and Regulations in an Audit of Financial Statements

It states that — Confidentiality is over ridden by Law or Courts

- SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" states that an auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.



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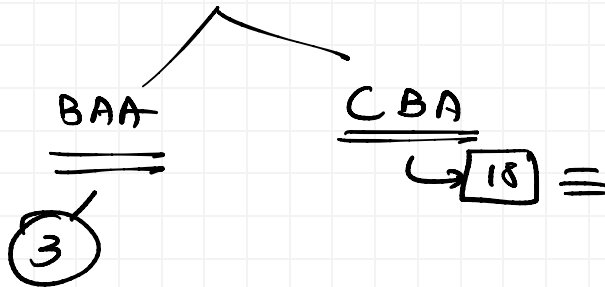
Is Auditor responsible for the Prevention and Detection of Fraud?

No, Management has the Primary responsibility for the prevention and detection of fraud and not the auditor. Management should take all necessary steps for fraud prevention and deterrence through implementing policies and controls. IC

- o Auditor Evaluate the overall System, Not Individual Transaction

on finding any irregularity or fraud in His Normal Course of Duties

He should report to RBI + MD CE of Concerned Bank





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A Scheduled Commercial Bank in India refers to a bank that is included in the Second Schedule of the Reserve Bank of India (RBI) Act, 1934.

The bank's paid-up capital and raised funds must be at least Rs. 5 lakh to qualify as a scheduled bank. These banks are liable for low interest loans from the RBI.

According to the RBI, there are 11 non-scheduled state cooperative banks and 1,500 non-scheduled urban cooperative banks.

Unlike scheduled banks, they are not entitled to borrow from the RBI for normal banking purposes, except, in an emergency or abnormal circumstances.

A nationalized bank in India refers to a bank that was once privately owned but was taken over by the government and brought under public sector control. The primary purpose of nationalization is to ensure that banking facilities are extended to the farthest corners of the country, providing financial inclusion and supporting the economic development of the nation.

Some of the prominent nationalized banks in India include Punjab National Bank (PNB), Bank of Baroda (BoB), and Canara Bank.



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Duty to Report on frauds under CA, 2013

— Study from Book.



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Engagement team Discussion

- Personnel performing Eng. + Experts
- Discussion — Better understanding
 - Bank
 - Environments
 - IC
 - Assessment of ROMM
 - Should be documented
 - Ordinarily done at planning stage



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Matters on which Discussion will take place

-) Error — likely to occur —
-) Error — Identified in previous year —
-) Methods of fraud ✓
-) Need to Maintain Professional Skepticism
-) Alert for Info / other (condition) indicating NMS
-) → Response to ER PR SR

Advantages

Risk of

→ Specific emphasis can be provided on NMS due to fraud and can plan apt response

→ Delegation of work → Appropriately experienced ET members

→ Review — The need to involve specialist



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Conduct an Audit

1) Initial Audit Consideration

Tip

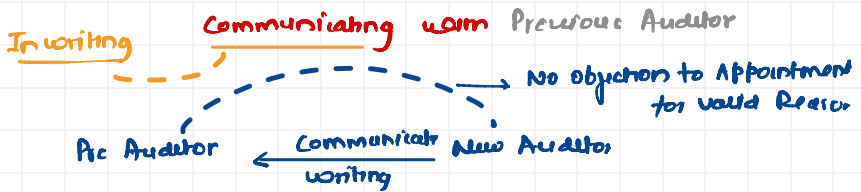
owes money to Auditor → Bank

- 1) • obtain Declaration on indebtedness
- 2) • Internal Assignments by Stat Auditor
 - No Stat Audit, if Associated through
through Internal Assignments

- 3) • Planning — P&A — 210
220
210

4) • Communication with Previous Auditor

- clause 8, Part I, First schedule
- Don't Accept Auditor Position without



5)

- Terms of A.E. — Agree on TOE, before beginning significant Portion, for each Audit Period.



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Initial Engagement

- 6)
- Perform SA **SIO** Procedure
 - if **DB** contains **MC** → Materially effect FS of Current Period
 - Effects No properly
 - Accounted
 - Disclosed
 - Issue Appropriately Modified opinion

7)

Assessment of Eng. Risk - Prior to Acceptance
- Effects Acceptance decision and Planning

8)

Establish Eng. Experienced team - Qualified, experienced team
Size, composition, - depend on
Size, Nature, Complexity of Bank

9)

Understanding Bank & Its Environment - SABIS
- I/A ROMM through
- U-E-E-IC
- ROMM - Assessment of
FS and Accrual Level
- whether due to Fraud, Error



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Understanding the Risk Mgt Process

Effective Risk Management involves following

- Oversight / Involvement in IC of TCWG — **Control Environment**
 - Approval of Risk Management Policies — by TCWG
 - Policies must be consistent with
 - objectives
 - strategies
 - Capital Strength
 - L/R

Identification Measuring Monitoring

- IMM Risk —
 - ↳ that could significantly impact Achievement of Bank's Goal should be Against R. ~~Approved~~

Control Activities 😊

Monitoring Activities → Risk Mgt Model, Assumptions — Regulatory Monitor & update

By independent Risk Mgt unit

- Reliable Information System for timely & consistent
 - Financial, operational, compliance Info
 - Helps in Risk Assessment and change in Risk Profile



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Engagement Team Discussions

The engagement team should hold discussions to gain better **understanding** of banks and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements.

Establish the Overall Audit Strategy

SA 300 "Planning an Audit of financial Statements" states that the objective of the auditor is to plan the audit so that it will be performed in an effective manner. For this purpose, the audit engagement partner should:

- **establish** the overall audit **strategy**, prior to the commencement of an audit; and
- involve **key** engagement **team** members and other appropriate **specialists** while establishing the overall audit strategy, which depends on the characteristics of the audit engagement.

Develop the Audit Plan

SA 300 deals with the **auditor's responsibility** to plan an audit of financial statements in an **effective manner**. It requires the involvement of all the key members of the engagement team while planning an audit.



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Audit Planning Memorandum — Imp 3 Marks / 4 Marks

- Summary of Audit Plan
- NET of Audit Procedures
- Significant Issues identified during { Plannin
- Decisions relating to reliance on Control { Risk Ast.
- Evidence of - Proper Audit planning
 - Apt. Response to ER — Eng Risk
 - PR — Peruasm Div
 - SR — Specific M.



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Determine Audit Materiality

The auditor should consider the **relationship** between the audit **materiality** and audit **risk** when conducting an audit. The determination of audit materiality is a matter of professional judgement and depends upon the knowledge of the bank, assessment of engagement risk and the reporting requirements for the financial statements.

Consider Going Concern

While obtaining an understanding of the bank, the auditor should consider whether there are **events** and **conditions** which may **cast significant doubt** on the **bank's ability to continue as a going concern**.

Assess the Risk of Fraud including Money Laundering

As per **SA 240** "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is

- to **identify** and **assess** the **risks** of material misstatement in the financial statements due to fraud,
- to **obtain sufficient appropriate audit evidence** on those identified misstatements and to **respond** appropriately.

The attitude of **professional skepticism** should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has from time to time issued guidelines ("**Know Your Customer Guidelines** – Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to **deter** and to recognise and **report money laundering activities**.



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Assess Specific Risks

The auditors should **identify** and **assess** the **risks** of material misstatement at the financial statement level which refers to risks that relate **pervasively** to the financial statements as a whole and potentially affect many assertions.

Risk Associated with Outsourcing of Activities

The modern day banks make extensive use of outsourcing as a means of both reducing costs as well as making use of services of an expert not available internally. There are, however, a number of risks associated with outsourcing of activities by banks and therefore, it is quintessential for the banks to effectively manage those risks.

Response to the Assessed Risks

SA 330 "The Auditor's Responses to Assessed Risks" requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. The auditor should **design** and **perform further audit procedures** whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

Stress Testing

Stress testing is a software testing activity that determines the robustness of software by testing beyond the limits of normal operation. Stress testing is particularly important for "mission critical" software, but is used for all types of software. (Source – Wikipedia)

RBI has required that all commercial banks shall put in place a Board approved **'Stress Testing framework'** to suit their individual requirements which would integrate into their risk management systems.



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Stress testing in banks is a **critical risk management** tool used to **evaluate** how a bank can handle **extreme financial situations**. These tests **simulate adverse economic scenarios** to assess the resilience of financial institutions against potential shocks.



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Substantive Procedures

→ to U March

- Examine all Large Advances
- Other Advances Sampling Basis
- Problem A/c's — Examine in Detail
(Unless, insignificant Amt)
- Extent of Sample — depends on efficacy of IC

depends on Volume of operation of Branch

Example 2% or 5% of Aggregate year-end Advances
whichever is less



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The Basel III framework is a set of international banking regulations developed by the Basel Committee on Banking Supervision (BCBS) to strengthen the regulation, supervision, and risk management within the banking sector.

Formulated in response to the deficiencies in financial regulation revealed by the global financial crisis of 2007-2008, Basel III aims to improve the banking sector's ability to deal with financial stress, improve risk management, and enhance the transparency and disclosures of banks.

Basel III significantly impacts the Capital Adequacy Ratio (CAR) by introducing more stringent capital requirements and higher quality of capital standards for banks worldwide. The aim is to enhance the resilience of the banking sector by improving their ability to absorb shocks arising from financial and economic stress, thus reducing the risk of a systemic banking crisis.

• Basel III framework

- Developed by Basel Committee on Banking Supervision
- Formulated in response to Global financial crisis of 2007-08
- It impacts Capital Adequacy Ratio



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- More
- It Advocate Stringent Capital Requirements.
 - AIM — Improve Resilience of Banks: by
 - Increasing their Ability to Absorb Shocks arising from Crisis.
 - and hence Reducing Risk of Systemic Bank Crisis.



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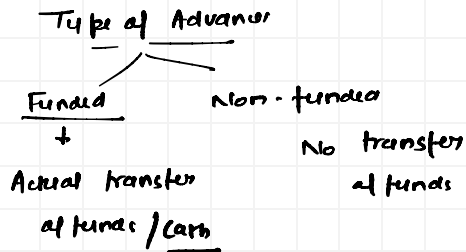
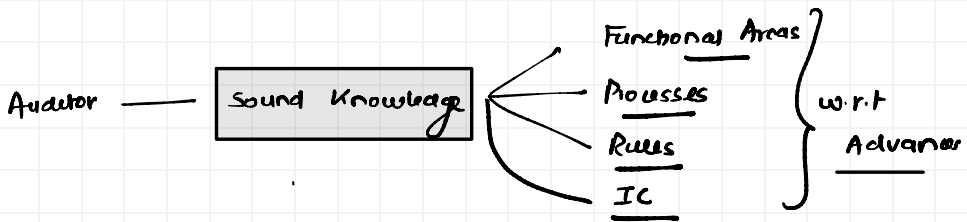
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Advances — Amount of Money $\xrightarrow[\text{By bank}]{\text{to}}$ Another Party
as a loan
with an Agreement of Repayment

- Bank changes interest on Advances
- Biggest item on Asset side
- Major source of income





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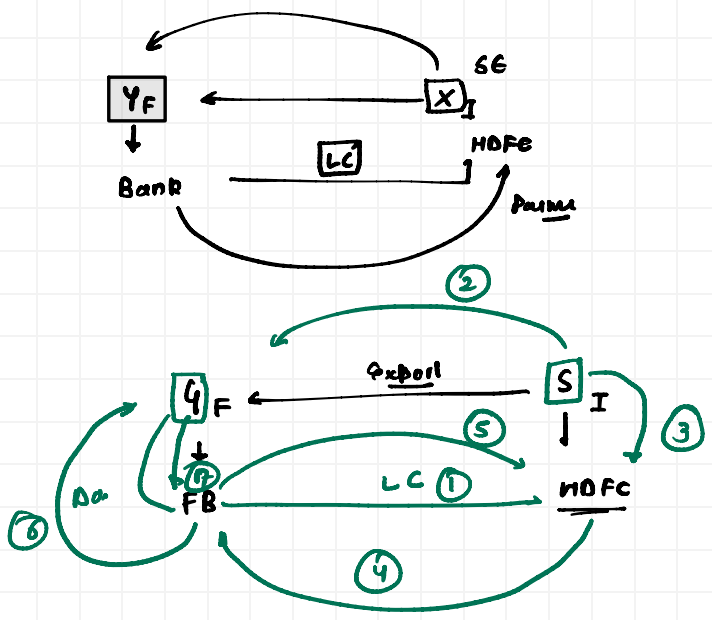
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CA INTER AUDIT CLASSES

- Funded - Term Loan -
 (Cash Disbursement) Cash Credit - =
 Overdraft - =
 Demand Loan →
 Bill Discounted
 Participation on Risk sharing Basis
 Interest bearing Staff Loan

- Non funded - Letter of Credit -
 (No Disbursement of Actual Cash) - Bank Guarantee -





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A Letter of Credit (LC) is a financial document used in international trade to provide an exporter with a guarantee of payment from an importer's bank. It ensures that the payment will be made to the exporter, provided that the terms and conditions specified in the LC are fully met. The LC can be particularly beneficial in transactions where the buyer and seller are operating in different countries and are thus unfamiliar with each other's business environments and legal systems. In the context of Indian trade, let's consider an example to illustrate how a Letter of Credit works:

An Indian exporter, "SpiceExporters Pvt. Ltd." from Kochi, agrees to sell spices to "GourmetImports Inc." in France. To secure payment, SpiceExporters requests a Letter of Credit (LC).

- **GourmetImports applies for an LC** at its French bank, detailing the trade terms.
- **The French bank issues the LC**, sending it to SpiceExporters' bank in India.
- **SpiceExporters ships the spices** and submits the shipping documents to their Indian bank.
- **The Indian bank verifies the documents** and forwards them to the French bank.
- **The French bank reviews and approves the documents**, then transfers the payment to SpiceExporters' bank, which credits SpiceExporters' account.
- **GourmetImports receives the shipping documents** from their bank to claim the goods.

This process ensures SpiceExporters is paid once the goods are shipped and the conditions of the LC are met, reducing risk in international trade.



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Classification of Advances — Sector wise

- Priority Sector — Agriculture, MSME, Education, Housing
- Bank — follow — RBI Guidelines
 - Interest
 - Service charges
 - Sanction
 - Repayment
 - RBI also give target for Priority Sector

Security-wise — Nature of Security

- Primary Security — Against which finance/loan/credit has been given by bank
 - Also known as Principal Security
- Collateral Security — Additional Security provided by borrower over and above Primary Security
 - Used when Primary Sec. fails



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Common types of securities accepted by bank

- **Personal Security of Guarantor:** A third party promises to repay the loan if the borrower fails to do so.
- **Goods/Stocks/Debtors/Trade Receivables:** Inventory or receivables that can be liquidated to repay the loan.
- **Gold Ornaments and Bullion:** Valuable metals that can be sold for cash.
- **Immovable Property:** Real estate properties like land or buildings.
- **Plantations (For Agricultural Advances):** Crops or agricultural land used as security for loans taken for farming purposes.
- **Third Party Guarantees:** Similar to personal guarantors, but may involve corporate entities.
- **Bankers General Lien:** A legal right that allows the bank to retain possession of any asset held until the associated debt is repaid.
- **Life Insurance Policies:** The cash surrender value of a life insurance policy can be used as collateral.
- **Stock Exchange Securities and Other Instruments:** Shares, bonds, and other financial instruments that can be sold in the market.



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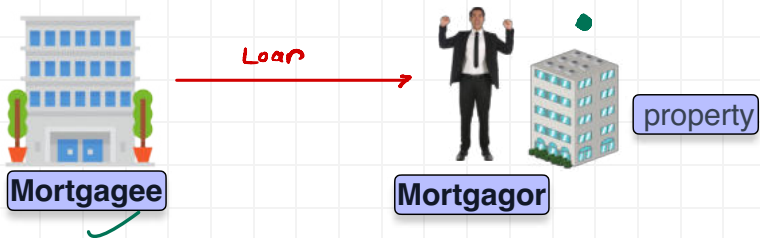


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Mode of Creation of Securities

Mortgage - Registered - Affected by Mortgage deed.

- Register the Property as to the Mortgagee as a security



Equitable - Mortgage by deposit of title deeds

- mere delivery of title deed / Document of title with intent to create securities.

pledge - Bailment / Delivery of Goods by Borrower to lender with intention of creating charge on them as securities

- legal ownership - Borrower

"Mr. Singh" owns a small jewelry business and requires a loan to expand his shop. To secure the loan, he decides to pledge a collection of valuable diamond necklaces as collateral. He physically hands over these necklaces to the bank, which keeps them in a secure vault.

- Physical Possession - Lender

- Specific Charge



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Hypothecation

Example: "AutoMotiles Pvt. Ltd." requires a loan to purchase inventory for their chain of automotive parts stores. They enter into a hypothecation agreement with the bank, where the inventory is used as security for the loan. The company retains possession of the inventory and can sell it as part of their business operations. However, they must report the inventory status to the bank, and the bank has a claim over the inventory (or its proceeds) if the loan defaults.

Assignment

Example: "Tech Solutions" has receivables from various clients for software projects completed. They need immediate cash flow and decide to assign these receivables to a bank in exchange for a loan. This means the bank has the right to collect the receivables directly from "Tech Solutions" clients. The assignment is documented in an agreement, transferring the rights to the bank.

Set off

Example: "Mr. Sharma" has a savings account and a personal loan account with the same bank. Due to financial difficulties, he is unable to continue repaying his loan. The bank exercises its right of set-off by using the funds in Mr. Sharma's savings account to reduce his loan balance, thus offsetting the debt against the savings.

Prudential Norms for IRAC & Provisioning for Advances

NPA

Loan Advance
Term

Interest And/or Principal Remains overdue for a Period of More than 90 days

OD/CC - For OD/CC - Remains out of order

Bills - Bill overdue for More than 90 days
Purchased
& Discounted

Out of order

- O/s Bal $>$ Sanctioned Limit / DP - Continuously for 90 Days

- O/s Bal $<$ Sanctioned Limit - BUT

No Credit
90 Days

- No Credits Continuously for 90 days as on B/c date

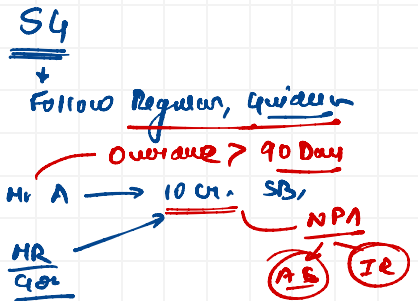
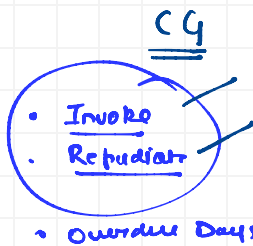
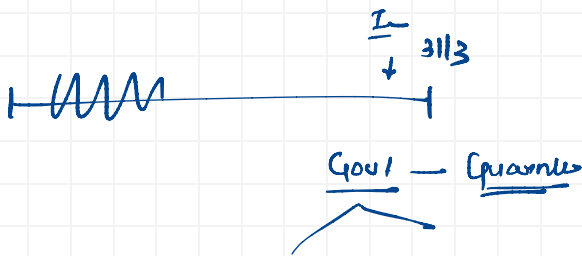
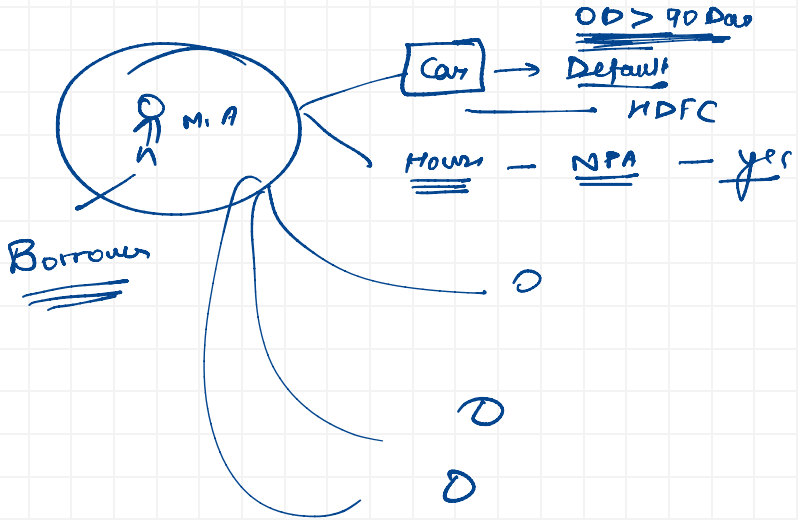
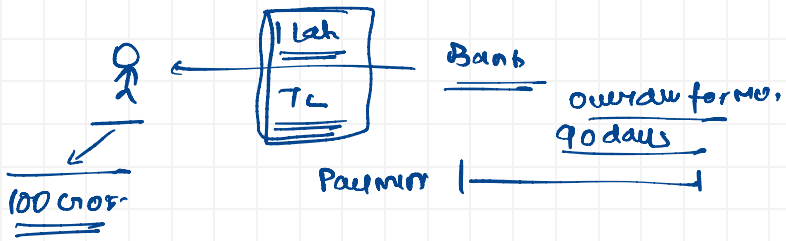
90 Day
I = 100000
Credit = 50000

- Credits Not enough to cover interest debited during

Overdue - Not Paid on due date fixed by Bank

6/8 7/8 overdue

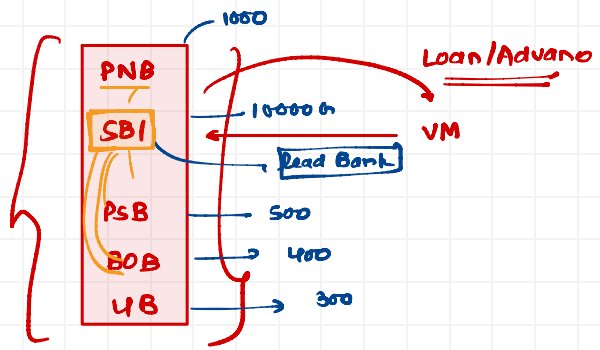
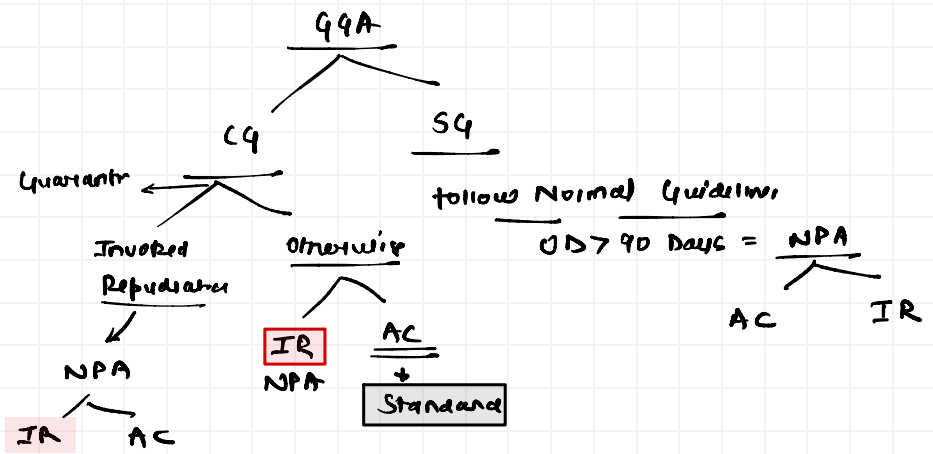




Asset Classification

• Standard Asset

• Income Recognition - NPA



- 1) Joint Appraisal — valuable Information of Borrower
- 2) Risk — Reduce
- 3) Exposure — Limit

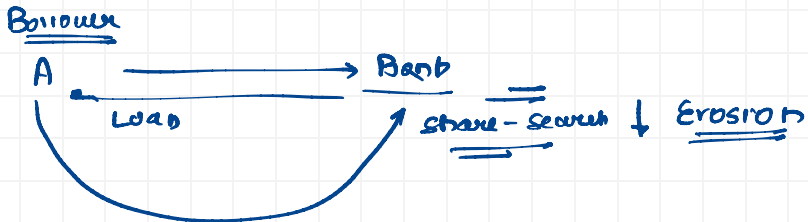
Advances Under Consortium

- Advances to a borrower by two or more banks jointly
- Benefits
 - Consolidated Appraisal Benefit
 - Risk — Reduce
 - Exposure — Limit
 - Information — Exchange
- Lead Bank → higher share
- Asset classification
 - Based on Records of Recovery by Individual member Bank
 - Borrower paid the Amt to Lead Bank
Lead Bank Not Paying to member
Member will treat the Amount as Not Secured / Not Recovered & Classify Accordingly
 - Participating Banks are responsible for Recovery of their Share from Lead bank

Drawing Power

- Lead Bank will compute & Allocate between members
- Can be changed also by lead bank

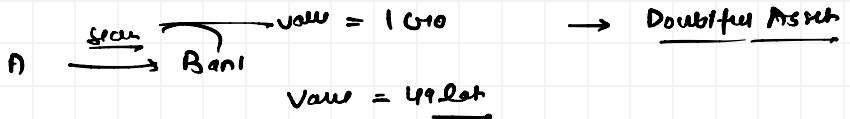
"InfrastructureCorp" has a consortium loan of INR 500 Crores, with "Bank A," "Bank B," and "Bank C" as consortium members. The repayment collected in "Bank A" amounts to INR 10 Crores, which was supposed to be distributed among the three banks. If "Bank A" fails to distribute "Bank B" and "Bank C"'s share for over 90 days, both "Bank B" and "Bank C" would need to classify their portion of the loan as NPA, despite "Bank A" holding the total repayment amount.



Advance → Security Erosion / Fraud

- o) → DF
- o) → LOSS

Case 1 Realisable value of security < 50% of Value Last Assessed



Case 2 RV < 10%

Erosion is security

RV < 50%

Last Assessed Value
Last inspection

+

Doubtful

RV < 10% of outstanding in Borrower Account

Loss Asset
Fully write off
100% Provision

Bank

↓

Staff Loan

Bank

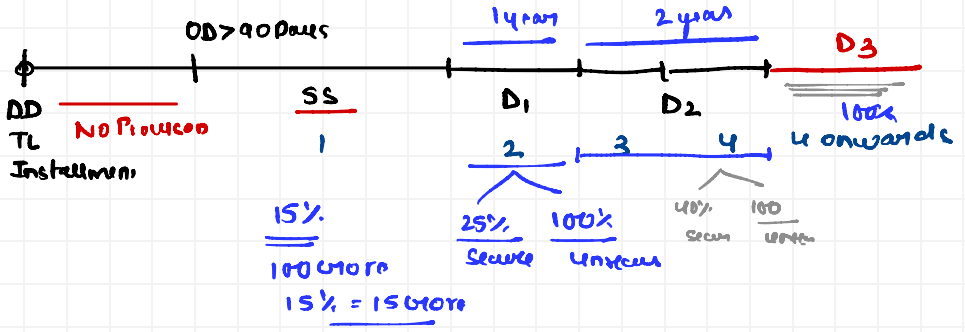
ER

100 000
95000 5000

Aduana

□ RO] ↓

□ Bank - EE - Principal xxx
I NPA





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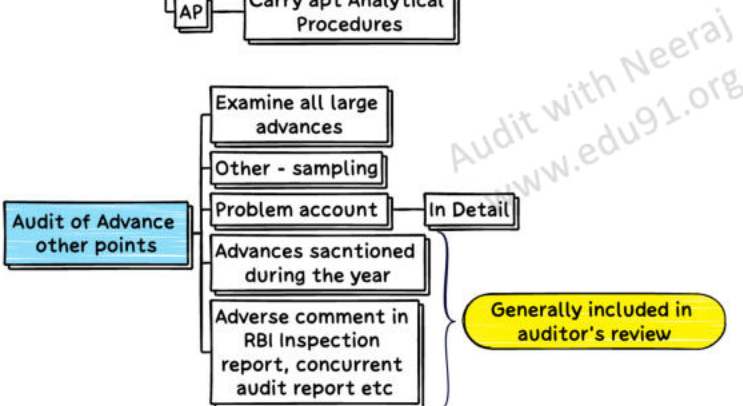
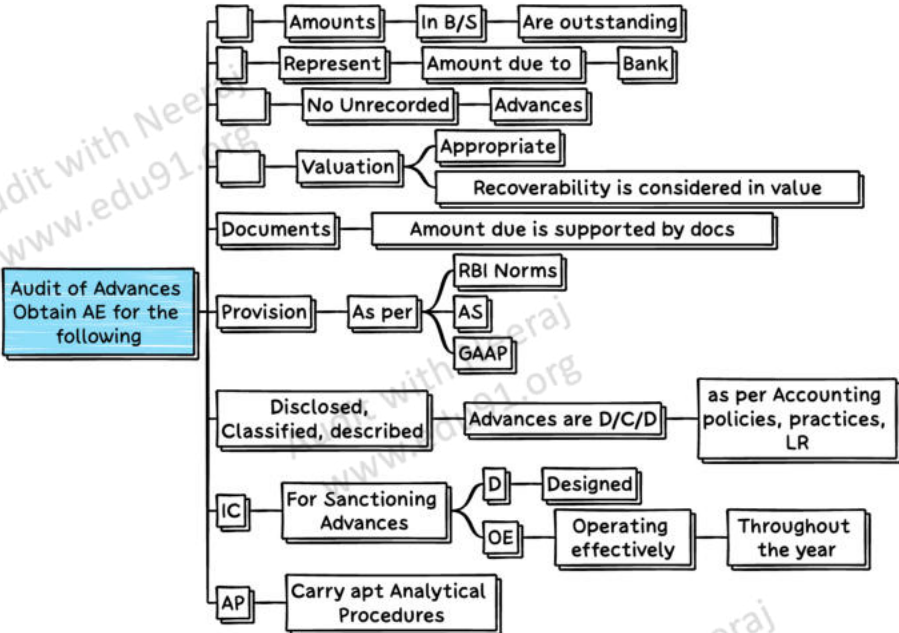
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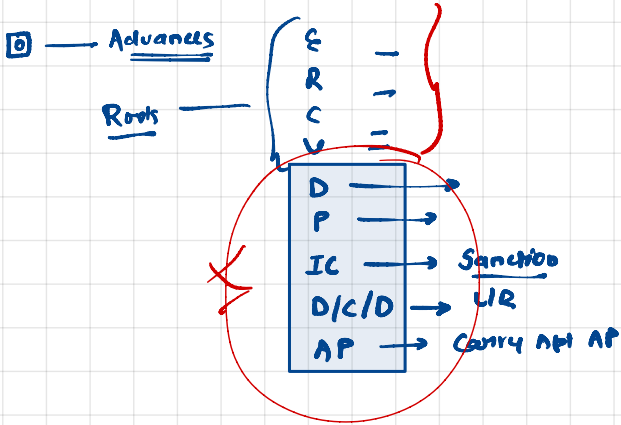


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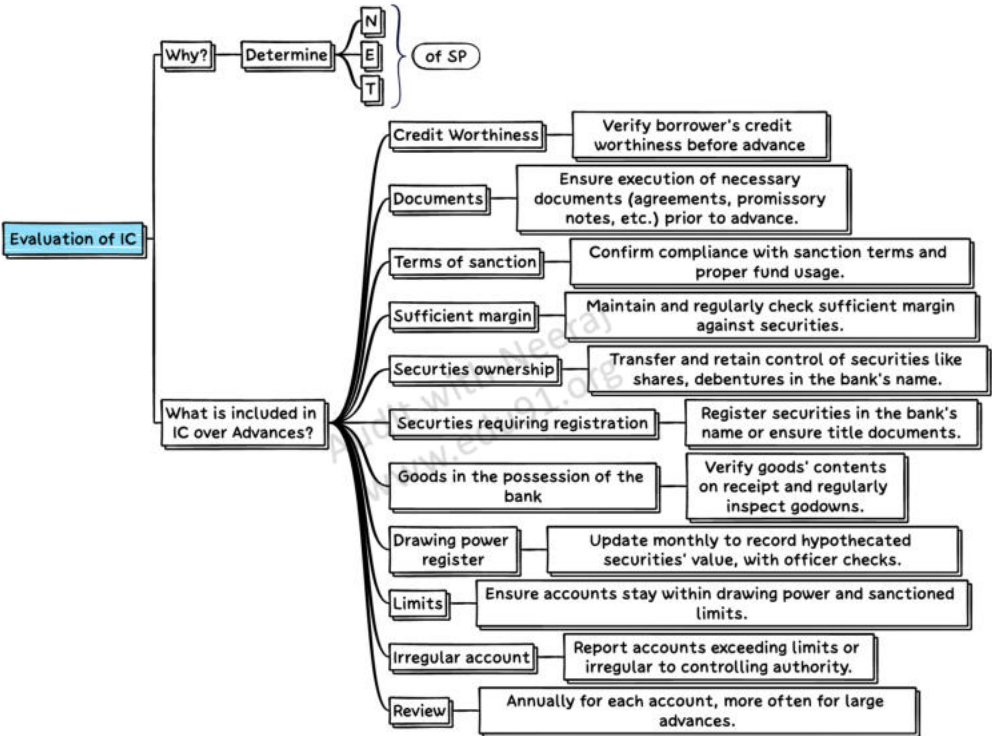
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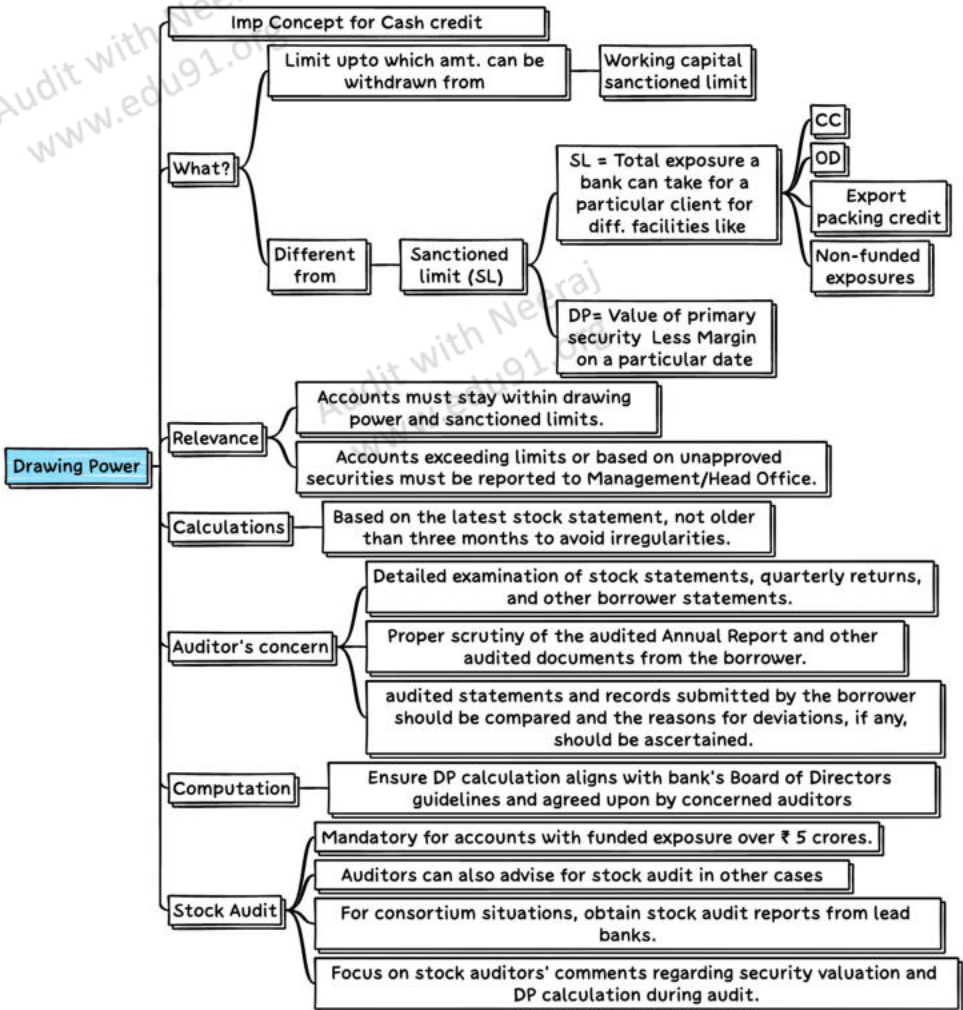
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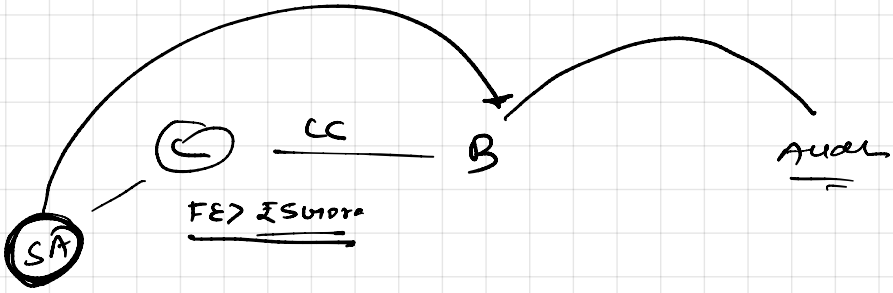


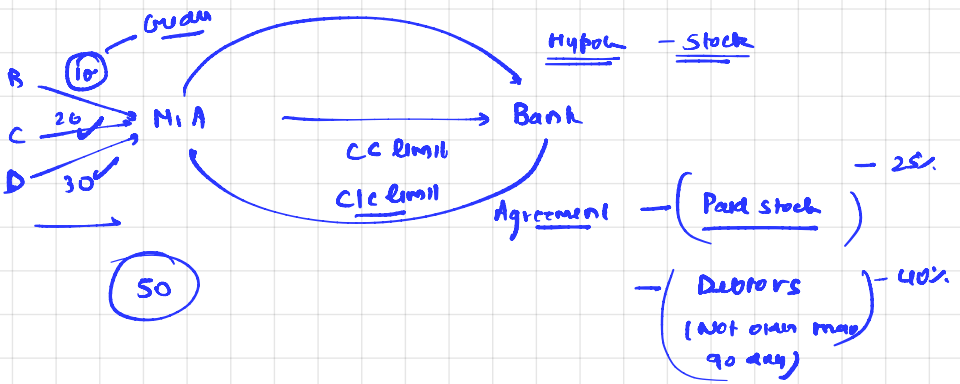
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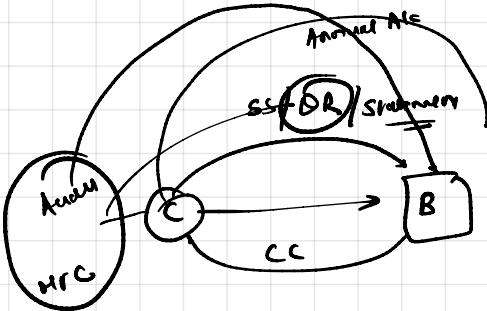


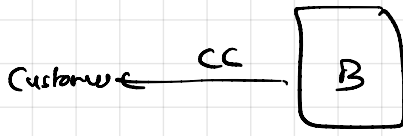
| | |
|--------------|-------------|
| <u>Stock</u> | 10 us |
| creditor | 2 us |
| DS - | 1 |
| | 7 |
| | 1.75 |
| | <u>5.25</u> |

| | |
|--------------------|------------|
| <u>Debtors</u> → | 12 |
| Older than 90 days | 8 |
| | 4 |
| Margin 40% | 1.6 |
| | <u>2.4</u> |

7.05

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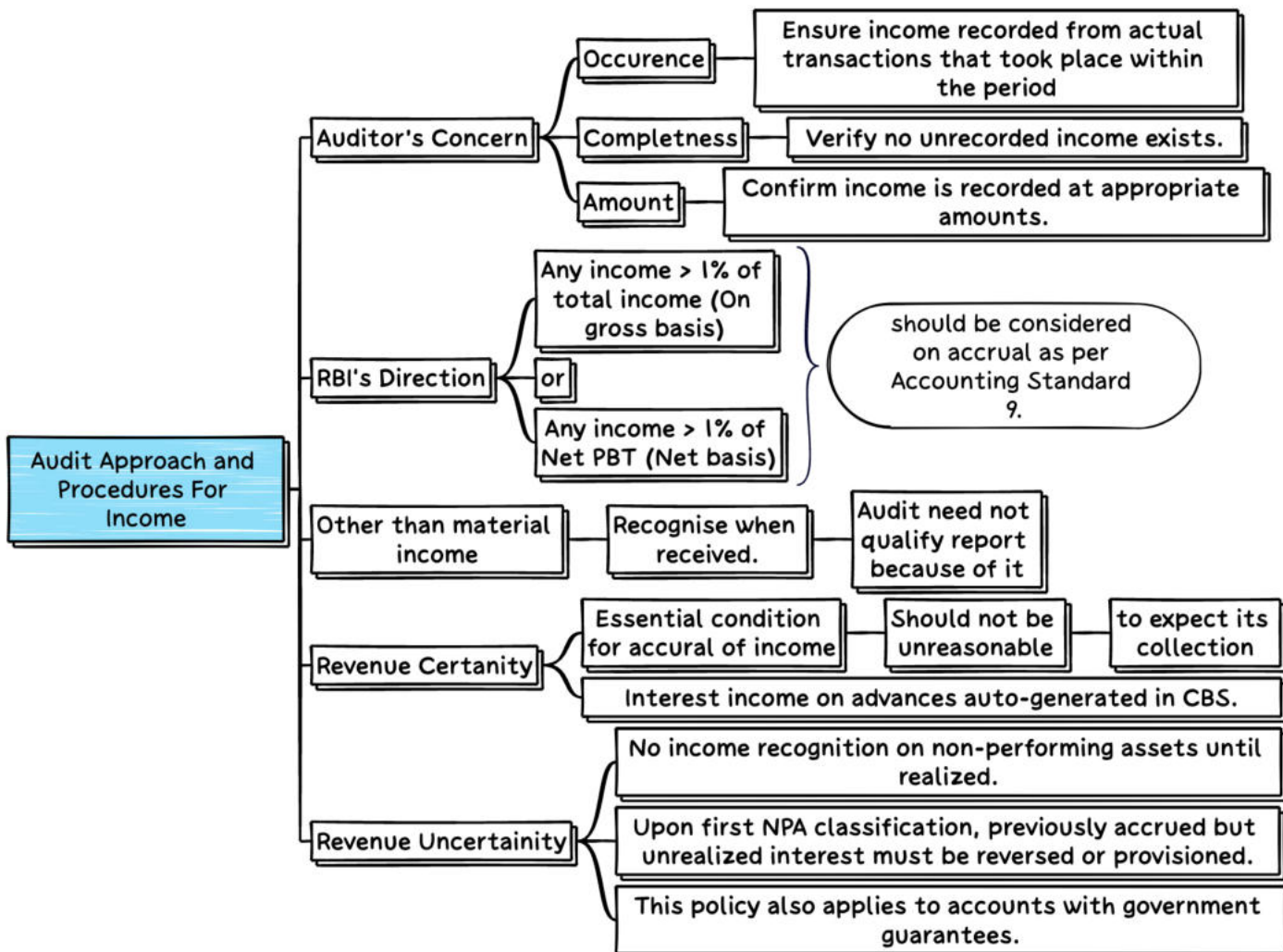
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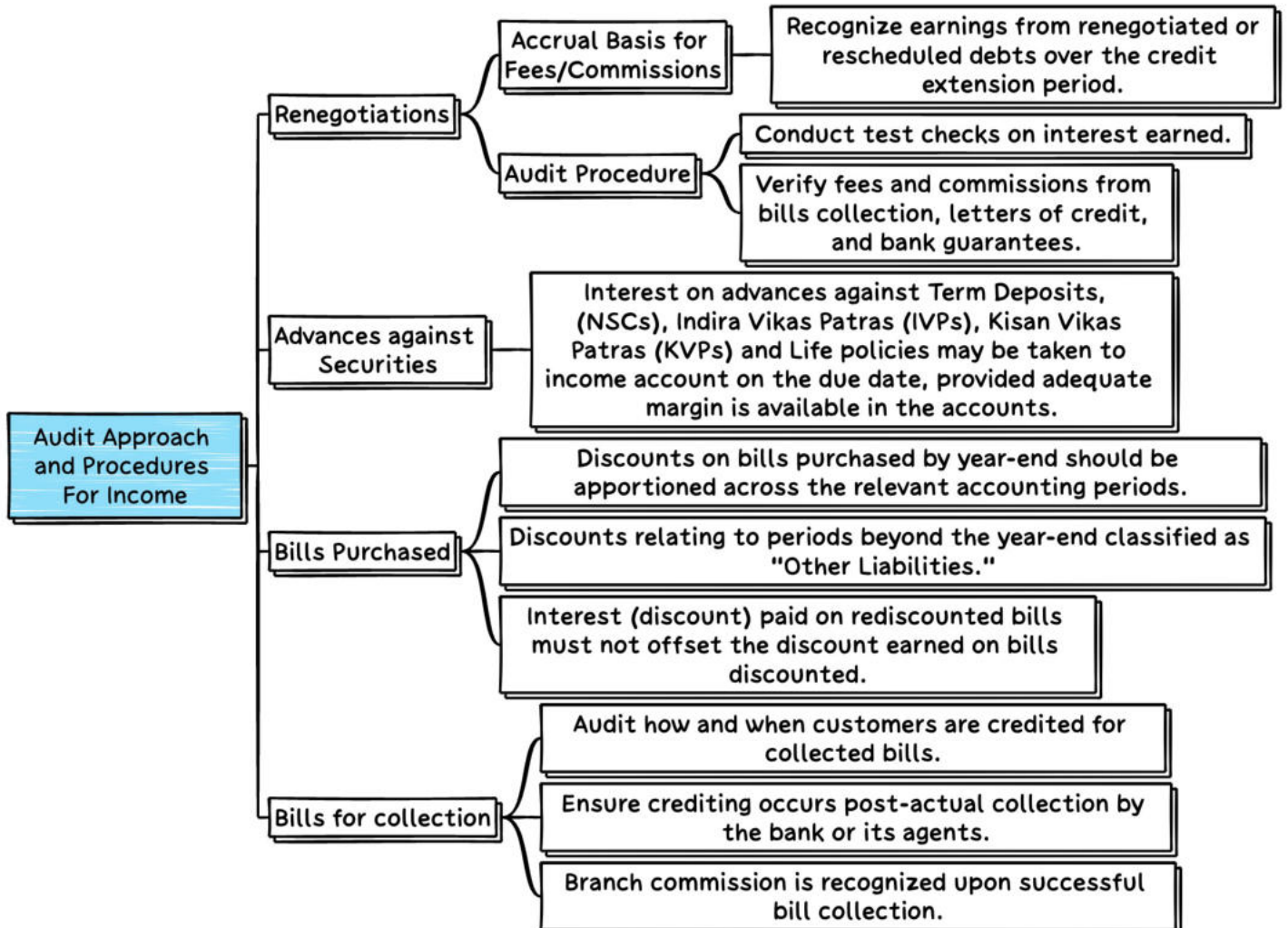
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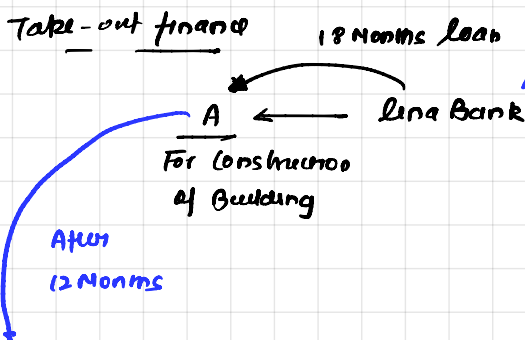


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Reversal of income

- For all NPAs - Interest Accrued & Credited should be Reversed, if Not Realised
Applicable for Govt. Guaranteed A/c's also
- Fee, Commission w.r.t NPAs → cease to Accrue
→ Reverse if Uncollected
- Inquire large debits - In Interest income A/c Unexplained
- Inquire About Communication from Borrowers - Pointing out difference in Interest charge, whenever Apt. Action taken in this regard
- Leased Assets - ^{Interest} Finance income Accrued and Credited to income Account before Asset become NPA, remaining unrealised, should be Reversed.



If Recognized as NPA should Not Recognise income unless realised from Borrower / Taking over Institution

Approached - Lina Bank with completed Prop as collateral
to take out loan (loan to pay ST loan of Lina Bank)
low interest - long period

Income Recognition on partial Recoveries in NPA's

- Interest received on NPA can be taken to be income
- Should not be from fresh / Additional Credit facilities sanctioned to borrowers
- No clear Agreement.
 - Use a Uniform / Consistent Accounting Policy for Appropriation

Memorandum Account

→ Debit P&L A/c

- NPA, Revised int charged not realized
- Stop further Application of interest
- Record such int in a Memorandum A/c
- Such interest should NOT be included in Gross Advances

Income from Investment

Interest ecb

- o) — Reasonableness —
 - o) Compare with py
 - o) Compare with Budget
 - o) Verify the calculation of int on forecast basis
 - o) Change in one Int Rate during the yr.
- } TOC
} 198D
} SAP



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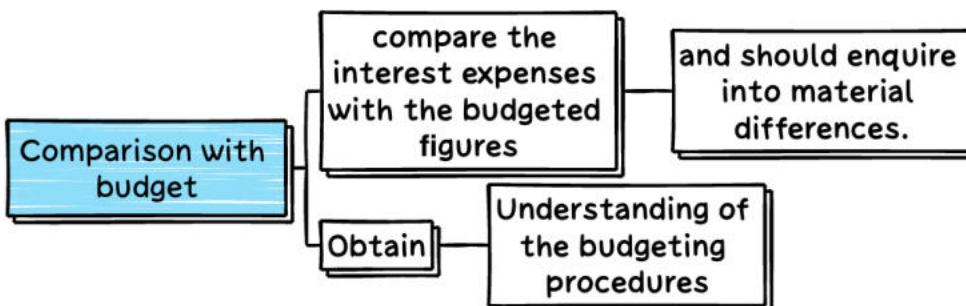
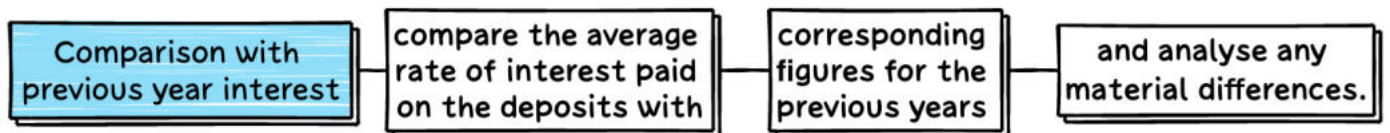
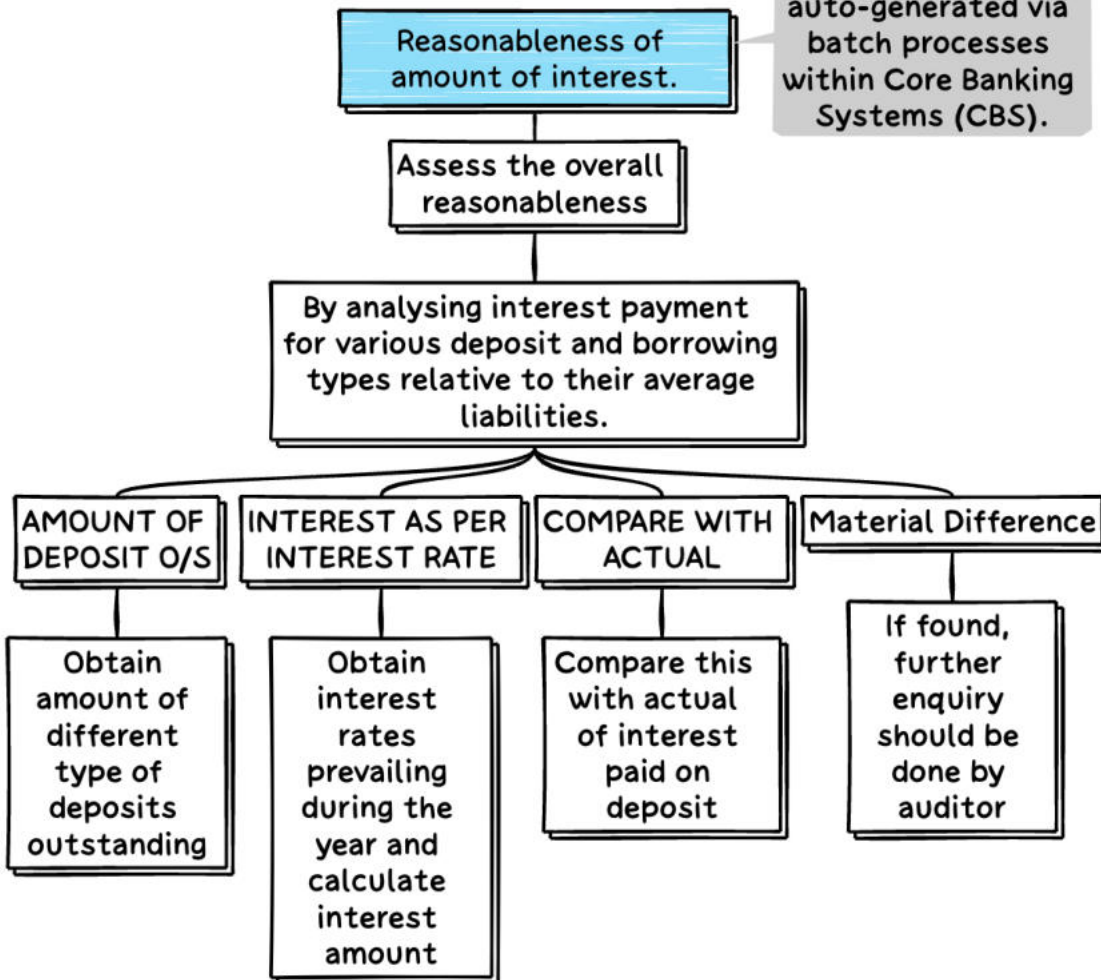


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Interest expense entries are typically auto-generated via batch processes within Core Banking Systems (CBS).





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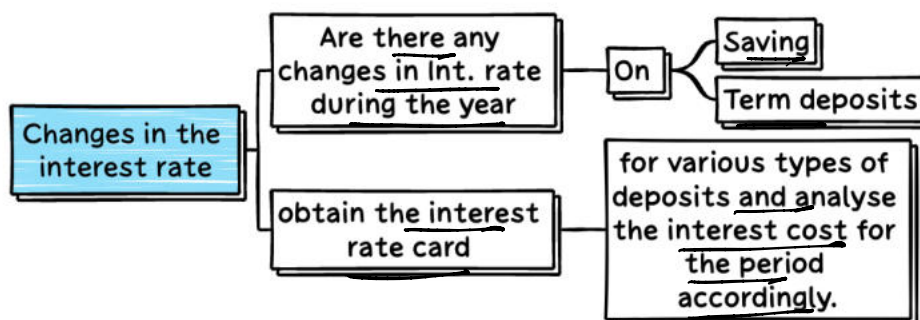
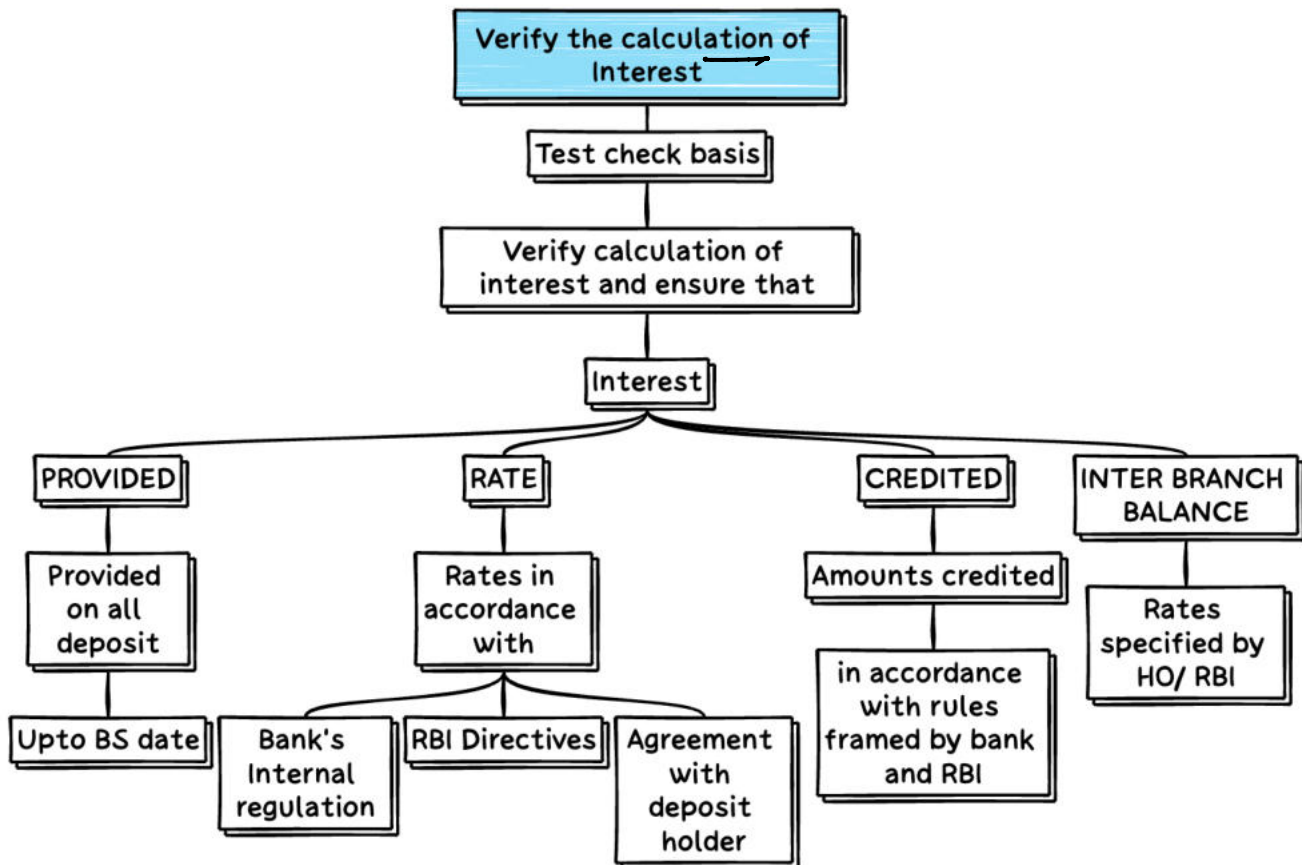
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Completeness

- The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers.



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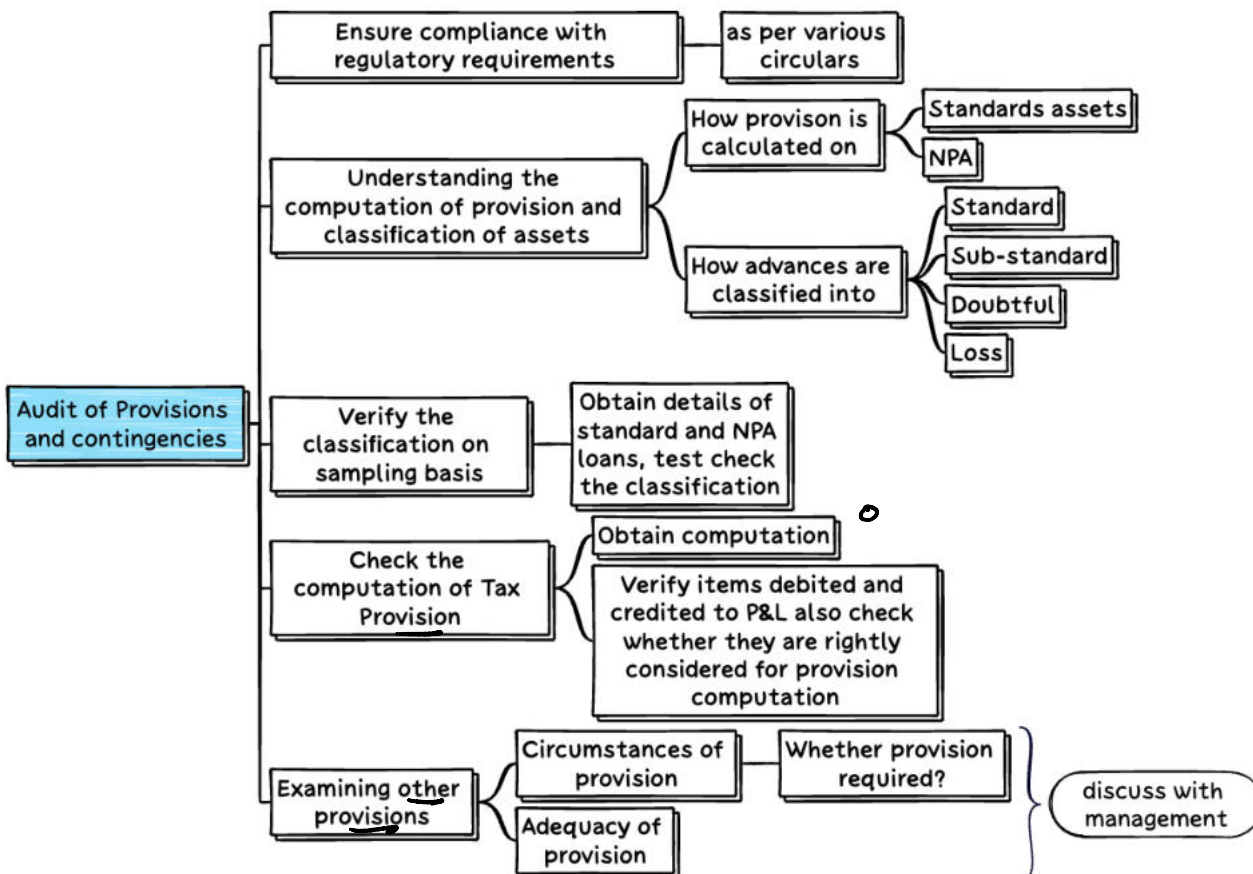
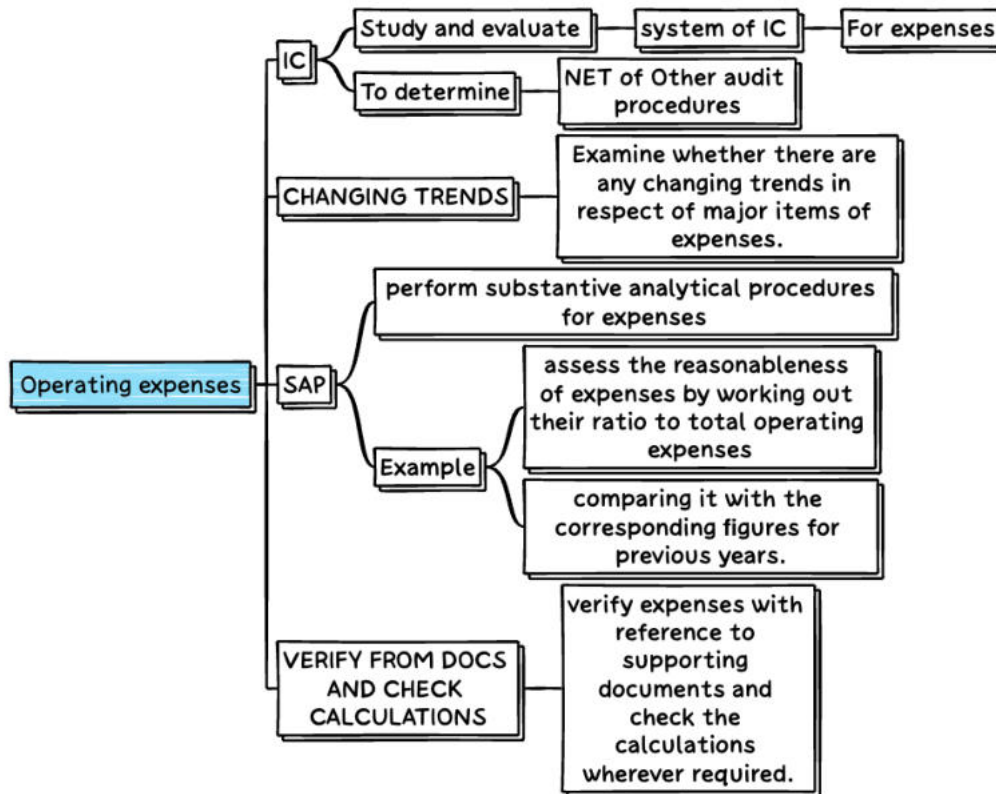
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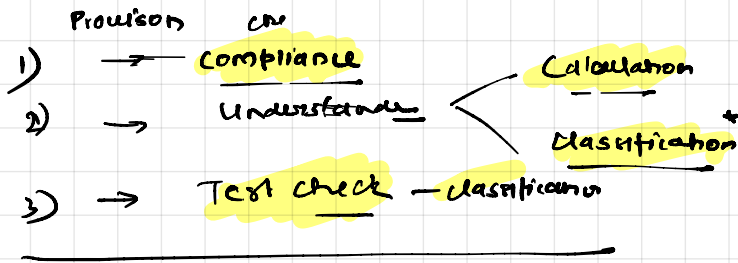


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o 4) → Provision for tax

o 5) → Other Provision & Contingency

- o Circumstances
 - o Adequacy
- } Hgt Discuss

