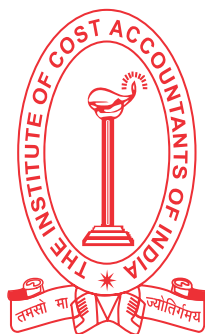


GUIDANCE NOTE ON RISK BASED INTERNAL AUDIT OF COMMERCIAL BANKS



THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory body under an Act of Parliament)
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Guidance Note On Risk Based Internal Audit of Commercial Banks

(Commercial Banks / Regional Rural Banks / Small Finance Banks /
Housing Finance Companies)

2022

NOTE: Banking Business Consists of Mobilization of Deposits, Extending Loans & Advances, Non-fund-based Business (LCs and BGs) and also Selling of Miscellaneous Products like Remittances (NEFT, RTGS, Demand Drafts, Pay Orders / Bankers' Cheque etc.), Selling of Third-Party Products (Like Life, General Insurance Products, Credit Cards, DEMAT etc.), Lockers, Safe Deposit Articles etc. And most of the Banks were implemented Alternate Delivery Channels like ATM, Mobile Banking, Internet Banking for the Convenience of their Customers under 'IT Platform' in addition to the Branch Banking Channel (i.e., Primary Channel).

Systems and Procedures / Guidelines for all the above-mentioned Banking / Financial Products are more or less common with a variation of 10% to 20%.

Some of the Banks, to Mitigate the Risks of their Financial Products, they may add more stipulations to be followed by their Bank Branches while Selling Bank Products to their Customers.

The **Nomenclature / Terminology** may differ from Bank to Bank but the process and product features are common in most of the 'Bank Financial Products'. Bank Risks are broadly Classified by **Basel Committee** is Credit Risk, Market Risk and Operational Risk and are common to All Banks.

Readers may take note of the above points while reading the Book.

MISSION STATEMENT

"The CMA Professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting."

VISION STATEMENT

"The Institute of Cost Accountants of India would be the preferred source of resources and professionals for the financial leadership of enterprises globally."

ABOUT THE INSTITUTE

The Institute of Cost Accountants of India is a Statutory body set up under an Act of Parliament in the year 1959. The Institute as a part of its obligation, regulates the profession of Cost and Management Accountancy, enrolls students for its courses, provides coaching facilities to the students, organises professional development programmes for the members and undertakes research programmes in the field of Cost and Management Accountancy. The Institute pursues the vision of cost competitiveness, cost management, efficient use of resources and structured approach to cost accounting as the key drivers of the profession. In today's world, the profession of conventional accounting and auditing has taken a back seat and cost and management accountants are increasingly contributing towards the management of scarce resources and apply strategic decisions. This has opened up further scope and tremendous opportunities for cost accountants in India and abroad.

After an amendment passed by the Parliament of India, the Institute is now renamed as "The Institute of Cost Accountants of India" from "The Institute of Cost and Works Accountants of India". This step is aimed towards synergising with the global management accounting bodies, sharing the best practices which will be useful to large number of trans-national Indian companies operating from India and abroad to remain competitive. With the current emphasis on management of resources, the specialized knowledge of evaluating operating efficiency and strategic management the professionals are known as "Cost and Management Accountants (CMAs)". The Institute is the 2nd largest Cost & Management Accounting body in the world and the largest in Asia, having approximately 5,00,000 students and 85,000 members all over the globe. The Institution headquartered at Kolkata operates through four Regional Councils at Kolkata, Delhi, Mumbai and Chennai and 114 Chapters situated at important cities in the country as well as 11 Overseas Centres. It is under the administrative control of Ministry of Corporate Affairs, Government of India, New Delhi.

Internal Auditing and Assurance Standards Board (IAASB)

The Institute & eminent resource persons from our profession have felt the need for the constitution of board for Internal Audit. The Present Council for the first time has nurtured the Board to formulate and issue standards, guidelines and advisory for the Internal Audit Function. The Cost Accountants have been recognized by the Companies Act, 2013 and other regulatory bodies for appointment as Internal Auditors.

First Edition: January 2022

DISCLAIMER:

The views expressed in this publication are those of author(s) which have been reviewed by the Internal Auditing & Assurance Standards Board of the Institute of Cost Accountants of India after taking into account the suggestions, opinions and comments of members and non-members of Institute.

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Behind every successful business decision, there is always a CMA

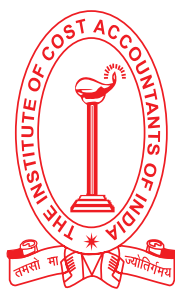
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Behind every successful business decision, there is always a CMA



Foreword

The banking industry in India is in a state of continuous growth and expansion, making its presence felt in all spheres of economic growth, domestic as well as global. Such marked presence at the domestic as well as international front makes it quintessential for the banking industry to benchmark with the international standards to ensure credibility, resilience as also transparency in its working in both domestic as well as international arena.

Establishment of risk-based Internal Audit Systems is one such measure recommended by the Basel Committee on Banking Supervision.

The Reserve Bank of India made a beginning in this direction by issuing a circular in August 2001 requiring the banks to take necessary steps to establish a risk-based internal audit system in banks. Over the period, the regulator also brought out detailed circulars, guidance notes etc., dealing with the topic of Risk-based supervision of banks. Implementation of risk-based supervision system in banks has to the need for a system of risk-based internal audit in banks. Now the same was extended to NBFCs / Housing Finance Companies / Urban Co-operative Banks.

The new system requires the Cost Accountants not only to hone their existing skills but also acquire new knowledge and skills to appropriately understand the complexities of the system and make the best possible use of their knowledge and expertise to help the banking industry reap maximum benefits of the system.

In view of the above, the Committee on Internal Auditing and Assurance Standards Board has brought out this publication, "Guidance Note on Risk Based Internal Audit of Commercial Banks" to help the members understand the fundamentals of the system.

I am sure that the members would find the Guide Note immensely useful in understanding and implementing the concept of Risk-based Internal Audit in Commercial Banks.

CMA P. Raju Iyer

President, ICAI

Chairman, Internal Auditing and Assurance Standards Board

Date 11.02.2022



Foreword

India's banking industry is moving from strength to strength to support one of the most vibrant economies of the world i.e., India. Notable changes have been made in policy and regulation to strengthen the said sector. These changes include not only Prudential Norms, Revitalization of Payment Mechanism but also integrate regulations between Commercial Banks, NBFCs and Co-operative Banks and Introduction of Structural Changes in the Urban Co-operative Banks.

The Urban Co-operative Banks are present in every State of the country. They are involved in financing not only agriculture-based activities like Personal Finance, Finance, Consumer Finance, various Small-scale Industries and Self-employment driven activities.

As State Co-operative Banks & District Central Co-operative Banks have now been brought under the regulatory regime of NABARD. A need was felt to guide the members so that they are aware of the peculiarities of the business of Urban Co-operative Banks, NBFCs and Housing Finance Companies. Audit serves as review mechanism to ensure that the transactions / decisions are within the policy parameters laid down and are in compliance with the applicable circulars of NABARD and RBI.

The Internal Auditing and Assurance Standards Board has brought out this publication, "Guidance Note on Risk Based Internal Audit of Commercial Banks". I am sure, members would find the guidance contained in this publication useful in conducting the audit of Commercial Banks.

A handwritten signature in black ink, appearing to read 'Vijender Sharma', with a stylized flourish at the end.

CMA Vijender Sharma

Vice President, ICAI

Date 11.02.2022



Preface

The Banking Industry, which covers the lifeline of any entity, has always thrown up newer opportunities and challenges, be it the Statutory Audits or other assignments such as Concurrent Audits or Internal Audits etc.

The dynamic environment in which this industry operates requires the members to not only use their existing skill sets to the best of their ability but also keep the same sharp enough at all times to effectively turn those challenges into opportunities.

The introduction of Risk-based Internal Audit System in UCBs/NBFCs/HFCs by the Reserve Bank of India is one such opportunity in the form of a challenge for the members to contribute towards the resilience and stability of the Banking / Financial System in India.

The Risk-based Internal Audit in Banks / UCBs / NBFCs / HFCs, as against the conventional Concurrent Audit or Internal Audit in Banks, is focused at improving the Risk Management System in Banks, necessitated on account of involvement of large amount of Public and Government monies.

Given the fact that even the implementation aspect of the Risk-based Internal Audit System in UCBs / NBFCs / HFCs is in nascent and learning stages, it is necessary that our members take an initiative to properly understand the intricacies or topicalities in carrying out a Risk-based Internal Audit and help not only the system to take firm roots in the industry but also the industry to derive maximum benefit out of the System.

The Institute under the aegis of the Professional Development Committee published the Monograph of Risk Based Internal Audit in the year 2005 which was later revised in year 2011.

Initially, the 1st edition included the essentials of risk management and risk audit process in the commercial banks. It also had the checklist of the concurrent and Risk Based Internal auditor to be followed during the audit process. The 2nd edition focused on the suggested risk assessment template based on risk and activity of the bank which was covered exhaustively in the handbook. It also had highlighted the credit rating along with creating a common language and semblance for the audit process.

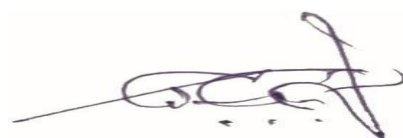
The third edition which was the enlarged edition from the earlier editions was published in the year 2016. The third edition covered the steps of the internal audit process from the understanding of the risk environment, risk assessment, audit planning and finally the reporting of the audit findings.

With multiple changes in various RBI Circulars and with onset of the Basel-III norms it was felt by the Institute to revise the previous handbook and bring out the 4th edition which would cater to the auditors and the bank executives on contemporary issues.

I am therefore, happy to note that the Committee on Internal Auditing & Assurance Standards Board has decided to bring out this fourth revised edition of Guide Note on Risk-based Internal Audit in Commercial Banks for the guidance of the members.

I am sure that the Committee on Internal Auditing & Assurance Standards Board will continue to bring out more of such topical publications for the benefit of the members.

Yours faithfully,



(CMA Chittaranjan Chattopadhyay)

Chairman

Banking, Financial Services & Insurance Board.

Date: 11.02.2022

CMA PRAMOD KUMAR BHATTAD
President



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MESSAGE FROM PRESIDENT

Risk Based Internal Audit (RBIA) is an approach confined to audit intending to protect and enhance organizational value by providing an objective assurance, advice, and insight, keeping intact the effectiveness of the risk management, control and governance systems. The function is an aid to senior management and the Board of Directors in reducing the risk of loss and reputational damage in their quest of attainment of business objectives.

Provisions of Section 138(1) of Companies Act 2013, inter alia stipulate that prescribed companies should appoint, among others, Cost Accountants to conduct internal audit of the functions and activities of the company.

I am happy to note that the Professional Development Committee has brought out the Monograph on risk based internal audit of Commercial Bank. It is the third edition published by the Institute and this Monograph has been an endeavour of the Institute to communicate with the stakeholders for the Internal Audit of treasury.

I am thankful to CMA Vijender Sharma, Chairman- Professional Development(PD) Committee, other members of the PD Committee and also the PD Department for their contributions in bringing out “Monograph on Risk Based Internal Audit of Commercial Banks” in the present form.

(CMA PRAMOD KUMAR BHATTAD)

15 July, 2016

New Delhi



CMA Kunal Banerjee
Past President (2008-09)

PREFACE TO SECOND EDITION

After implementation of Basel II, Reserve Bank of India directed all the Financial Institutions to switch over from normal inspection to Risk Based Internal Audit. Considering the gravity of the situation, the Institute of Cost and Works Accountants of India (ICWAI), the only Institution set up by Govt. of India under an Act of Parliament for imparting education and training in Cost and Management Accounting profession, though not yet assigned with the duties to conduct Risk Based Internal Audit, Concurrent Audit and Financial Inspection of Financial Institutions by the Regulator, but could not undermine their role as a responsible professionals. As a consequence, ICWAI came out with a monograph as early as 2006 where elaborate discussions were made about the Reserve Bank of India's Policy Guideline on Risk Based Internal Audit, Risk assessment template and preparation of Risk Matrix, identification, measurement and exercising control over risks.

In the wake of Sub Prime Lending and global financial disaster, it is being felt that identification of risk before its crystallization is more important than that of identification of risk after crystallization. In view of this, the Cost Accountants who are associated with different Financial Institutions as employees experienced that the Credit Risk Rating system by means of which an attempt is being made to ascertain the risk elements in the counter party has been proved to be inadequate and some changes are imminent to find out the risk associated with the counter party.

Normally, while calculating the credit risk more stress is being given on the financial, economic, market and the borrower itself, certain non-economic factors also play a definite role while assessing the credit risk of a borrower. For an example, in case of a housing loan, the place changes by the borrower before availing of the loan as well as duration of his association with his present employer are also important to assess the consistency in the character of the borrower.

The first edition of the monograph covered Concurrent Auditors' checklist in detail. The present edition will help the Concurrent Auditors to have more introspection on their audit job with the suggestive template based on Risk associated with each of the activity of a Bank. It is felt that this monograph will be of immense help to both the Concurrent Auditors and Risk Based Internal Auditors in discharging their responsibilities under changed circumstances when each of the transaction of any bank either having some degree of risk or initially no risk but may devolve into risky transaction.

Keeping all the above aspects in mind, the first edition on Risk Based Internal Audit and Concurrent Audit in Commercial Banks needs to be enlarged covering a separate chapter on credit rating and also framing some common language so that all the inspecting officials will speak in the same language and the risk assessment shall not be a matter of perception and guess. An exemplary separate risk assessment template has been designed by the Institute where degree of risk in each activity has been devised, though it may vary from Institution to Institution, but in no case Inspector to Inspector/Auditor to Auditor.

We hope and trust that the apex Bank i.e., RBI will appreciate such endeavour of the Institute of Cost and Works Accountants of India for the cause of more efficient and effective Risk based supervision of the Commercial Banks and Financial Institution in India and utilize the expertise of the services of the Cost Accountants of

India. Once the members of ICWAI are considered by RBI for providing such services to the Commercial Banks/Financial Institutions, ICWAI will feel pleasure to hand over such exhaustive risk assessment template before RBI for streamlining the Risk Based Internal Audit procedure in the Commercial Banks. We are sure, that the present volume of the book will be of immense useful/importance to the inspecting officials for conducting Risk Based Internal Audit and Concurrent Audit in commercial banks. Utmost care has been taken to prepare this monograph. Nevertheless, there might be some typographical mistakes which might have gone unnoticed. Suggestion for further improvement of this publication will be given due cognizance by the Institute.

July, 2009

CMA Kunal Banerjee
President



CMA Pravakar Mohanty
Past President (2005-06)

PREFACE TO FIRST EDITION

With the advent of globalization and the financial sector reforms growing integration of domestic markets with external markets has become inevitable and banks in India are now naturally exposed to several major risks in the course of their business. Especially in view of proposed introduction of the new Basle Capital Accord II, the capital maintained by the banks will be more aligned to the risks undertaken. It is therefore important that banks introduce effective risk management system. The adoption of risk based internal audit will help the banks to provide an aid to the ongoing risk management by providing necessary checks and balances in the system.

The Cost and Management Accountants having expertise in Risk Management, Strategic decision making technique coupled with Logistic and Management Information System can contribute significantly for such Risk Based Internal Audit in Banks.

Concurrent audit was introduced in the Banking Industry as mandatory as per recommendation of Jilani committee. Since then in commercial banks the concurrent audit is being conducted and the practicing Chartered Accountants are presently doing the work.

The members of the Institute of Cost and Works Accountants of India (ICWAI) felt that since concurrent audit is not statutory and the appointment of auditors are not guided by any law of the land, the Cost Accountants having proficiency and expertise in Internal Control and Management Information System can also contribute to this emerging area.

In the light of the above a Committee was constituted by the EIRC of ICWAI in the year 2004-05 headed by Shri Chittaranjan Chattopadhyay, the then Chairman, EIRC of ICWAI and guided by Shri R.K Chakraborty, a senior Cost Accountant, Shri Ranjan Hui, a Cost Accountant working in RBI to prepare a Monograph for the use of Cost Accountants so that they would be confident and can understand the role of a Risk-based Internal Auditor and Concurrent Auditor in a commercial bank. Although Dr. Subramanya is no more with us, this monograph will be a fitting tribute to his contribution to the professional development activities of the Institute.

The present monograph brings out the essentials of the Risk Management and Risk Audit in commercial Banks and also the approach to concurrent audit in banks. I am sure it will be very useful to the banking professionals and also practicing professionals.

The Institute acknowledges the service rendered by the members who have volunteered to prepare such manual for the benefit of the professional fraternities.

The ICWAI Centre for Excellence, Chennai has to be commended for the efforts put in for acting as a facilitator for this publication.

Shri H.N. Prasad, the Regional Director of Reserve Bank of India has released the draft guidance note on 3rd July, 2005 in the Diamond Jubilee celebration at Kolkata.

*Dated: January 20, 2006
Bhubaneswar*

CMA Pravakar Mohanty
President

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Historically, the internal audit system in banks has been concentrating on transaction testing, testing of accuracy and reliability of accounting records and financial reports, integrity, reliability, and timeliness of control reports, and adherence to legal and regulatory requirements.

Financial Auditing is the process of examining an organization's (or individual's) financial records to determine if they are accurate and in accordance with any applicable rules (including accepted accounting standards), regulations, and laws. This process of auditing is carried out with different objectives, if objective of auditor is establish fairness of the financial result it is called External Auditing, when exercise has been done with an objective of judging effectiveness of Internal Control Systems it is called Internal Audit, When efforts are aimed at ensuring compliance of management's plans and policies it is management auditing and finally when efforts are directed towards diagnosis, assessment, incorporation and mitigation of risk involved in transactions, procedures and flow it is Risk Based Internal Audit.

The 'Institute of Internal Auditors' defines Risk Based Internal Auditing (RBIA) as—

“A Methodology that links internal auditing to an organization's overall risk management framework and that allows internal audit to provide assurance to the board that risk management processes are managing risk effectively, in relation to the Risk Appetite.”

- a. Compliance Procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. The auditor needs to ensure that internal control exist and that the internal control is operating effectively and being operating continuously throughout the period under audit to ensure that they can be relied upon. In summary, by doing Compliance Tests, the auditor can then able to ascertain the existence, effectiveness and continuity of the internal control system. Compliance Procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect.
- b. Substantive Procedures are tests designed to obtain evidence to ensure the completeness, accuracy and validity of the data produced by the accounting system.

Shift: In earlier periods Internal Auditing in Banks was done through checking transactions done to ensure fairness of the data and compliance of extant guidelines. Now-a-days Auditing is being done with an objective to assess, measure and mitigate risk involved in Events & Transactions and Internal Control Mechanism or in simpler words we can call it Work flow.



It is a well-known fact that an independent and effective internal audit function is of special importance to all corporates for mitigation of their risk. And it has increased importance for a financial sector entity as it provides for reasonable assurance to the board and its senior management regarding the quality and effectiveness of the entity's internal control, risk management, and governance framework.

Given the current relatively uncertain economic environment which has put significant pressure on debt servicing capabilities of corporates and businesses, there is a need to critically examine the existing portfolio and take an account of the related risk management and accounting practices.

This on-going stressed situation coupled with the uncertain economic environment and the increased global regulatory watch requires financial institutions to critically evaluate the quality of their regulatory submissions, risk model, capital adequacy, and conduct in the financial markets.

Risks Involved in Banking Sector:

(i) Credit Risks

Credit risk is the risk that arises from the possibility of non-payment of loans by the borrowers. Although credit risk is largely defined as risk of not receiving payments, banks also include the risk of delayed payments within this category. Often times these cash flow risks are caused by the borrower becoming insolvent. Hence, such risk can be avoided if the bank conducts a thorough check and sanctions loans only to individuals and businesses that are not likely to run out of income over the period of the loan. Credit rating agencies provide adequate information to enable the banks to make informed decisions in this regard. The profitability of a bank is extremely sensitive to credit risks. Hence, even if credit risk rises by a small amount, the profitability of the bank can get extremely impacted. Therefore, to deal with such risks banks have come up with a wide variety of measures. For instance, banks always hold a certain amount of funds in reserves to mitigate such risks. The moment a loan is made, a certain amount of money is appropriated to the provision account. Also, banks have started utilizing tools like structured finance to mitigate such risks. Securitization helps remove the concentrated risk from the bank's books and diffuse it amongst the various investors in the capital markets. Credit derivatives like credit default swap have also come into existence to help banks survive in the event of a credit default. Unpaid loans were, are and will always be a by-product of conducting the banking business. Modern banks have realized this and are prepared to handle the situation without becoming insolvent until a catastrophic loss occurs.

(ii) Operational Risks

The Basel Committee on Banking Supervision (BCBS) defines operational Risk as "the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events". This definition excludes strategic and reputational risks but includes legal risks.



Banks have to conduct massive operations in order to be profitable. Economies of scale work in the favour of larger banks. Hence, maintaining consistent internal processes on such a large scale is an extremely difficult task. Operational Risk occurs as the result of a failed business processes in the bank's day-to-day activities. Examples of operational risk would include payments credited to the wrong account or executing an incorrect order while dealing in the markets. None of the departments in a bank are immune from Operational Risks. Operational Risks arise mainly because of hiring the wrong people or alternatively they could also occur if there is a breakdown of the information technology systems. A lapse in the internal processes being followed could also lead to catastrophic errors. For instance, Barings Bank ended up bankrupt because of its failure to implement appropriate internal controls. One trader was able to bet so much in the derivatives market that the equity of Barings Bank was wiped out and the bank simply ceased to exist.

(iii) Earnings at Risk

It is the amount of change in net income due to changes in interest rates over a specified period. It helps investors and risk professionals understand the impact that a change in interest rates can make on a company's financial position and cash flow.

(iv) Liquidity Risk

Is one type of liquidity risk of a financial institution that is generated by deposits with the defined maturity dates (then such deposits are called time or term deposits) or without the ones (then such deposits are called demand or non-maturity deposits).

(v) Deposit Risk

Is a risk of probable cash outflows from a financial institution that is caused by changes in depositors' behaviour. In its turn, it consists of early withdrawal or redemption risk, rollover risk and run risk.

- ✓ Early Withdrawal Risk of time deposits is a risk that a depositor withdraws his or her deposit from an account before the agreed-upon maturity date. It might occur when the corresponding option was declared in a deposit agreement or determined by local laws. When an early withdrawal is made, the depositor usually incurs an early withdrawal fee or penalty.
- ✓ Rollover Risk of time deposits is a risk that a depositor refuses to roll over his or her matured time deposit.
- ✓ Run Risk of non-maturity deposits is a risk that a depositor takes back money from his or her accounts at any time. Thus, a run risk has characters of both early withdrawal and rollover risks. For instance, it occurs when depositors expect a bank to fail. As a result, these risks might lead to dropping or even losing a liquidity of a financial institution if it cannot to attract new deposits instead of withdrawn ones. Wherein, the impossibility of the financial institution to refinance by borrowing in order to repay existing deposits is called a refinancing risk.



(vi) Bank Branches Risk

Conducting Branch Risk Assessments is an essential part of Risk Based Audit.

Risks in Bank Branch Management:

- (i) **Lack of Continuity:** Changes in the organization or development of new business lines may result in new activities even though existing ones are more effective.
- (ii) **Lack of Co-ordination:** Often, activities apply to multiple risks or commitments across functional lines. The inability to formally tie activities to risk or commitments hinders inter-functional coordination, resulting in business silos and duplication of effort.
- (iii) **Activity Fatigue:** Staff may ignore certain activities because of a lack of time to assess them.
- (iv) **Wasted Resources:** If a risk changes, most bank branches would have no way of knowing how (or even if) these changes will affect their resources and activities.
- (v) **Activity Obsolescence:** In a changing environment, there is no effective way to know when activities no longer apply.
- (vi) **Lack of Prioritization:** Picking activities to focus on is likely to be on an ad hoc basis and subject to the whims of current staff.

Why RBIA?

The evolvement of financial instruments and markets has enabled banks to undertake varied risk exposures. In the context of these developments and the progressive deregulation and liberalisation of the Indian financial sector, having in place effective risk management and internal control systems has become crucial to the conduct of banking business. This is also significant in view of introduction of the Basel Capital Accord under which capital maintained by a bank will be more closely aligned to the risks undertaken and Reserve Bank's move towards Risk-Based Supervision (RBS) of Banks. Under the RBS Approach, the supervisory process would seek to leverage the work done by internal auditors of banks.

To achieve the objectives, banks have to move towards risk-based internal audit which include, in addition to selective transaction testing, an evaluation of the risk management systems and control procedures prevailing in various areas of a bank's operations. The implementation of risk-based internal audit would mean that greater emphasis is placed on the internal auditor's role in mitigating risks. While focusing on effective risk management and controls, in addition to appropriate transaction testing, the risk-based internal audit would not only offer suggestions for mitigating current risks but also anticipate areas of potential risks and play an important role in protecting the bank from various risks.

Functions of the Risk Management Committee / Department (RMC/RMD) and the Role of Risk-Based Internal Audit need to be distinguished. The RMC / RMD focuses on areas such as identification, monitoring and measurement of risks, development of policies and procedures, use of risk management models, etc., The risk-based internal audit, on the other

hand, undertakes an independent risk assessment *solely for the purpose of formulating the risk-based audit plan* keeping in view the inherent business risks of an activity / location and the effectiveness of the control systems for monitoring the inherent risks of the business activity. It needs to be emphasized that while formulating the audit plan, every activity / location of the bank, including the risk management function, should be subjected to risk assessment by the risk-based internal audit.

(i) Advantages of RBIA:

The advantages of Risk-Based Approach of the Internal Audit Function in Banks are as follows:

- ✓ It appropriately defines the audit universe and identifies the auditable bank branches within the Bank for which these analyses would be carried out.
- ✓ It assists the management in identification of appropriate risk factors to reflect the managements concerns.
- ✓ It results in development of an appropriate format for evaluating risk factors so that the more important risk factors play a more prominent role in the risk assessment process than less important risk factors.
- ✓ It develops a combination rule for each branch, which will properly reflect its riskiness over several risk factors that have been identified and a method of setting up audit priorities for the bank branches.
- ✓ It results in appropriate audit coverage plan, which provides a roadmap for the management of internal audit staff skills so that they are available to carry out audits of appropriate scope when they are needed the most.

Risk-based internal audit results in a process-oriented audit with a risk management perspective, which gives advice to management on the steps to be taken for effective risk management on a bank-wide basis.

(ii) Applicability:

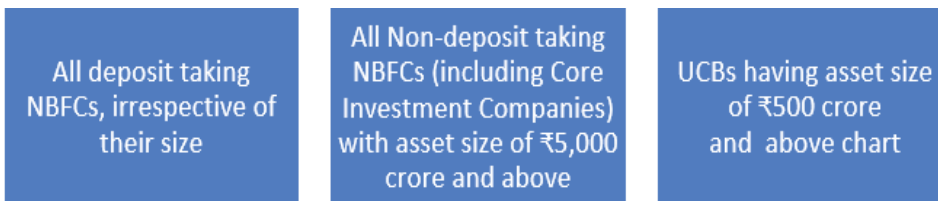
All Commercial Banks, Local Area Banks, Small Finance Banks, and Payment Banks have already implemented the Risk Based Internal Audit as mandated by Reserve Bank of India (RBI).

In recent times, Non-Banking Financial Companies (NBFCs) / Urban Co-operative Banks (UCBs) have grown in size and have become systemically important in the economy given their increased participation in the financial credit market. Just like banks, NBFCs and UCBs face similar risks by virtue of being engaged in financial intermediation activities, hence, it makes sense that their internal audit systems should also broadly align while keeping in mind the principle of proportionality.

To increase focus on the risk management function of NBFCs / UCBs, the RBI on 3rd February 2021 issued a Circular prescribing the requirement for Risk-Based Internal



Audit (RBIA Framework). The requirements prescribed under the Circular are to be implemented by **31st March 2022**. The said Circular is applicable for---



The framework for NBFCs and UCBs draws largely from the framework for Banks.

RBI on 11th June, 2021 has issued a circular stating "On a review, it has been decided that the provisions of Circular dated 3rd February, 2021 shall be applicable to all deposit taking HFCs, irrespective of their size and Non-deposit taking HFCs with asset size of ₹5,000 crore and above.

HFCs, as mentioned above, shall now be required to be undertake Risk Based Internal Audit and put in place RBIA framework by **June 30, 2022**.

(iii) RBIA: A Sub-set of Risk Management Framework:

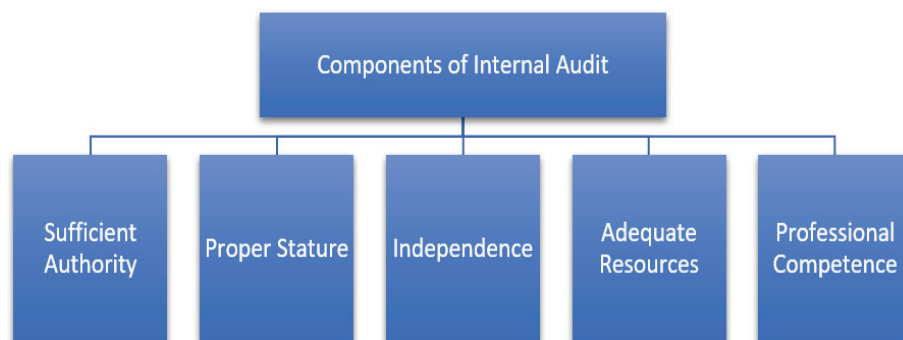
An essential characteristic of an effective RBIA Framework would be that it should be a connecting link between various components of Risk Management framework and should provide for reasonable assurance that organisation's internal controls, risk management, and governance related systems and processes are adequate to deal with risk faced by it.

The internal audit function should ideally be targeted towards contributing to the overall improvement of the organization's governance, risk management, and control processes using a systematic and disciplined approach.

RBI Circular provides that internal audit function is an integral part of Sound Corporate Governance and is considered as the third line of defence. The inference for different lines of defence for risk management may be drawn from the RBIA circular for Banks, which provides as follows:



Based on the recent developments and emerging trends, the focus areas for robust internal audit should ideally *inter-alia* the following components:



The Internal Audit function in NBFCs / UCBs has generally been concentrated on accounting requirements and regulatory compliance etc. However, considering the market developments, testing limited to these factors may not be sufficient. Therefore, the current framework includes, above aspects along with, an evaluation of the risk management systems and control procedures in various areas of operations. This will help in anticipating areas of potential risks and mitigating such risks.

The RBIA should be conducted based on a RBIA plan which is required to be formulated after considering the elements of risk management framework of the entity.

(iv) Actionable:

As mentioned above, reasonable amount of time is provided to NBFCs / UCBs to prepare for effective implementation of the RBIA Framework, that is, by 31st March 2022. However, though the requirements are to be complied by the end of the financial year 2021-2022 the preparedness for the same must be initiated immediately. Similarly, for HFCs the effective implementation date is June 30, 2022. A list of actionable on the part of NBFCs/UCBs/HFCs for reference are given below:

Immediate Actionable	Actionable upon implementation of the framework
• The circular is to be placed before next board meeting • Constitute a committee of senior executives with the responsibility of formulating a suitable action plan. • Formulation of suitable action plan • Regular reporting of progress periodically to the Board and senior management	• Formulate a board approved policy for the RBIA • Appoint Head of Internal Audit • Appoint requisite staff to undertake RBIA • Amend ToR of Audit committee to include consideration of RBIA report • A consolidated position of major risks faced by the organization shall be presented at least annually to the ACB/Board



Role and Responsibilities:

Basel Committee on Banking Supervision (BCBS) in its guidance note gave 18 principles for the implementation of RBIA. The principles are:

Objectives and tasks of the internal audit function

Principle 1

The bank's board of directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate and effective system of internal controls, a measurement system for assessing the various risks of the bank's activities, a system for relating risks to the bank's capital level, and appropriate methods for monitoring compliance with laws, regulations, and supervisory and internal policies.

Principle 2

The bank's senior management is responsible for developing processes that identify, measure, monitor and control risks incurred by the bank.

Principle 3

The internal audit function is part of the ongoing monitoring of the system of internal controls and of the bank's internal capital assessment procedure, because it provides an independent assessment of the adequacy of, and compliance with, the bank's established policies and procedures. As such, the internal audit function assists members of the organisation in the effective discharge of their responsibilities as described above.

Principles of internal audit Permanent Function – Continuity

Principle 4

Internal audit within a bank should be a permanent function. In fulfilling its duties and responsibilities, the senior management should take all necessary measures so that the bank can continuously rely on an adequate internal audit function appropriate to its size and to the nature of its operations. These measures include providing the appropriate resources and staffing to the internal audit department to achieve its objectives. Independent function

Principle 5

The bank's internal audit department must be independent of the activities audited. The department must also be independent from the every day internal control process. This means that the internal audit department is given an appropriate standing within the bank and carries out its assignments with objectivity and impartiality.

Audit charter

Principle 6

An audit charter guarantees the standing and authority of the internal audit department within the bank.

**Impartiality****Principle 7**

The internal audit department should be objective and impartial, which means it should be in a position to perform its assignments free from bias and interference.

Professional competence**Principle 8**

The professional competence of every internal auditor and of the internal audit department as a whole is essential for the proper functioning of the bank's internal audit function.

Scope of activity**Principle 9**

Every activity and every entity of the bank should fall within the scope of the internal audit.

The bank's internal capital assessment procedure**Principle 10**

Within the framework of the bank's internal capital assessment process, the bank's internal audit department should carry out regularly an independent review of the measurement system for assessing the various risks faced by the bank, the system developed by the bank to relate risk to the bank's capital level and the method established for monitoring compliance with internal capital policies.

Functioning of internal audit Working methods and types of audit**Principle 11**

Internal audit includes drawing up an audit plan, examining and assessing the available information, communicating the results, and following up recommendations and issues.

Management of the internal audit department**Principle 12**

The head of the internal audit department should be responsible for ensuring that the department complies with sound internal auditing principles.

Relationship of the supervisory authority with the internal audit department and with the external auditor. The relationship of the supervisory authority and the internal audit department**Principle 13**

The board of directors should ensure that senior management establishes an internal control system and a capital assessment procedure and reviews them at least once a year. At least



once a year, senior management should report to the board of directors on the scope and performance of the internal control system and of the capital assessment procedure. Bank supervisors can evaluate the work of the bank's internal audit department and, if satisfied, can rely on it to identify areas of potential risk.

Principle 14

Supervisory authorities should have periodic consultations with the bank's internal auditors to discuss the risk areas identified and the measures taken. At the same occasion, the extent of the collaboration between the bank's internal audit department and the bank's external auditors may also be discussed.

Principle 15

Supervisors are encouraged to arrange regular discussions of policy issues jointly with the chief internal auditors of the banks under their supervision.

The relationship of the internal auditors and the external auditors

Principle 16

Supervisory authorities should encourage consultation between internal and external auditors in order to make their cooperation as efficient and effective as possible.

The relationship between the supervisory authority and the external auditor

Principle 17

Work performed for a bank's supervisory authority by an external auditor should have a legal or contractual basis. Any task assigned by the supervisory authority to the external auditors should be complementary to his/her regular audit work and should be within his/her competence.

Cooperation among the supervisory authority, the external auditors and the internal auditors

Principle 18

Cooperation among the supervisor, the external auditor and the internal auditor aims to make the contributions of all concerned parties more efficient and effective in order to optimise supervision. The cooperation may be based on periodic meetings of the supervisor and the external and internal auditor.

These 18 principles form the basis of fulcrum, around which various nations can frame their RBIA Framework.

It is a well understood notion that to get a particular task done, a fixed responsibility centre should be set-up, this enables proper implementation and also increases the efficiency of the implementation. Considering the same RBI has prescribed for responsibilities of senior management, Board and Audit committee to ensure proper implementation of RBIA Framework. The allotted role and responsibilities shall be as follows----

**Board of Directors / ACB:**

The Board of Directors (the Board) / Audit Committee of Board (ACB) of NBFCs / UCBs shall have the primary responsibility of overseeing the internal audit function in the organization. The major responsibility of the Board and ACB would be to establish and further review the RBIA systems.

The RBIA policy is to be formulated with the approval of the Board and would be disseminated widely within the organization. The policy should be consistent with the size and nature of the business undertaken, the complexity of operations and should factor in the elements of internal audit. The ACB and Board would further review the performance of RBIA and shall also formulate and maintain a quality assurance and improvement program that covers all aspects of the internal audit function.

(v) Senior Management:

The senior management shall be responsible for implementation of the systems established by the board and ACB.

The senior management shall ensure adherence to the internal audit policy guidelines as approved by the Board and development of an effective internal control function that identifies, measures, monitors, and reports all risks faced. The senior management shall ensure audit reports is placed before the ACB / Board. Further, a consolidated position of major risks faced by the organization shall be presented at least annually to the ACB / Board, based on inputs from all forms of audit.

The senior management shall also be responsible for establishing a comprehensive and independent internal audit function that should promote accountability and transparency. It shall ensure that the RBIA Function is adequately staffed with skilled personnel of right aptitude and attitude who are periodically trained to update their knowledge, skill, and competencies.

(vi) Internal Audit Function: Major Elements:

The Internal Audit Department of a bank should be independent of the internal control process in order to avoid any conflict of interest and should be given an appropriate standing within the bank to carry out its assignments. Normally, the head of the internal audit department shall directly report to the Board of Directors / Audit Committee of the Board. The management should also ensure that the supervisory staff entrusted with the internal audit job should not be assigned the responsibility of performing other accounting or operational functions. RBI further said that the internal audit function should not be outsourced. However, where required, experts, including former employees, could be hired on a contractual basis subject to the Audit Committee of the Board of Directors (ACB) being assured that such expertise does not exist within the audit function of the bank. It has also said banks must ensure and demonstrate through proper documentation that their RBIA framework captures all the significant criteria /

principles suited for their organizational structure, the business model, and the risks.

The RBIA Framework broadly provides for a comprehensive internal audit function the major elements and their requirements are summarised as follows-

Authority, Stature, Independence and Resources	• The internal audit function must have sufficient authority, stature, independence and resources to carry-out their responsibilities effectively • Head of Internal Audit (HIA) shall be a senior executive with the ability to exercise independent judgement • HIA and functionaries shall have access to all records that are necessary to carry out the entrusted responsibilities
Competence	• The Internal auditor shall have Requisite professional competence, knowledge and experience
Rotation of Staff	• The staff conducting internal audit shall be rotated on a regular basis as per the prescription of Board
Tenor for appointment of Head of Internal Audit	• The HIA shall be appointed for reasonably long period, preferably for a minimum of three years
Reporting Line	• The HIA shall directly report to either the ACB/Board/MD & CEO or to the Whole Time Director (WTD) • The ACB/Board shall meet the HIA at least once in a quarter, without the presence of the senior management (including the MD & CEO/WTD). • The HIA shall not have any reporting relationship with the business verticals of these SEs and shall not be given any business targets.
Remuneration	• The remuneration policies should be structured in a way to avoid creating conflict of interest and compromising audit's independence and objectivity.

Risk Matrix:

A risk matrix is a matrix that is used during risk assessment to define the level of risk by considering the category of probability or likelihood as against the category of consequence severity. This is a simple mechanism to increase visibility of risks and assist in management decision making.

RBI Circular requires that the RBIA function should consider risk matrix while setting up action plan. Further, certain risk mentioned shall be given enhanced attention during the RBIA, the matrix and areas of focus are marked red in graph below —

Severity / Magnitude				
Probability / Likelihood		High	Medium	Low
	High			
	Medium			
	Low			

i. Assessment of Risk:

Risk Assessment can be defined as the “Overall Process of Risk Analysis and Risk Evaluation”. Risk assessment has also been defined as “Identification and Analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risk should be managed”. Risk Assessment has three processes viz. risk identification, risk estimation and risk evaluation. The objective of the risk assessment process is to draw up a risk-matrix, taking into account both the factors viz, inherent business risks and control risks. The risk matrix appropriately places all the auditable bank branches or offices into one among the Three Categories of risk profiles-High, Medium or Low. The Risk Assessment process includes the following:

- Determine the vulnerability of each activity undertaken by Business Unit (B / U).
- Identification of inherent business risks in various activities undertaken by the B / U.
- Evaluation of the effectiveness of the control systems for monitoring the inherent risks of the business activities (‘Control Risk’).
- Drawing up a risk-matrix for taking into account both the factors viz., inherent business risks and control risks. Once the risk matrix is prepared, a risk-based audit plan based on the risk profile of the BUs is prepared. This involves decision to be taken on the frequency, timing and the scope of the internal audit of the auditable BUs. These decisions are based on the internal audit priorities and keeping in view the objective of internal audit function as a risk management tool. The risk-based internal audit plan as prepared by the internal audit function of the Bank is duly approved by the Chairman / Audit Committee of the Board of Directors of the Bank.



The Banks may prepare a Risk Audit Matrix as shown below:

Risk Audit Matrix

Magnitude of Risk (M) ↑	High	High M Low F	High M Medium F	High M High F
	Medium	Medium M Low F	Medium M Medium F	Medium M High F
	Low	Low M Low F	Low M Medium F	Low M High F
		Low	Medium	High

Frequency of Risk (M) →

The Audit Plan should prioritize audit work to give greater attention to the areas of:

- ✓ High Magnitude and high frequency.
- ✓ High Magnitude and medium frequency.
- ✓ Medium magnitude and high frequency.
- ✓ High magnitude and low frequency.
- ✓ Medium Magnitude and medium frequency.

The precise scope of risk-based internal audit must be determined by each bank for low, medium, high, very high and extremely high-risk areas. However, at the minimum, it must review/report on:

- ✓ Process by which risks are identified and managed in various areas.
- ✓ The control environment in various areas.
- ✓ Gaps, if any, in control mechanism which might lead to frauds, identification of fraud prone areas.
- ✓ Data Integrity, Reliability and Integrity of MIS.
- ✓ Internal, Regulatory and Statutory Compliance.
- ✓ Budgetary Control and Performance Reviews.
- ✓ Transaction testing / verification of assets to the extent considered necessary monitoring compliance with the risk-based internal audit report variation, if any, in the assessment of risks under the audit plan vis-à-vis the risk based internal audit.

The scope of risk-based internal audit should also include a review of the systems in place for ensuring compliance with money laundering controls; identifying potential inherent business risks and control risks, if any; suggesting various corrective measures and undertaking follow up reviews to monitor the action taken thereon.

The risk-based internal audit undertakes risk assessment solely for the purpose of formulating the risk-based audit plan. The risk assessment would, as an independent activity, cover risks at various levels (corporate and branch; the portfolio and individual transactions, etc.) as also the processes in place to identify, measure, monitor and control the risks. The internal audit department should devise the risk assessment methodology, with the approval of the Board of Directors, keeping in view the size and complexity of the business undertaken by the bank.

The Risk Assessment Process should, inter alia, include the following:

- ✓ Identification of inherent business risks in various activities undertaken by the bank.
- ✓ Evaluation of the effectiveness of the control systems for monitoring the inherent risks of the business activities ('Control risk').
- ✓ Drawing up a risk-matrix for taking into account both the factors viz., inherent business risks and control risks.

The basis for determination of the level (High, Medium, Low) and trend (Increasing, Stable, Decreasing) of inherent business risks and control risks should be clearly spelt out.

The risk assessment may make use of both quantitative and qualitative approaches. While the quantum of credit, market, and operational risks could largely be determined by quantitative assessment, the qualitative approach may be adopted for assessing the quality of controls in various business activities. In order to focus attention on areas of greater risk to the bank, an activity-wise and location-wise identification of risk should be undertaken.

The risk assessment methodology should include, inter alia, the following parameters:

- ✓ Previous internal audit reports and compliance.
- ✓ Proposed changes in business lines or change in focus.
- ✓ Significant change in management / key personnel.
- ✓ Results of latest regulatory examination report.
- ✓ Reports of external auditors.
- ✓ Industry trends and other environmental factors.
- ✓ Time elapsed since last audit.
- ✓ Volume of business and complexity of activities.
- ✓ Substantial performance variations from the budget.



For the risk assessment to be accurate, it will be necessary to have in place proper MIS and data integrity. The internal audit function should be kept informed of all developments such as introduction of new products, changes in reporting lines, changes in accounting practices/policies etc. The risk assessment should invariably be undertaken on a yearly basis. The assessment should also be periodically updated to take into account changes in business environment, activities and work processes, etc.

Risk Matrix				
Inherent Business Risks ↑	High	A High Risk	B Very High Risk	C Extremely High Risk
	Medium	D Medium Risk	E High Risk	F Very High Risk
	Low	G Low Risk	H Medium Risk	I High Risk
		Low	Medium	High
Control Risks →				

Inherent business risks indicate the intrinsic risk in a particular area / activity of the bank and could be grouped into low, medium and high categories depending on the severity of risk. Control risks arise out of inadequate control systems, deficiencies / gaps and / or likely failures in the existing control processes. The control risks could also be classified into low, medium and high categories.

In the overall risk assessment both the inherent business risks and control risks should be factored in. The overall risk assessment as reflected in each cell of the risk matrix is explained below:

A-High Risk: Although the control risk is low, this is a High-Risk area due to high inherent business risks.

B-Very High Risk: The high inherent business risk coupled with medium control risk makes this a Very High-Risk area.

C-Extremely High Risk: Both the inherent business risk and control risk are high which makes this an Extremely High-Risk area. This area would require immediate audit attention, maximum allocation of audit resources besides ongoing monitoring by the bank's top management.

D-Medium Risk: Although the control risk is low this is a Medium Risk area due to medium inherent business risks.

E-High Risk: Although the inherent business risk is medium this is a High-Risk area because of control risk also being medium.



F-Very High Risk: Although the inherent business risk is medium, this is a Very High-Risk area due to high control risk.

G-Low Risk: Both the inherent business risk and control risk are low.

H-Medium Risk: The inherent business risk is low and the control risk is medium.

I-High Risk: Although the inherent business risk is low, due to high control risk this becomes a High-Risk area.

The banks should also analyse the inherent business risks and control risks with a view to assess whether these are showing a stable, increasing or decreasing trend. Illustratively, if an area falls within cell 'B' or 'F' of the Risk Matrix and the risks are showing an increasing trend, these areas would also require immediate audit attention, maximum allocation of audit resources besides ongoing monitoring by the bank's top management (as applicable for cell 'C'). The Risk Matrix should be prepared for each business activity / location.

All banks need to put in place an independent risk assessment system in the internal audit department for focusing on the material risk areas and prioritizing the audit work. The methodology may range from a simple analysis of why certain areas should be audited more frequently than others in the case of small sized banks undertaking traditional banking business, to more sophisticated assessment systems in large sized banks undertaking complex business activities.

ii. **Audit Plan:**

The annual audit plan, approved by the Board, should include the schedule and the rationale for audit work planned. It should also include all risk areas and their prioritisation based on the level and direction of risk. Illustratively, the areas or activities identified as high, very high or extremely high risk (based on risk matrix) may be audited at shorter intervals as compared to medium or low risk areas, which may be audited at longer intervals subject to regulatory guidelines, as applicable.

- a. **Scope:** The primary focus of risk-based internal audit will be to provide reasonable assurance to the Board and top management about the adequacy and effectiveness of the risk management and control framework in the banks' operations. While examining the effectiveness of control framework, the risk-based internal audit should report on proper recording and reporting of major exceptions and excesses. Transaction testing would continue to remain an essential aspect of risk-based internal audit. The extent of transaction testing will have to be determined based on the risk assessment.

Illustratively, the bank should undertake 100 per cent transaction testing if an area falls in cell "C-Extremely High Risk" of the risk matrix. The bank may also consider 100 per cent transaction testing if an area falls in cell "B-Very High Risk" or "F-Very High Risk", and the risks are showing an increasing trend. The banks may also consider transaction testing with an element of surprise in respect of low-risk areas which would be audited at relatively longer intervals.



Accordingly, every bank has to put in place a risk based internal audit policy developed under Board approved internal audit policy, that focuses on risk identification, prioritization of audit areas and allocation of audit resources in accordance with the risk assessment instead of full-scale transaction testing. However, transaction testing would continue to remain an essential aspect of risk-based internal audit and it should include the same in its report of major exceptions and excesses. The extent of transaction testing will have to be determined based on the risk assessment.

In some cases where an area falls in cell "C-Extremely High Risk" or cell "B-very high risk" or cell "F-Very high risk" of the risk matrix formulated by the regulator, banks may consider 100 percent transaction testing. Further, the policy guidance on audit function shall include the risk assessment methodology for identifying the risk areas based on which the audit plan would be formulated. The methodology may range from a simple analysis of why certain areas should be audited more frequently than others in the case of small sized banks undertaking traditional banking business, to more sophisticated assessment systems in large sized banks undertaking complex business activities. The banks may also consider transaction-testing with an element of surprise in respect of low-risk areas which would be audited at relatively longer intervals. The approved policy needs to lay down the maximum time period beyond which even the low-risk business activities / locations should not remain unaudited.

- b. **Communication:** The communication channels between the risk-based internal audit staff and management should encourage reporting of negative and sensitive findings. All serious deficiencies should be reported to the appropriate level of management as soon as they are identified. Significant issues posing a threat to the bank's business should be promptly brought to the notice of the Board of Directors, Audit Committee or top management, as appropriate.
- c. **Performance Evaluation:** The Internal Audit Department should conduct periodical reviews, annually or more frequently, of the risk-based internal audit undertaken by it vis-à-vis the approved audit plan. The performance review should also include an evaluation of the effectiveness of risk-based internal audit in mitigating identified risks.

The Board of Directors / Audit Committee of Board should periodically assess the performance of the risk-based internal audit for reliability, accuracy and objectivity. Variations, if any, in the risk profile as revealed by the risk-based internal audit vis-à-vis the risk profile as documented in the audit plan should also be looked into to evaluate the reasonableness of risk assessment methodology of the Internal Audit Department.

- d. **Audit Resources:** The Internal Audit Department should be provided with appropriate resources and staff to achieve its objectives under the risk-based internal audit system. The staff possessing the requisite skills should be assigned the job of undertaking risk-based internal audit. They should also be trained periodically



to enable them to understand the bank's business activities, operating procedures, risk management and control systems, MIS, etc.

- e. **Outsourced Internal Audit Arrangements:** The internal audit function cannot be outsourced. However, where required, experts including former employees can be hired on a contractual basis subject to the ACB / Board being assured that such expertise does not exist within the audit function of the NBFC / UCB. Any conflict of interest in such matters shall be recognised and effectively addressed.

However, where required, experts, including former employees, could be hired on contractual basis subject to the ACB being assured that such expertise does not exist within the audit function of the bank. Any conflict of interest in such matters shall be recognised and effectively addressed. Ownership of audit reports in all cases shall rest with regular functionaries of the internal audit function.

The Board of Directors and top management are responsible for ensuring that the risk-based internal audit continues to function effectively even though some of the areas is outsourced. The following aspects may, inter-alia, be kept in view to prevent any risk of breakdown in internal controls on account of outsourcing arrangements:

- i. Before entering into an outsourcing arrangement for risk-based internal audit, the bank should perform due diligence to satisfy itself that the outsourcing vendor has the necessary expertise to undertake the contracted work. The contract, in writing, should at the minimum, specify the following:
 - ✓ The scope and frequency of work to be performed by the vendor.
 - ✓ The manner and frequency of reporting to the bank the manner of determining the cost of damages arising from errors, omissions and negligence on the part of the vendor.
 - ✓ The arrangements for incorporation of changes in the terms of contract, should the need arise.
 - ✓ The locations where the work papers will be stored.
 - ✓ The internal audit reports are the property of the bank and that all work papers are to be provided to the bank when required.
 - ✓ The employees authorized by the bank are to have reasonable and timely access to the work papers.
 - ✓ The supervisors are to be granted immediate and full access to related work papers.
- ii. The management should continue to satisfy itself that the outsourced activity is being competently managed.
- iii. All work done by the vendor should be documented and reported to the top management through the internal audit department.

- iv. To avoid significant operational risk that may arise on account of a sudden termination of the outsourcing arrangement, the bank should have in place a contingency plan to mitigate any discontinuity in audit coverage.

Risk-based internal audit is expected to be an aid to the ongoing risk management in banks by providing necessary checks and balances in the system. However, since risk-based internal audit will be a fairly a vital exercise for most of the Indian banks, a gradual but effective approach would be necessary for its implementation. Initially the risk-based internal audit may be used as a management / audit tool in addition to the existing internal audit / inspection. Once the risk-based internal audit stabilizes and the staff attains proficiency, it should replace the existing internal audit / inspection.

f. **Monitoring and Follow-up:**

Monitoring and follow-up actions form an integral part of entire internal control system to ensure effective functioning of the procedures. Accordingly, the process as well as findings under the RBIA Framework should be regularly monitored. The said responsibility lies with the Board and Senior Management, as discussed above.

Information Systems Audit (IS Audit) – Risk Based Approach:

Banks should form a Task Force of senior executives and entrust them with the responsibility to chalk out an action plan for switching over to risk-based internal audit, identifying and addressing transitional and change management issues, implementing the plan and monitoring the progress during the transitional period and report to the Board of Directors, periodically.

Banks are expected to re-orient their approach, in line with the evolving best practices, as a part of their overall Governance and Internal Control framework. Banks are encouraged to adopt the International Internal Audit standards, like those issued by the Basel Committee on Banking Supervision (BCBS) and the Institute of Internal Auditors (IIA).

To bring uniformity in approach followed by the banks, as also to align the expectations on Internal Audit Function with the best practices, banks are to following are the regulatory guidelines as under:

- a) **Authority, Stature and Independence:** The internal audit function must have sufficient authority, stature, independence and resources within the bank, thereby enabling internal auditors to carry out their assignments with objectivity. Accordingly, the Head of Internal Audit (HIA) shall be a senior executive of the bank who shall have the ability to exercise independent judgement. The HIA as well as the internal audit function shall have the authority to communicate with any staff member and have access to all records or files that are necessary to carry out the entrusted responsibilities.
- b) **Policy for Risk-Based Internal Audit:** Under risk-based internal audit, the focus will shift to full-scale transaction testing to risk identification, prioritization of audit areas and allocation of audit resources in accordance with the risk assessment. Banks will,



therefore, need to develop a well-defined policy, duly approved by the Board, for undertaking risk-based internal audit. The policy should include the risk assessment methodology for identifying the risk areas based on which the audit plan would be formulated. The policy should also lay down the maximum time period beyond which even the low-risk business activities/locations should not remain unaudited.

- c) **Functional Independence:** The Internal Audit Department should be independent from the internal control process in order to avoid any conflict of interest and should be given an appropriate standing within the bank to carry out its assignments. It should not be assigned the responsibility of performing other accounting or operational functions. The management should ensure that the internal audit staff perform their duties with objectivity and impartiality. Normally, the internal audit head should report to the Board of Directors / Audit Committee of the Board.

The Board of Directors and top management will be responsible for having in place an effective risk-based internal audit system and ensure that its importance is understood throughout the bank. The success of internal audit function depends largely on the extent of reliance placed on it by the management for guiding the bank's operations.

- d) **Competence:** Requisite professional competence, knowledge and experience of each internal auditor is essential for the effectiveness of the bank's internal audit function. The desired areas of knowledge and experience may include banking operations, accounting, information technology, data analytics and forensic investigation, among others. Banks should ensure that internal audit function has the requisite skills to audit all areas of the bank.
- e) **Staff Rotation:** Except for the entities where the internal audit function is a specialised function and managed by career internal auditors, the Board should prescribe a minimum period of service for staff in the Internal Audit function. The Board may also examine the feasibility of prescribing at least one stint of service in the internal audit function for those staff possessing specialized knowledge useful for the audit function, but who are posted in other departments, so as to have adequate skills for the staff in the Internal Audit function.
- f) **Tenor for appointment of Head of Internal Audit:** Except for the entities where the internal audit function is a specialised function and managed by career internal auditors, the HIA shall be appointed for a reasonably long period, preferably for a minimum of three years.
- g) **Reporting Line:** The HIA shall directly report to either the Audit Committee of the Board (ACB)/ MD & CEO or Whole Time Director (WTD). Should the Board of Directors decide to allow the MD & CEO or a WTD to be the 'reporting authority' of the HIA, then the 'reviewing authority' shall be with the ACB and the 'Accepting Authority' shall be with the Board in matters of performance appraisal of the HIA. Further, in such cases, the ACB shall meet the HIA at least once in a quarter, without the presence of the senior management, including the MD & CEO / WTD. The HIA shall not have any reporting

relationship with the business verticals of the bank and shall not be given any business targets. In foreign banks operating in India as bank branches, the HIA shall report to the internal audit function in the controlling office / head office.

- h) **Remuneration:** The independence and objectivity of the internal audit function could be undermined if the remuneration of internal audit staff is linked to the financial performance of the business lines for which they exercise audit responsibilities. Thus, the remuneration policies should be structured in a way that it avoids creating conflict of interest and compromising audit's independence and objectivity.

The evolvement of financial instruments and markets has enabled banks to undertake varied risk exposures. In the context of these developments and the progressive deregulation and liberalisation of the Indian financial sector, having in place effective risk management and internal control systems has become crucial to the conduct of banking business. This is also significant in view of Basel Capital Accord under which capital maintained by a bank will be more closely aligned to the risks undertaken and Reserve Bank's guidelines move towards risk-based supervision (RBS) of banks. Under the proposed RBS approach, the supervisory process would seek to leverage the work done by internal auditors of banks.

A sound internal audit function plays an important role in contributing to the effectiveness of the internal control system. The audit function should provide high quality counsel to management on the effectiveness of risk management and internal controls including regulatory compliance by the bank. Historically, the internal audit system in banks has been concentrating on transaction testing, testing of accuracy and reliability of accounting records and financial reports, integrity, reliability and timeliness of control reports, and adherence to legal and regulatory requirements. However, in the changing scenario such testing by itself would not be sufficient. There is a need for widening as well as redirecting the scope of internal audit to evaluate the adequacy and effectiveness of risk management procedures and internal control systems in the banks.

Banks must ensure and demonstrate through proper documentation that their risk-based internal audit framework captures all the significant criteria / principles suited for their organisational structure, the business model and the risks.

Recently, vide circular DoS.CO.PPG. /SEC.04/11.01.005/2020-21 dated January 07, 2021, RBI asked banks to align their internal audit function with international best practices, like those issued by the Basel Committee on Banking Supervision (BCBS). The above direction of the central bank was in view of the changing scenario such testing by itself would not be sufficient. 'There is a need for widening as well as redirecting the scope of internal audit to evaluate the adequacy and effectiveness of risk management procedures and internal control systems in the banks', it said.

To bring uniformity in approach followed by the banks, as also to align the expectations on internal audit function with the best practices, RBI has advised them certain norms on 'Authority, Stature and Independence', 'Competence', 'Staff Rotation', 'Tenor for Appointment of the Head of Internal Audit', 'Reporting Line' and 'Remuneration'.

Credit management in simple words is the process of monitoring and collecting payments from the borrowers. A specialized credit management system eases the amount of capital tied up with debtors.

The principles of credit management revolve mainly around the concepts of Safety, Liquidity, Diversity, and Profitability. The banks all over the world examine following details with care before acceding to a loan request.

Safety means that the borrower must be in a position to repay the loan and interest at regular interval as per sanction terms. The repayment of the loan relies on the nature of security and the potential of the borrower to repay the loan. The prime security can be hypothecation/pledge of stock, book debts or other assets created out of bank finance. Bank may insist for a charge on immovable property as a collateral security in addition to prime security and a third-party guarantee (which is also treated as security to bank finance). The main concern is that security available to the bank should be good enough to fall back upon in the event of adverse circumstances. The value of security accepted should be steady and easy to ascertain. All precaution to be taken while accepting the immovable property as security that the security offered has a clear marketable title. It is also inevitable to ascertain and confirm through legal opinion from an experienced advocate so that bank could easily take possession of such security with very little expenses and dispose-off the same to recover its dues when the account goes bad.

Liquidity plays a paramount role when a bank lends the money. Generally, banks give money for short duration of time. This is because banks are dealing with depositors' money. This money can be withdrawn by the depositor at any point of time. Therefore, banks should ensure that it has sufficient funds to satisfy both maturing short-term liabilities and sudden withdrawal of demand deposits or time deposits before maturity. Hence, it is very important to have good credit management practices for efficient cash flow.

Commercial Banks should abide by the principle of diversity while lending. It should never allow all its funds to flow to a specific sector or type of advances. Concentration on specific industrial or service sectors can indeed become a major problem to the banks when that business is passing through bad times with wide-spread sickness.

Profitability is another important objective of the credit management. A bank should only invest (lend) if it earns sufficient profits from it. Thus, it should, invest in such assets (loans and advances) that have a fair and stable return on the funds invested.



Credit Risk Management Policy of Banks:

The Board of Directors of each bank shall be responsible for approving and periodically reviewing the credit risk strategy and significant credit risk policies.

Credit Risk Policy:

- Every bank should have a credit risk policy document approved by the Board. The document should include risk identification, risk measurement, risk grading/ aggregation techniques, reporting and risk control/ mitigation techniques, documentation, legal issues and management of problem loans.
- Credit risk policies should also define target markets, risk acceptance criteria, credit approval authority, credit origination/ maintenance procedures and guidelines for portfolio management.
- The credit risk policies approved by the Board should be communicated to branches/ controlling offices. All dealing officials should clearly understand the bank's approach for credit sanction and should be held accountable for complying with established policies and procedures.
- Senior management of a bank shall be responsible for implementing the credit risk policy approved by the Board.

Credit Risk Strategy:

- Each bank should develop, with the approval of its Board, its own credit risk strategy or plan that establishes the objectives guiding the bank's credit-granting activities and adopt necessary policies / procedures for conducting such activities. This strategy should spell out clearly the organisation's credit appetite and the acceptable level of risk-reward trade-off for its activities.
- The strategy would, therefore, include a statement of the bank's willingness to grant loans based on the type of economic activity, geographical location, currency, market, maturity and anticipated profitability. This would necessarily translate into the identification of target markets and business sectors, preferred levels of diversification and concentration, the cost of capital in granting credit and the cost of bad debts.
- The credit risk strategy should provide continuity in approach as also take into account the cyclical aspects of the economy and the resulting shifts in the composition/ quality of the overall credit portfolio. This strategy should be viable in the long run and through various credit cycles.
- Senior management of a bank shall be responsible for implementing the credit risk strategy approved by the Board.

Credit Process / Products in Banks:

The credit process in banks is divided into TWO components viz. Pre-sanction process and post-sanction process. For designating the Bank's functionaries to carry out the functions in the two processes, the pre- and post-sanction function are treated as distinct processes. For



quick decision making in sanctions, selectively some of the line functionaries are delayed, i.e., they are not required to handle sanction related functions. However, there is not such layering in the handling of post-sanction functions.

a) **Stages in Credit Process:**

To prescribe to the functionaries at the Bank Branches / Controlling offices appropriate role in credit process the pre and post sanction process are further categorized into three stages each as mentioned below:

Pre-sanction Process: - Appraisal & Recommendation

- Assessment
- Sanction

Post-sanction Process: - Follow-up

- Supervision
- Monitoring & Control

The second stage in the pre-sanction process viz. 'Assessment' refers to Risk Management of credit exposure and not merely the quantitative assessment of an exposure.

b) **Different Types / Forms of Credit facilities in Banks:**

Fund-based Facilities:

- o Demand Loan.
- o Cash Credit.
- o Overdraft.
- o Term Loan.
- o Bill Financing.

Non-fund-based Facilities:

- o Letters of Credit and its Variants.
- o Bank Guarantees including Deferred Payment Guarantees (DPGs).

Fund Based Products of Banks:

The different types of fund-based credit facilities made available by the Bank and security therefor are given below:

i. **Demand Loans:**

Demand loans may be granted against:

- Any of the types of security enumerated under 'Overdrafts', except without security.
- Pledge of Gold Ornaments.



- Against Own Fixed Deposits, NSCs.
- Pledge of other goods or produce or documents of title thereto (including warehouse receipt).
- Debentures or fully paid shares of Limited Liability Companies.
- Immovable property or documents of title thereto.
- Units of Mutual Funds / Units of UTI.

A demand loan account is an advance for a fixed amount and no debits to the account may be made subsequent to the initial advance except for interest, insurance Premium and other sundry charges. As an amount credited to a loan account in reduction of the borrower's liability to the Bank has the effect of permanently reducing the original advance, any further drawings permitted on the account are not secured by the demand promissory note deposited to cover the original loan. A fresh loan account must, therefore, be opened for every new advance granted and a new demand promissory note taken as security.

Both in the case of demand loans granted against the personal liability of the borrowers alone, and demand loans against the personal liability of the borrowers jointly with co-obligants, demand promissory notes on the Bank's standard forms, as applicable, will be taken. In the latter case, the notes will be made by the borrowers in favour of the co-obligants and endorsed by the latter to the Bank, and must be delivered to the Bank with a delivery letter on the Bank's standard form, signed by both the borrowers and the co-obligants. The stamp duty applicable on demand promissory notes will be as per the extant statutory provisions.

Under the Limitation Act, the holder of a demand promissory note may sue upon it up to three years from the date of the execution, provided it is not accompanied by any writing restraining or postponing the right to sue. In order to obviate the possibility of the Bank's rights against the parties to demand promissory notes becoming time-barred, every such note must be diarized for renewal well ahead and should then be renewed if the loan is still current.

With the exception of demand loans to banks, existing demand loans must be liquidated when further loans are granted against the same security. Thus, if the advance value of a borrower's security is ₹10,000/- and he wishes his existing loan of ₹5,000/- to be increased to ₹7,000/- a new demand loan account must be opened for ₹7,000/- out of which the amount of the old loan, plus any interest due thereon, will be liquidated and the balance paid to the borrower.

A separate account for each demand loan will be kept in the appropriate demand loan ledger in Core Banking System (CBS). The Amount of the demand promissory note, the name, designation and address of the borrower (and of the co-obligants, if any), the rate of interest to be charged and a full description of the security, and the margin to be maintained must be entered in CBS.

Interest on demand loans will be charged at rates advised by the Bank, subject to a minimum charge of interest for seven days, except in the case of loans granted to banks where the minimum charge of interest need be for one day only.

**ii. Cash Credits:**

Cash credit may be given against----

- Pledge of goods or produce or documents of title thereto.
- Pledge of goods or produce or documents of title thereto, with the additional security of demand promissory notes bearing two or more names.
- Hypothecation of stocks of goods or produce (sometimes supported by hypothecation of other assets).
- Debentures or fully paid shares of limited liability companies, or
- Immovable property or documents of title thereto.
- Hypothecation of book debts and other assets.

A cash credit account is a drawing account against credit granted by the Bank and is operated in exactly the same manner as a current account on which an overdraft has been sanctioned. The distinction between an overdraft and a cash credit advance is that the nature of the security against which the latter is granted necessitates certain documents being taken in evidence of an agreement between the borrowers (and guarantors, if any) and the Bank.

When the advance is secured by the pledge or hypothecation of goods or produce, the security may change from time to time according to the borrower's business requirements. However, banks should ensure that the balance outstanding in the account is always fully covered by the value of security, with the stipulated margin.

Where loans are given for seasonal operations, those must be repaid on completion of the purpose for which they were given; borrowings on cash credit accounts must ordinarily be cleared at the end of the season for which they were allowed and the accounts should not be overdrawn again until the next season begins. Bank Branches must take utmost care that cash credit accounts do not run block, i.e., remain permanently overdrawn to their limit regardless of the season and current market conditions.

iii. Overdrafts:

Overdrafts may be granted against----

- Government or other securities as per Delegation of Financial Powers of the Bank.
- Debentures or other securities of certain district boards, municipalities, port trusts and improvement trusts.
- Debentures and fully paid shares of limited liability companies.
- Fully paid shares and debentures of public corporations other than companies with limited liability.
- The Bank's own deposits.



- The surrender value of life insurance policies.
- Gold Deposit Certificates, or
- Other securities advised by the Bank from time to time.

Overdrafts without security or against any security not listed above may also be granted to constituents by Managers to the extent of their discretionary powers laid down in the 'Delegation of Financial Powers'.

iv. Term Loans:

The types of term assistance extended by the Bank can be broadly classified into ----

- (i) Term Loans for acquiring Fixed Assets (Movable and Non-movable).
- (ii) Term Loans (including foreign currency loans).
- (iii) Deferred Payment Guarantees (DPGs).
- (iv) Underwriting of Shares / Debentures.

The salient features of term loans are given below:

A term loan is an advance, usually against security of the borrowers' fixed assets, for a fixed period to a business or an industrial undertaking whether an individual, firm, company or co-operative society and may be drawn by the borrower either in a lump sum or in instalments. A term loan may be granted for any period in excess of three years but normally not exceeding seven years for the purpose of acquisition of fixed assets, viz., land, buildings and plant and machinery for setting up new industrial units or expansion or modernization of existing undertakings.

While loans with deferred payment period up to three years will be termed as short-term loans (STLs), loans with maturity exceeding three years but up to seven years will be termed as medium-term loans (MTLs) and those with longer maturity will be known as long term loans or simply term loans (TLs).

v. Bills Financing (Discounted and Purchased):

The following types of bills may be discounted or purchased----

Discount of local or inland bills of exchange or promissory notes, whether clean or documentary, the currency of tenure not exceeding six months at the time of discount or fifteen months if drawn for the purpose of financing seasonal agricultural operations, or purchase of inland demand drafts, whether clean or documentary.

Short-term credit bills arising from normal trade transactions of regular customers of the Bank be discounted and finance against receivables be provided to the seller by discounting the usance bills / promissory notes. The document of title to goods becomes the security for such discounted bills.

Under a contract for sale of machinery on deferred payment basis, payment for sale may involve:

- A down payment being insisted upon by seller - say, 10% at the time of signing the contract and another 10% at the time of delivery of machinery; and
- The balance, say 80% being permitted to be paid in convenient half-yearly or yearly instalments over a period of time, ordinarily 3 to 5 years.

These instalments constitute the deferred receivables of the seller who draws a series of usance bills with graded maturities to coincide with the due dates of payment of the relative instalments together with a finance charge, being interest on the payments so deferred. The usance bills drawn by the seller will be accepted by the buyer before they are discounted by the seller's bankers. Alternatively, usance promissory notes may be made out by the buyer payable to the seller or order. With a view to ensuring prompt payment of the deferred instalments, the seller insists on the buyer furnishing an acceptable guarantee by a commercial bank / financial institution.

By discounting the usance bills / notes offered by the seller arising from his sale of machinery on deferred payment basis, the Bank lays down funds which will be repaid only over a period of time when the buyer pays the scheduled instalments by retiring the usance bills / notes on their respective due dates. Thus, from the point of view of the extended period and source of repayment, a usance bills / notes discounting facility is similar to a term loan. However, from the point of view of the risk to be assumed by the Bank, the position is different. Since all such usance bills / notes are required to be guaranteed by an approved commercial bank / financial institution, the primary risk inherent in the transaction will be borne by the bank / institution which executes the requisite deferred payment guarantee on behalf of the buyer.

Although the usance bills / notes to be discounted on behalf of the seller will be fully secured by a deferred payment guarantee executed by an approved bank / institution, the importance of an evaluation of the credit risk from the seller's angle is not to be lost sight of.

Non-Fund Based Products of Banks:

Bank guarantees including deferred payment guarantees, letters of credit, or its variants e.g., stand-by LC, letters of comfort, etc. are the different forms of non-fund-based credit facilities extended by the Bank. Guarantees and letters of credit issued by the Bank constitute part of its contingent liabilities. In respect of these facilities, though it does not have to lay out funds immediately, commitments thereunder contain inherent risks inasmuch as if the customers do not meet the related obligations when due, the Bank has to meet them and the concerned commitments would turn into fund-based exposures. Further, capital adequacy norms are applicable to non-fund-based business and involve a cost to the Bank.

i. Letters of Credit:

A letter of credit (LC) is defined as "An arrangement whereby a Bank (Issuing Bank), acting at the request of and on the instructions of customer (Applicant) is to make payment to or to

the order of a third party (Beneficiary) or it is to pay, accept or negotiate bills of exchange (Drafts) drawn by the beneficiary or authorize another Bank (Negotiating Bank) to effect such payments or to pay, accept or negotiate such bills of exchange (drafts) against stipulated documents, provided the terms and conditions of the credit are fully complied with".

All transactions relating to foreign letters of credit are governed by----

- a) Exchange control regulations framed by RBI under Foreign Exchange Management Act (FEMA).
- b) Rules framed by FEDAI.
- c) Uniform Customs and Practices for Documentary Credit (UCPDC) framed by International Chamber of Commerce (ICC Brochure 600).

I. Advantages of Letters of Credit: Letters of Credit offer the following benefits to the applicant and the beneficiary:

- 1. To the seller / exporter / beneficiary.
 - a. Payment for the goods / machinery supplied is assured, provided the terms and conditions stipulated in the LC are complied with.
 - b. Immediate payment is made after dispatch of goods.
 - c. It assures that importer in a foreign country has obtained the required import licence.
 - d. Bank finance can be availed of at pre-shipment and post-shipment stages.
- 2. To the Purchaser / Importer / Applicant.
 - a. Issuing Bank's superior credit is substituted for his relatively inferior and unknown credit.
 - b. Payment for the goods ordered is made only when all the terms of the LC are complied with.
 - c. Bank finance can be availed.

II. Types of Letters of Credit: Letters of Credit can be opened for supply of goods from a place within the country (Inland LC) or from abroad (Foreign LC). Various types of LCs are explained below:

- a. **Irrevocable LC:** Such letters of credit cannot be amended or cancelled without the agreement of all parties concerned.
- b. **Confirmed LC:** An intermediary bank, generally from the country of exporter, adds its confirmation.
- c. **Without recourse LC:** Drawer's liability ends when the bill is negotiated.
- d. **Back-to-Back LC:** It is an ancillary credit established at the request of the beneficiary of an LC.



- e. **Revolving LC:** LC is reinstated automatically for the initial amount.
- f. **Transferable LC:** The credit can be transferred in full or in part to one or more third parties.
- g. **Red clause LC:** This provides for pre-shipment advance to be made available to the beneficiary at the risk and responsibility of the LC issuing Bank.
- h. **Green clause LC:** This is an extension of Red clause LC in that it envisages payment to the beneficiary for storage facilities at the port in addition to pre-shipment advance.
- i. **Acceptance LC:** For exports made, usance bills of particular tenor are drawn and are normally be accepted by the opening Bank.
- j. **Deferred payment LC:** Provides for payment in instalments on due dates / for supplies made.

III. Stages of Letter of Credit Transactions: The various stages involved in the LC transaction are as follows:

- a. Applicant / Purchaser / Importer concludes a contract with the supplier of goods. Thereafter, he submits an application and requests the bank to open a letter of credit in favour of the supplier.
- b. Opening bank, after considering the proposal opens the LC. Where goods are to be imported from a foreign country and an import licence is required, LC will be opened on production of an exchange control copy of a valid import licence by the applicant.
- c. The advising bank receives the LC from the opening bank and advises the beneficiary.
- d. The beneficiary checks the LC and if necessary, asks the importer to effect amendments to the credit. He then proceeds to effect shipment.
- e. Shipment is effected and invoices, documents of title to goods etc. submitted to the negotiating bank.
- f. Negotiating bank checks them and if found in order, negotiates and pays the beneficiary. The bills are then sent to the opening bank for realization.
- g. Opening bank checks them and, if found in order, reimburses / confirms reimbursement. Under a letter of credit, payment is made against documents. It is therefore necessary to ensure that all documents are strictly in conformity with the terms of the LC. Where there is any discrepancy, the confirmation of the party at whose instance the LC was opened should be obtained before effecting payment. The bill is thereafter presented to the opener for payment / acceptance.
- h. The opener of LC pays / accepts the Bill, and gets documents of title to goods purchased by him.



IV. Basic aspects to be considered while opening letters of credit:

1. Bank Branches should ascertain the means and standing of the applicant for the Letters of Credit who should normally be a constituent, whose account has been satisfactorily operated. Normally, the applicant should confine his dealings only with the Bank.
2. The application-cum-guarantee form should be adequately stamped as an agreement.
3. The issue of Letter of Credit should be authorized by the Manager or a Manager of a Division, within the power delegated to him, who should satisfy himself that the necessary requirements have been complied with.
4. A Letter of Credit issued should be entered in the Letter of Credit Established Register and the Letters of Credit Liability Register.
5. The application-cum-guarantee form after issue of the Letters of Credit should be kept in the Strong Room / Fire Proof Safe and in the custody of the Manager / Manager of a Division / Supervising official specially authorized by the Controlling Authority.
6. Letters of Credit permitting payment against documents which do not confer on the Bank a full and undisputed title to the relative goods, e.g., transport documents of an unapproved transport agency or incomplete set of documents of title to goods made out to the order of the applicant should be treated as clean credit and should not ordinarily be issued.
7. Letters of Credit should open only after preparation of an appraisal memorandum which would cover, inter-alia, the liabilities of the applicant to the Bank as also to third parties, the means by which the applicant is expected to meet his commitment after the bills under the Letters of Credit are received, the margin the applicant is to deposit with the Bank and details of other securities he is offering to the Bank.
8. In case of Letters of Credit for purchase of machinery and where the borrower's own funds are unlikely to be sufficient to meet the cost, it should be verified whether confirmed term loan has been sanctioned to the unit for the purchase of the machinery in question. Where considered necessary it may be stipulated that a lien will be maintained on the unutilized portion of the cash credit account for the value of the bills to be received under the Letter of Credit. Needless to say, the creditworthiness of the applicant is to be examined in detail and the responsibility for his rests solely with the branch authorizing issue of the Letters of Credit.
9. The Letters of Credit issued / limits sanctioned should be commensurate with the borrower's turnover and cash credit limits and should be for his genuine trade / manufacturing activity, e.g., a borrower who is sanctioned a cash credit limit of ₹10 lacs, should not be sanctioned a Letters of Credit limit of, say ₹50 lacs, unless



Banks are confident that the applicant can arrange for the balance ₹40 lacs from his own funds.

10. Opening "Revolving Letters of Credit" requires still greater care. The validity of the Letters of Credit should not be more than 1 Year and the value of the Letters of Credit should be based on the value of material the borrower needs for his genuine manufacturing / trading requirements during this period. A special limit for the "Revolving" amount should be invariably stipulated, e.g., if the total amount of Letters of Credits is for ₹10 lacs and it is expected to revolve 10 times, the outstanding liability at any one time should be for not more than, say, ₹1 lac. The sub-limit of ₹1 lacs will be restored only after the beneficiary's bank receives the advice that the earlier bill(s) for ₹1 lac has been paid.
11. Detailed opinion reports should be recorded on all parties for who Letters of Credit are established, except where 100% margin is available. Delivery against Acceptance (D/A) facilities should be granted only to applicants of undoubted standing and where the security available is much more than the value of the Letter of Credit.
12. The stipulated price of the goods should not be more than the market price. It should be ensured that only such goods are covered where the market price is relatively stable.
13. The standing of the beneficiary should be ascertained. Where the opener and the beneficiary are sister concerns or are otherwise linked there should ordinarily be no need for Letters of Credit. In other words, Letters of Credit should not serve as a means of kite flying between the applicant and the beneficiary.
14. Each Letter of Credit should be complete and precise in itself and should not call for a reference to extraneous documents, e.g., Sale Contract, Pro-forma Invoice, etc. Excessive details as rightly belonging to the underlying contract should not be included.
15. Suitable insurance instructions safeguarding Bank's interest in the goods on warehouse-to-warehouse basis should be invariably incorporated. In case where insurance is being obtained by the applicant, suitable cover notes should be obtained at the time of opening of the Letters of Credit in the joint names of the Bank and the applicant and the cover notes and the insurance policies thereafter should be deposited with the bank.
16. All documents negotiated under Bank's Letters of Credit should be scrutinized on receipt for any discrepancies and non-compliance of terms and conditions, if necessary, by consulting the applicant whether to retain the bills or return them in the event of discrepancies.
17. The Managers should take immediate steps to protect Bank's interest in the goods in case payment is not made by the applicant on presentation of the bills, these steps should include advising the railway authorities or the transport company



of the Bank's interest in the goods and ensuring continuance of the insurance covering the goods for the risks of fire, theft etc.

18. Where the importer enjoys credit facilities with other Banks, the reasons for his approaching the Bank for opening and LC should be ascertained and, invariably, reference should be made to his existing bankers with whom he is enjoying credit facilities.
19. LC Contains:
 - The particulars of Import license if any.
 - The full and correct address of beneficiary.
 - Precise / brief description of goods.
 - Amount, price and value of goods in words and figures.
 - Origin of goods required.
 - Mode of transport – Sea / Air / Land / Rail.
 - Last date of shipment of goods / negotiation of documents.
 - Port of shipment / destination.
 - Whether pre-shipment / transshipment permitted.
 - Value of Goods – Cost, Insurance & Freight (CIF) / Cost, Freight (CF) / Free on Board (FOB) and its currency.
 - Payment terms – Delivery against Payment (D/P) or Delivery against Acceptance (D/A) – tenor of bill.
 - Expiry date of LC.
 - Instructions regarding Negotiation of documents and reimbursement.
 - Documents to accompany and number of copies required e.g., Draft, Invoice, Bill of Lading (B / L) or Air Way Bill (AWB) or Railway Receipt (R / R) or Lorry Receipt (L / R), packing list, weight list, certificate of origin, Insurance Policy/ Certificate, Quality certificate, Consular invoice / certificate & Inspection certificate.

ii. Bank Guarantees:

Bank Guarantees (BG) comprise both performance guarantees (PG) and financial guarantees (FG) and are structured according to the terms of agreement viz., security, maturity and purpose. Banks should confine themselves to the issuance of FG and exercise due caution with regard to PG business. Bank guarantees should not normally extend beyond 10 years. Banks may issue guarantees (BG) for periods beyond 10 years taking into account the impact of very long duration guarantees on their Asset Liability Management and in tune with their policy on issuance of guarantees beyond 10 years as approved by the Board.

**a) Types of Bank Guarantees:**

- Financial Guarantees.
- Performance Guarantees.
- Deferred Payment Guarantees.
- Advance Payment Guarantee.
- Bid Bond Guarantee (Tender Bonds).
- Performance Bond.

By issuing guarantees, Banks act as intermediaries between the buyer and the seller, the provider and the recipient of services, the contractor and the contractee. Bank Guarantees are non-funded exposures which are gaining greater importance in modern banking. Guarantees offer a vast avenue for generating commission earnings for the Bank, an area which is being very successfully exploited by foreign and private sector banks.

A guarantee provided by a Bank constitutes part of its contingent liabilities. The exposure is an off-balance sheet item yielding fee-based income in as much as the Bank does not have to lay out any funds immediately as in the case of Cash Credit type of facility. The margin contributions if taken in cash, yield the additional advantage of increasing the deposit level of Bank branches. Guarantees issued can also act as leads towards securing the business of beneficiary. Non-fund business is not included as a component of Commercial Advances Account.

However, like any credit decision, the issuance of guarantees also have an associated risk. Guarantees contain inherent uncertainties as the Bank issuing a guarantee undertakes the obligation to meet the liability in the event of default by its constituent the guarantee then, in effect, becomes an advance i.e., a funded liability. Even though guarantees are non-fund business, these should therefore be looked at as any other credit exposure, and the pros and cons pragmatically weighted.

Further, Capital Adequacy norms are applicable to guarantee business and this involves a cost to the Bank. Different risk weightage has been given for various types of guarantees depending both on the nature of counter guarantee available, as also on whether it is financial or a performance guarantee. The very fact that no funds are lent out, sometimes results in a casualness in approach which may lead to future NPAs in the books of the Branch. The salient features of the bank guarantee business especially in the context of risk related aspects, are discussed here.

Guarantees are issued by the bank, inter-alia, for the following purposes:

- In lieu of security deposit / earnest money deposits for participating in tenders.
- Mobilization advance / advance money before commencement of project by the contractor and for the contractor and for money to be received in various stages like plan layout, design / drawings in project finance.



- In respect of raw material supplies or for advances by the buyers.
- In respect of due performance of specific contracts by the borrowers and for obtaining full payment of the bills.
- Performance guarantee for the warranty period on completion of contract which would enable the supplier to realize the proceeds without waiting for warranty period to be over.
- To allow units to draw funds from time to time from the concerned indenters against part execution of contracts etc.

b) Appraisal of Bank Guarantee Limit:

The issue of Bank Guarantees is to be treated more or less as funded exposure for taking precautions. Whenever an application for the issue of Bank Guarantee (or sanction of Bank Guarantee limit) is received, the bankers should examine and satisfy by them thoroughly about the following aspects:

- o **Purpose:** Should be for genuine business requirements.
- o **Need for the Bank Guarantee:** Is it related to the applicant's normal trade / business? Is it on an adhoc or continuous basis? A scrutiny of partnership deed or the Memorandum and Articles of Association will reveal whether the purpose of guarantee is within the usual course of business of the applicant.
- o **Nature of Bank Guarantee:** Financial or performance.
- o **Amount of Bank Guarantee:** Should be for specific amount only. While assessing the overall limit, the amount of advance payment likely to be received during the year, the cash / funds flow position should also be looked into, to ascertain if the applicant will be in a position to meet the commitments on due dates or in case of invocation of guarantee.
- o Applicant's financial strength / capacity (through an analysis of his financial statements and opinion reports) to meet the liability / obligation under the Bank Guarantee in case of invocation.
- o **Past record of the applicant in respect of Bank Guarantees issued Earlier:** Was a guarantee issued on behalf of the applicant (s) invoked at any time? If so, the reasons thereof. How did the customer respond to the invocation? Did they make good the money within a reasonable time and without creating complications?
- o Present outstanding on account of Bank Guarantees already issued.
- o **Margins:** Cash margins act as a security buffer and provide a cushion against devolvement.
 - If the applicant is an existing borrower, margin on Bank Guarantee may be the same as on his cash credit account. Otherwise, higher margins may be insisted upon. Margin money may be in the form of cash, Fixed Deposit etc. Margin may also be



retained by way of lien on drawing power but in such cases the stipulated ceiling of indebtedness may not be exceeded.

- In respect of non-borrower applicants, the approach should be to obtain full margins. However, a credit risk can be taken on the applicants based on the financial parameters, credit worthiness, security available etc. It may be remembered that in the event of invocation, the non-fund-based guarantee requires an immediate outlay of funds, such requests should therefore be processed in the same manner as any other credit proposal /exposure.
- 100% margin to be retained in respect of guarantees issued in connection with disputed customs / central excise duties.
- o The guarantee agreement and the counter guarantees are to be stamped as an agreement as per the rates prescribed in the Stamp Duty Act of the State in which the guarantee is issued.
- o **Collateral Security offered:** Adequate collateral security by way of equitable mortgage/ extension of charge on current / fixed assets or third-party guarantee should be obtained, depending on the merits of each case.
- o General Aspects
 - The Guarantees should usually be secured by an extension of the charge on current assets obtained to cover the other working capital facilities.
 - In the case of performance guarantee, the bank should exercise caution and have sufficient past dealings with the customer to satisfy itself that the customer has the necessary experience, capacity and means to perform the obligations under the contract and is not likely to commit any default.
 - **Export Performance Guarantee Favouring Customs:** As part of support given to Corporate Customers and exporter's guarantees, banks are issued favouring Customs Department for amounts linked to the customs duty relief availed on importing of capital goods under the Export Promotion Capital Goods Scheme (EPCG). Such guarantees stand on the footing of long-term financing of a project and are similar to a DPG commitment i.e., while there is no outlay of funds, the amount of the EPCG Guarantee should be added to the project cost / cost of machinery while undertaking the appraisal. The assessment of such a guarantee limit should be done on the basis of technical, financial and marketing ability of the applicant and should provide for achievement of exports of the required value and within the time allowed under the duty concessions scheme. The guarantees are to be supported by the same security available for the Term Loan / DPG commitments for the project.

Stages in Credit Process in Banks:

a) Pre-sanction Stage:

The pre-sanction credit process comprises three stages viz., appraisal & recommendation, assessment and sanction. The quality of credit of bank loans is primarily based on strict



implementation of all stages of pre-sanction functions by the credit officers. Pre-sanction is a foundation to mitigate the credit risk of the banks. If banks are following the laid down instructions of Pre-sanction functions in credit process, it not only reduces provisions on NPA but also capital requirements of the bank substantially.

An indicative list of functions under pre-sanction credit process is given below:

i. KYC Norms

Banks and financial institutions (FIs) have been advised to follow certain customer identification procedure for opening of accounts and monitor transactions of suspicious nature for the purpose of reporting the same to appropriate authority. These 'Know Your Customer' (KYC) guidelines have been revisited in the context of the recommendations made by the Financial Action Task Force (FATF) on Anti Money Laundering (AML) standards and on Combating Financing of Terrorism (CFT). Detailed guidelines based on the recommendations of FATF and the paper issued on Customer Due Diligence (CDD) for banks by the Basel Committee on Banking Supervision (BCBS), with suggestions wherever considered necessary, have been issued. Banks / FIs have been advised to ensure that a proper policy framework on 'Know Your Customer' and Anti-Money Laundering measures is formulated and put in place with the approval of their Boards. KYC Norms are applicable to all type of products i.e., Deposits, Advances and other products.

- Latest Passport Size Photograph of Borrower / Guarantor should be obtained, attested by Branch Officials and pasted on Loan Application Form.
- ID Proof: Photocopy of Aadhar / Voter ID / Employee ID Card / Driving License / PAN Card / Passport duly verified by Branch Officials with the Originals, should be obtained to establish Identity of the Borrower / Guarantor. Brand the seal, "Verified with Original" on the Xerox Copy and sign it full in token of having verified it with the original.
- Photocopies of latest Electricity / Telephone / Credit Card Bill / other Utility Bills should be obtained to verify address of the Borrower / Guarantor as per the KYC norms.
- Apart from obtaining the above Documents, evidence of visit to Residential / Office / Business Premises of Borrower / Guarantor to verify genuineness of their antecedents should be recorded.

Other Areas:

- Ensure the application received is filled-in properly and copies of the necessary documents are enclosed.
- Enter all Loan Application received by the Branch in "Loan Application Register".
- Mention the name of his neighbours in the pre-sanction "Survey Report" and record the contents of the interaction with them.
- Make a roadmap of the location mentioning village / location, street, landmark etc. i.e., any temple, school, big shop, pond etc. near to the house or place of work & record the



observations at above points, while recommending for sanction.

- Prepare a rough sketch of the properties and mark the landmarks for easy identification of the property.
- Verify whether unrestricted free access is available to the properties offered as security.
- Obtain his e-mail address, mobile & land line phone number if available.
- Discuss the loan proposal (Interview with prospective borrower) and note it on the application.
- Visit and identify the properties offered as collaterals with the help of the 'Title Investigation Report-TIR', verify the details and confirm its ownership.
- Record the pre-sanction inspection and prepare the 'Pre-sanction Inspection Report'.

a. Individuals

- o Documents obtained originally viz. Proof of ID, Proof of Address and Photograph is held on record.
- o Proof of ID, Proof of Address and Photograph are updated, as prescribed / full particulars of the documents are entered in the CBS correctly.

b. Companies:

- o Documents obtained originally viz. Certificate of Incorporation.
- o Copy of Memorandum and Articles of Association, resolution from the Board of Directors, officially valid document in respect of managers, officers or employees authorized under Board Resolution to transact on behalf of the company have been obtained.

c. Partnership Concerns:

- Certified copy of----
- o Registration Certificate.
- o Partnership deed and
- o Officially valid document of Proof of Identity, Proof of Address, in respect of the persons authorized to transact on behalf of the firm have been held on record.
- o In addition to the Original Valid Documents applicable to the proprietor, other prescribed KYC documents have been obtained while opening of the account in the name of a proprietary concern.

d. Hindu Undivided Family (HUF):

- Certified copies of the
 - o Declaration from the Karta.
 - o Proof of Identification of Karta and



- o Prescribed Joint Hindu Family Letter signed by all the adult co-parceners have been obtained for HUF account.

e. Non-Face-to- Face Customers (Individual NRE Accounts):

- Copies of Passport and Residence Visa duly attested by the authorized officials for Non-Face-to- Face Customers (Individual NRE Accounts) are held on record.

f. Self Help Groups:

- KYC verification of all the office bearers of the SHG has been carried out.

g. Small Accounts (BSBD / PMJDY):

- o Holder of Basic Savings Bank Deposit Account (BSBDA) is not maintaining other regular Savings Bank Deposit account in the Bank.
- o Small Account holders are not breaching extant terms & conditions while transacting with the Bank as per laid down guidelines.

ii. Title Investigation Report (TIR):

- Ensure that the legal opinion is in prescribed format and the documents as listed in the 'Title Investigation Report-TIR' are received direct from the Panel Advocate.
- Panel Advocates should clearly confirm that they have conducted independent Search in the Records of Sub-Registrar Office concerned and that the documents are genuine, convey Clear, Absolute and Marketable Title and are valid for creation of a valid Mortgage.
- 'Legal Opinion Report' should be perused thoroughly. Branch should obtain all the 'Original Documents' and other 'Link Documents' as stipulated by the Advocate in the TIR.
- Ensure that 'No conditions' are mentioned in the TIR and 'Search Report' is enclosed with the TIR.
- In case of doubt with regard to the title or its genuineness, 2nd Opinion Report from the Bank's Law Officer should be obtained.
- 'Supplementary-TIR' wherever necessary should be invariably obtained and be kept on record.
- Up-to-date 'Encumbrance Certificate (EC) for the last 13 years' for non-Agricultural and '31 years for Agricultural properties' should be obtained.
- Up-to-date Land Revenue / Property Tax (Like: Municipality Taxes etc.) Receipts should be obtained.
- Chitta, Adangal, Patta and Revenue Records to be obtained and kept on record for agricultural lands.

iii. Valuation Report:

- Ensure the 'Valuation Report' is from the Panel Valuer, Photograph of the property is scanned in the report and compare the valuation of the property with the market value prevailing in the area, to ascertain there is no excess / exorbitant valuation and record the assessment of the valuation.

a) Verification of genuineness of Collateral Security Documents:

- Original Registered Sale Deed / Agreement to Sale should be obtained and the following should be ensured.
- Exercise adequate care before creation of EM to verify the genuineness of the 'Original Title Deeds' as Colour Photo copies look identical to the original documents.
- Laminated documents should not be accepted.
- Verify the availability of Seal / stamp of Office of Sub-Registrar on all pages of the documents.
- Adequate Stamp Duty should have been paid for Registration as per the relevant Stamp Act.
- Ensure that the Stamp Papers used are purchased 'in the name of one of the Parties', i.e., either Seller or Purchaser.
- Photograph of the Purchaser / Seller from the Sale deed / Agreement for Sale should be verified. (In case of Recent Agreements).
- Signature of the Sub-Registrar on 'Registration Fee Receipt' should tally with the signatures on the 'Index-II' and other pages (Follow the State Practices in this regard)
- Original 'Index-II' should be submitted. The Stamp Duty, Date of Registration, Market Value mentioned in 'Index-II' should tally with other documents (Follow the State Practices in this regard).

iv. Income Proof-Individuals:

- Obtain regular 'Salary Certificate' for the last three months to avoid fabrication.
- Obtain 'Income Tax Returns' for the last 2-3 years and scrutinize the Income Tax department stamp & receipt number (if manually submitted).
- If income tax returns are submitted for the 'previous years' on the same date, make it a point to verify these from ITO office and narrate it in the pre-sanction survey report. Verify the returns with the originals and record it on the Xerox copy (Earlier AY / FY IT Returns).
- Income of the Applicant from Various Sources (Salary / Business / Agriculture etc.) should be substantiated / recorded with evidence i.e., Income should be computed judiciously (Income from sources for which no documentary proof is available should not be included so that eligible loan amount is not inflated deliberately).



- Obtain Form-16 in case of employees.
- Confirm the genuineness of the Certificate by contacting the issuing authority and record it.

v. Borrower / Guarantor's Net Worth and Tangible Net Worth (TNW):

- Assets and Liabilities Statements of Borrowers / Guarantors should be obtained with detailed particulars on Standard Formats.
- Power of Attorney-POA (if applicable) in Bank's Standard Format duly stamped and Notarized / Attested by Indian Embassy / Consulate (for NRI Borrowers) should be obtained. Legal opinion on standard format of the bank on POA obtained from the Bank's empanelled Advocate.
- Opinion Reports on Borrowers / Guarantors should be compiled in Standard Formats. Verify with the details with Original Documents and sign it.
- Discrete Enquiries should be made and record the credentials / antecedents of Applicant / Guarantor. Feedback from Salary Disbursing Officer / Institution / Neighbour should be recorded. In case of Professionals / Self-Employed persons, name of the Firm, Constitution, Activity, Address, Phone number, Years of existence etc. should be verified and recorded.

vi. Credit Appraisal Standards:

Banks have, over the years, developed a scientific credit appraisal methodology which is being constantly honed in the light of experiences gained from time to time. However, the basic standards for working capital facilities-both fund based and non-fund based and term credit facilities have stood the test of time and are well understood. Certain basic parameters have, by and large, evolved over the years. These could broadly be classified as qualitative and quantitative.

(i) Qualitative:

The proposition is examined from the Bank's prudential levels of exposure to the firms, company, group and industry. Thereafter a view is taken about past experience with the promoters, if there is a track record to go by. Where it is a new connection for the Bank but the entrepreneurs are already in business, opinion reports from existing bankers and published data if available are carefully perused. In case of a maiden venture, in addition to the drill mentioned below, an element of subjectivity has to be perforce introduced as scant historical data would be available and weightage has to be placed on impressions gained out of the serious dialogues with the promoter and his business contacts.

(ii) Quantitative:

a. Working Capital:

The basic quantitative parameters underpinning the Bank's credit appraisal are as follows:

Liquidity: The bench mark for current ratio as per projected balance sheet method of lending is 1.33. However, like all other financial ratios this, per se, is not sacrosanct and



greater emphasis is laid on the trend and the underlying reasons. A somewhat lower ratio may be tolerated provided there is consolidation and steady improvement. On the other hand, a better ratio with continued slippages for the reasons not acceptable to the Bank would be viewed with concern.

Net Working Capital: Although this a corollary of current ratio, the movements in Net Working Capital are watched to ascertain where there is a mismatch of long-term funds vis-à-vis long term uses for purposes which may not be readily acceptable to the Bank so that corrective measures are suggested.

Financial Soundness: This will be dependent upon the owner's stake or the leverage. Here again the benchmark will be different for manufacturing, trading, hire-purchase and leasing concerns. For industrial ventures a Total Liability / Equity Ratio of 3.0 is reasonable but deviations in selective cases for understandable reasons would be accepted.

Turnover: The trend in turn-over is carefully gone into both in terms of quantity and value as also market share wherever such data is available. What is more important is to establish a study output if not a rising trend in quantitative terms because the sales realization may be varying on account of price fluctuations.

Profits: While net profit is the ultimate yardstick, cash accruals i.e., profit before depreciation and taxation conveys the more comparable picture in view of changes in the rates of depreciation and taxation which may have taken place in the intervening years. However, for the sake of proper assessment, the non-operating profits are excluded as these are usually one time or extraordinary income. Companies incurring net losses consistently over 2 or more years will be given special attention and their accounts closely monitored. Should the trend persist, the Bank will examine all options, including recall of the advance, at an early opportunity.

Credit Rating: Wherever the Company has been rated by a Credit Rating Agency for any instrument such as Commercial Papers (CPs) / Fixed Deposits (FDs) this will be taken into account while arriving at a final decision. In some cases, it would be useful to have a general assessment of the company done, if felt necessary. However, as the credit rating involves additional expenditure, banks not normally insist on this and only use this tool.

b. Term Loan:

- o In the case of term loans and deferred payment guarantees the project report is obtained from the customer which may have been compiled either in house or by a firm of consultants / merchant bankers. The technical feasibility and economic viability are vetted by the Bank and wherever it is felt necessary, the Credit Officer would seek the benefit of a second opinion either from the Bank's Technical Consultancy Cell or from the consultants of the Bank.
- o Promoter's contribution of at least 20% in total equity is normally expected.
- o The other basic parameters would be the net debt service coverage ratio i.e., exclusive of interest payable, which should normally not go below 2. On a gross basis DSCR should not be below 1.75.



- o As regards margin on security, this will depend on Debt: Equity gearing for the project which should not normally be above 2:1 i.e., Debt should not be more than 2 times the equity contribution.
- o Other parameters governing working capital facilities would also govern Term Credit facilities, to the extent applicable.
 - Opinion Reports of the borrower / guarantor / partners / directors.
 - Clearly record all the negative information which come across while appraising the request.
 - Ensure there is no encumbrance, clear title and marketability of collaterals offered by making searches in the Sub-Registrar Offices.
 - Deviations if any observed should be reported to the Controllers and their approval to be obtained before sanction of the credit limit.
 - Ensure the bank guidelines on LTV, NMI / EMI ratios for each and every loan product.

c. MSME Loans:

If the applicant is a Company or Partnership Firm or Private or Public Limited Company, obtain the documents as advised under KYC norms under each head.

Visit the Business premises of the company / firm, factory premises. Visit work place of the individuals and residences of the borrower / Guarantor / Promoter / Partner / Director.

Verify all the records viz. Sales / Purchases, Debit / Credit Notes, Book Debts, Orders on hand, Suppliers / Buyers Particulars, Statutory Dues, Subsidiary Units, Employees and their wages payment etc. to know about the unit.

Verify the genuine credit needs of the company, its sales at normal as well as peak level etc.

Availability of infrastructure at the premises of the unit.

Market Trend for each activity.

Verify whether all the required licenses for doing the business are obtained viz. SSI / GST, Water & Sewage Board Approvals, Power Connection, NOC from Pollution Control Authorities and necessary certificates from other Govt. Agencies.

Complete analysis of Balance Sheet, Remarks by the Auditor.

Ensure that the projections are reasonable, achievable and in tune with the industry / market trend.

Consider the details of the technology, manufacturing process, availability of construction / production facilities etc., and estimates of cost of the project.

Consider the details of the proposed means of financing indicating the extent of promoters' contribution etc.



Consider the Debt service coverage ratio (DSCR) to know the viability of project and for fixing the repayment period and the quantum of annual instalments and the Internal rate of return (IRR) to ascertain the income generating capacity of the total funds used in the project over its life time.

Ensure the, commercial viability, Technical Feasibility, Economic Viability, Financial Feasibility, Managerial Competency, Environmental concern etc.

Ensure that the quotations / invoices are obtained from reputed / standard manufacturers/ dealers / companies.

The machineries / equipment / articles to be purchased out of bank finance are of ISI / BIS approved.

Stocks pledged / hypothecated to the Bank must be inspected at irregular intervals which should ordinarily not exceed one month.

Obtain cash budget, if any, QIS statements or Financial Follow-up Reports (FFRs), as the case may be, monthly statement of select operational data etc.

Confirm the level of activities by verifying Electrical meter reading.

Confirm maintenance of invoices for Purchase and Sales and Registers for Sundry Debtors / Sundry Creditors.

Ensure that maintenance of all the correspondence with the unit and controllers are filed properly.

Ensure that no information is suppressed which is detrimental to the interest of the Bank.

Ensure Registration of charge with ROC in case of Companies.

Ensure periodic search of charge with ROC to protect the Bank's interest.

d. Agriculture / SHG Loans:

Obtain copies of the Patta, Chitta and Adangal. If tenant cultivator ensure that his name is entered in the Adangal and the crop is indicated (Follow the State Practices in this regard).

Ensure that eligibility is calculated as per scale of finance approved by District Level Bankers Committee (DLBC).

In case of SHG loans note to obtain KYC documents for each member of the Group separately and open and link the CIF to the loan account. Before dispersal the group should be visited by an official and records should be verified in the meeting.

Ensure that appropriate document-KCC / Term Loan Documents such as, KCC / ATL Documents, Arrangement Letter, TL Agreement, Guarantee Agreement, Agreement to Create Mortgage, Tripartite Agreement, and General Power of Attorney is used.



e. Retail Loans:

i. Personal Loans:

Ensure the eligibility criteria including Income Proof. Loan amount should be based on Net Salary / income taken from salary certificate / Form 16 / Income Tax Returns.

Permanent Salaried employees of Government / PSUs / Reputed Private Organizations only are eligible.

Latest Original Salary Certificate / Form-16 duly stamped and signed by Drawing & Disbursing Officer (DDO) / Employer should be obtained.

Signature of DDO / Employer appearing on the Salary Certificate / Form-16, other documents should be verified to ensure genuineness.

Take Home Salary normally should not be less than 50% of the Gross Salary, after accounting for the proposed EMI on the Housing Loan.

It should be ensured that Income is not inflated by showing Income from Sources which are not verifiable or for which no records are available.

Check-Off Facility should be available and should be signed by Competent Authority. In case, it is not available, Post-Dated Cheques (PDCs) should be insisted upon.

ii. Housing Loans:

Building Plan approved by the Competent Authority should be obtained and perused and Evidence of Independent Site Verification should be on record. A Location Sheet indicating landmarks signed by the Visiting Official should be annexed.

Civil Estimate prepared by a Civil Engineer or an approved Architect should be obtained. Cost of the project should be scrutinized and found to be reasonable in relation to the Built-up Area and as per the prevailing Market Rate. Cost of amenities included in the Total Project Cost should be reasonable.

iii. Additional Requirements – Purchase of Flats from Builders:

Feedback on the credentials / antecedents of the Builder with previous Projects, experience should be enumerated / recorded. This can be verified from other Reputed Builders in the locality. Also, there should be a record whether the Builder is on the Approved List of the Bank (if any) or is of a Member of the Local Builders' Association.

From few residents of existing projects promoted by the Builder; feedback on quality of construction, timely completion, conveyance of ownership title, disputes / litigations, if any, may be obtained/ recorded.

Builders' Banker's may also be contacted to verify his credentials.

Copy of Approved Plan should be obtained and verified with the Original (May be verified from Govt. Office for genuineness and also to ensure that construction only to the permissible extent / level has been carried out).



Valuation Report of an Approved Valuer should be on record. Cross checking of valuation should be done independently. Valuation Report should also contain Realizable Value, in case of a Distress Sale.

Adequate comments about Access to the Property, Locality, Habitation Conditions, and Landmarks for identification of the Property. Display of signboards of the Apartment's / Builder's name at the Construction Site etc. should be recorded.

The documents should be executed by the Land owner / Builder himself. In cases, where document is executed by a Power of Attorney Holder, the document should clearly specify the rights of each Party.

Original Allotment Letter issued (verified with the records of the Builder) should be on record. If it is not in English, its English version, duly vetted, should be annexed.

Possession Letter / Share Certificate in respect of the flat should be available and should be printed / typed on the letterhead of the Builder / Developer.

The Floors / Flats should be within the given range permitted for Development / Construction by the Appropriate Authority.

In case, Society has not been formed despite completion of construction, resulting in non-availability of Share Certificate, a Stamped Deed of Undertaking-cum-Power of Attorney (Standard Format) should be obtained from the Builder / Flat owner for delivery of the Share Certificate direct to the Bank as and when the Society is formed.

iv. Miscellaneous:

Opinion Report about the Suppliers to be obtained from their Bankers—for Term Loans.

Ensure stipulated margins are brought in by the borrowers / units as per the sanction letter.

b) Sanction Stage:

- The Loans should be sanctioned as per the Delegation of Financial Powers. Sanction should be recorded properly.
- The amount of Loan Sanctioned and Terms of Repayment viz., EMI, Repayment Period, and Date of Commencement of Instalments should be properly recorded.
- Control Form should be submitted to the next Higher Authority and the Confirmed copy should be on record. Deviations, if any, should have the approval of the Competent Authority and kept on record.
- Sanction of the credit limit should be properly advised to the applicants / guarantors.

c) Post Sanction Stage:

The post-sanction credit process can be broadly classified into three stages viz., follow-up, supervision and monitoring, which together facilitate ensuring an efficient and effective credit management and maintaining high level of standard assets. Broadly, the objectives of the three functions are as under:



i. Documentation:

Banks are well established systems and procedures for documentation in respect of all credit facilities. These have been laid down keeping in view that ultimate objective of documentation which is to serve as primary evidence in any dispute between the Bank and the borrower and for enforcing the Bank's right to recover the loan amount together with interest thereon, in the event of all other recourses proving to be of no avail, through a court of law as the final resort. In order that this objective is fulfilled, documentation process attempts to ensure that--

- The owing of the debt to the Bank by the borrower is clearly established by the documents.
- The charge created on the borrower's assets as security for the debt is maintained and enforceable, and
- The Bank's right to enforce the recovery of the debt through court of law is not allowed to become time-barred under the Law of Limitation.

a. Guidelines of Documentation:

- Ensure that appropriate document – Cash Credit - CC (For Working Capital requirements) / Term Loan (TL) Documents, Arrangement Letter, TL Agreement, Guarantee Agreement, Agreement to Create Mortgage, Tripartite Agreement, and General Power of Attorney is used.
- Ensure all the documents are properly filled-in and are complete in all respects.
- Borrower / Guarantors should have signed on each page of the Loan Documents including Sanction / Arrangement Letter. These should be dated and witnessed, wherever applicable.
- Ensure that the documents are executed in the own premises, dated and the place of execution is marked on all the documents. If it is executed elsewhere, ensure the documents are properly stamped as applicable at the place of execution and the facts that the documents are executed elsewhere has to be noted in CC / TL Register.
- Documents should be adequately stamped as per the State or Central Govt. Stamp Act.
- Embossing / Cancellation of Documents should be done under Full Signature (not initials) of the Manager with Seal (not round seal of the Branch).
- Obtain PDCs, wherever necessary (for Retail Segment Loans) and record it in the PDC register and system for effective follow up.
- Cuttings in Documents should be authenticated by the Borrower / Guarantor with full signature.
- Arrangement letter / sanction letter conveying the terms and conditions of the loan should be signed by the borrowers.
- The completed documents should be kept securely in a Fire Proof Cabinet / Safe.



Thus, documentation is not confined to more obtention of security documents ab-initio. It is a continuous and ongoing process covering the entire duration of an advance comprising the following stages:

- **Pre-execution formalities:** These cover mainly searches at the Office of Registrar of Companies and search of the Register of Charges maintained by Companies (applicable to Corporate borrowers), also capacity of borrowers to borrow and the formalities to be completed by the borrowers, searches at the office of the Sub-Registrar of Assurance or Land Registry to check the existence or otherwise of prior charge over the immovable property offered on security, besides taking other precautions before creating equitable / registered mortgage.
- **Execution of documents:** This covers obtention of proper documents, appropriate stamping and correct execution thereof as per terms of the sanction of the advances and the internal directives of a corporate borrower such as Memorandum and Articles of Association etc.
- **Post-execution formalities:** This phase covers the completion of formalities in respect of mortgages, if any, registration with the Registrar of Assurances, wherever applicable, and the registration of charges with the Registrar of Companies within the stipulated period, etc.
- **Protection from Limitation / Safeguarding Securities:** These measures aim at saving the documents from getting time-barred by limitation and protecting the securities charged to the Bank from being tampered with any charge that might be created by the borrower to secure his other debts, if any. The objectives are sought to be achieved by:
 - o Obtention of revival letter within the stipulated period.
 - o Obtention of Balance Confirmation from the borrower at least at annual intervals.
 - o Taking periodical searches at the office of the Registrar of Companies and search of the Register of Charges maintained by Companies.
 - o Insurance of assets charged – (unless specially waived) to insure the Bank against the risk of fire, and other hazards, etc.
 - o Keeping the above broad objectives and the documentation process in view, the Bank has devised standard documents in most cases for various types of loans given to the borrowers. Furthermore, changes in the documentation procedures and the implementations involved are circularized from time to time to all the Bank branches / offices of Banks so that those who are responsible for obtaining and safeguarding the documents are made fully conversant with them.
 - o An appropriate control system is also in operation in tune with this delegation structure. The powers exercised by the various functionaries are required to be reported to the next higher authority as laid down in the delegation of powers issued by the concerned banks.



ii. Geo Tagging of Property locations:

As an extra safeguard, banks do capture the Geographical Coordinates viz., the Latitude and Longitude of the properties charged to them. This ensures easy identification of the location of the properties at a subsequent date by any official of the Bank. Wherever applicable, the Geo tagging should be done and placed on record.

iii. Review / Renewal of Advances:

The working capital facilities are granted by the Bank for a period of 1 Year and thereafter they are required to be renewed each year, i.e., fresh sanction is accorded for the limits.

Where, however, renewal is not possible for some reason, sanction for the continuance of the limits is obtained in each case by reviewing the facilities. As regards the term loans, these are required to be reviewed once in a year.

iv. Equitable Mortgage (EM):

- Before creation / extension of EM obtain encumbrance certificate for the broken period- Period between the date of TIR and the date of EM creation.
- EM should be created / extended for the property offered as security before disbursement. Recital of EM Register should be made as per the Standard Format and in chronological order. All particulars in the Recital should be filled in properly. Recital should be made after completion of all EM formalities and witnessed by two officials of the Branch/ Bank.
- Standard EM Confirmation Letter, Form 'A' in case of fresh creation of EM and Form 'B' in case of extension of existing EM should be received at the Branch by Registered post. It should be dated subsequent to the date of creation of EM (Otherwise it may attract Advalorem Stamp Duty).
- In case of extension of EM ensure that all the persons who have signed Form 'A' have signed Form 'B'.
- After creation of EM, it is mandatory to register Mortgage of Documents (MOD). Obtain an Encumbrance Certificate (EC) after registration of MOD and confirm that the Bank's interest is recorded in the EC.

a. Steps to be taken by Non-notified Centre (Lending) Branch:

The Bank Branches should record details of EM documents (including a copy of the Recital) in Title Deeds Register after receipt of the same from the Notified Centre Branch and send an acknowledgement thereof to the Notified Centre Branch.

b. Steps to be taken at the Notified Centre Branch:

Should complete all necessary formalities of creation of EM.

Should forward all Documents relating to EM and a copy of Recital to the Non-notified Centre (Lending) Branch by Regd. and Insured Post under the cover of a letter detailing all Documents and must obtain an acknowledgement.

The Notified Centre Branch must preserve the acknowledgement for scrutiny by the Branch Auditors / Bank Auditors.

v. Other Areas:

In the case of Houses allotted by Housing Board / Development Authority, written Permission from the Housing Board / Development Authority concerned (if such a stipulation is found in the Allotment Letter / Sale Agreement) for creation of EM in favour of the Bank should be obtained.

In the case of financing houses allotted by Housing Co-operative Societies, written permission from Housing Co-operative Society (if any) for creation of EM should be obtained. The Society should confirm having noted Lien and should undertake Delivery of Title Deeds, when ready.

vi. CERSAI:

Central Registry of Securitization Asset Reconstruction and Security Interest of India is a Government of India Company licensed under section 8 of the Companies Act, 2013 with Govt. of India having a shareholding of 51% by the Central Government and select Public Sector Banks and the National Housing Bank also being shareholders of the Company.

The object of the company is to maintain and operate a Registration System for the purpose of registration of transactions of securitization, asset reconstruction of financial assets and creation of security interest over property, as contemplated under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

CERSAI is providing the platform for filing registrations of transactions of securitization, asset reconstruction and security interest by the banks and financial institutions. At present the portal provides facility to file security interest in immovables created through all types of mortgages and in units under constructions besides filing of Security Interests in movables, intangibles and factoring transactions is also available on the portal.

More than a statutory obligation CERSAI is a risk mitigation tool for the Banks / Housing Finance companies, Fls and public at large to prevent multiple financing against the same property.

Online search is available to public to enable them to search and inspect the records maintained by the Registry on payment of fees prescribed under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Rules, 2011. The search can be made on the basis of both Asset Details as well as on the basis of Debtor's details.

The objective of setting up of Central Registry is to prevent frauds in loan cases involving multiple lending from different banks on the same immovable property.

The registration of transactions of creation of security interest, securitization and asset reconstruction has been made mandatory in respect of all mortgages, across all segments created on or after 31st March 2011. The timeline of 30 days, for registration of such transactions needs to be adhered to by all the Operating units.



A Central Register shall be kept for the purpose of maintaining records of registration of transactions relating to securitization, reconstruction of financial assets and security interest created over properties, under the Act.

All electronic documents, required to be signed by the Central Registrar under the Act or rules made thereunder, shall be authenticated through his digital signature.

Particulars of every transaction of securitization or reconstruction of financial assets and satisfaction of such transaction on realization of the financial assets or creation, modification or satisfaction of any security interest required to be registered under Sections 23, 24 and 25 of the Act, shall be filed in such Forms as may be specified by the Central Government from time to time as hereinafter provided.

Particulars of every transaction of securitization and reconstruction of financial assets and creation, modification or satisfaction of security interest by way of mortgage by deposit of title deeds shall be filed in Form I, Form II, Form III or Form IV, as the case may be, and shall be authenticated by a person specified in the Form for such purpose by use of a valid digital signature.

The Central Government may specify Forms for filing particulars of creation, modification or satisfaction of security interest other than mortgage by deposit of title deeds by amendment to these rules from time to time.

If any security interest being created in favour of two or more lenders, the details as to inter se priority amongst them and whether they hold it on a pari-passu or subordinate basis shall be required to be specified:

Provided that if the ranking of security is not available, the Central Registrar may allow such time, not exceeding sixty days from the date of application, for the same to be furnished by the secured creditors.

a. Time limit for registration and condonation of delay:

The particulars of every transaction referred to in sub-rule (1) of rule 3 shall be filed the Central Registrar within a period of thirty days from the date of such transaction.

In cases where there is a delay in filing the particulars of transaction for registration or modification or satisfaction within the time specified in sub-rule (1), the Central Registrar, on an application in specified form, stating the reasons for delay not exceeding thirty days from next following the period of thirty days provided in sub-rule (1) may allow filing of the particulars of transaction on payment of additional fees as specified in these rules.

b. Inspection of records of Central Register:

The particulars of any transaction kept in the Central Registry shall be open for inspection to any person through the website of the Central Registry and during the business hours at the Central Registry on payment of fee specified in rule 7:

Provided that the Central Registry may allow the inspection to be carried out through such person, authorized by it in this behalf.

c. Fees:

Every Form for registration of any transaction relating to security interest over any property and every request for inspection of any record maintained by the Central Registry shall be accompanied by a fee specified in the Table given below to be paid to the Central Registry in such manner as may be specified from time to time.

- It is also mandatory to register the particulars of the EM under "CERSAI" to protect the security interest of the property.
- Now movables like CAR Loan particulars are to be register under CERSAI to protect the security interest of the property.
- Mortgage Uploaded in CERSAI on the same day of creation of mortgage. Noting is this regard is made in the EM Register.
- Process of registration is completed and print out of CERSAI Registration is generated and kept on record.

vii. Control Returns / Forms:

- Send the control report to higher authorities / controllers immediately after documentation.
- If any objections raised by the controlling authority that is to be answered and rectified by the Bank branches.
- For each and every advance sanctioned by the Bank Branches / Central Processing Centres (CPCs) are to be rectified by their Controllers. If not rectified, then those loans are not properly sanctioned.
- Auditors are to be verified, whether all loans and advances sanctioned by the Bank Branches / CPCs are properly controller by their controllers. If not, those accounts are to be mentioned in the Audit Report.

viii. Disbursement:

- Disbursement should be done only after completion of documentation and dispatch of control returns.
- The borrower must open a SB / CA and deposit the margin money in it.
- Disbursements should be made after completion of all formalities including Documentation and creation of EM.
- Ensure to make payment direct to the Suppliers' / Vendor's account through electronic payment modes – RTGS / NEFT.
- Ensure that "Hypothecation / Pledged to Bank Name" clause must be written on the bills/ invoices.



Disbursement for Housing Loans:

Disbursements should be made in phases, in accordance with stages of construction except in case of outright purchase of a Ready-built Flat / House.

Records of Post sanction Inspection by Branch officials should be prepared and kept on record to evidence progress of construction.

Necessary evidence for purchase of materials by the borrower should be obtained in case advance payments are made.

Reimbursement of Expenditure Incurred, should be made on the basis of Stage Completion Certificates, issued by a Civil Engineer / Architect, confirmed by the borrower and duly verified by the Branch Officials.

In case of Flats, payment should be made directly to the Builder by way of electronic payment- RTGS / NEFT. A Letter of Authority from the Borrower should be obtained for effecting direct payment by the Bank to the Builder.

Disbursements should be made after ensuring Proportionate Contribution by the Borrower Stipulated as Margin.

In case of Housing Loans sanctioned for purchase of ready built houses / flats / plots ensure that the amount entered in the agreement to sale tallies with the amount entered in the sale deed.

ix. Insurance:

- Insurance, wherever applicable must be obtained with bank's hypothecation clause with renewal annually.
- Insurance for full value of the Flat / Building and 110% of stocks should be obtained and Original Policy retained at the Branch. The Policy should be current and in force.
- Insurance Policy should cover all risks like Earthquakes, Fire, and Riots etc.
- Insurance Policy should bear the name of the Financing Branch.
- Insurance Register should be maintained and updated to ensure timely renewal of Policies.
- In case Insurance waiver for a particular loan, appropriate authority approval letter on record or bank instructions in this regard.

x. Inspections:

- Credit Officers are to be inspected the units at monthly irregular intervals. The Credit Officer need not conduct monthly inspection during the month in which Manager/ Manager of the Division has inspected the unit unless the circumstances so demand.
- Ensure end use of funds by immediately inspecting the assets purchased out of bank's funds and record it in the Inspection Register with details.

- Regular inspections must be conducted & recorded in the Unit Inspection Register.
- In car loans for Standard Assets accounts, periodical inspections are waived by Banks. However, if there is a default of two instalments, inspection is required.
- Half Yearly inspections are required in NPA accounts.
- In case Housing loans for standard assets accounts, inspections are required after every disbursement during construction, thereafter, once in a year. However, if there is a default of two instalments, inspection is required immediately.
- Adverse features and irregularities may be advised to the higher authorities / controllers immediately and steps to be initiated for regularizing the position under advice to controllers.
- Where movable assets are created out of the finance, one post-disbursement inspection within one month should be undertaken. Creation of the asset to be invariably ensured and recorded.
- Irregular term loans (any amount) – Monthly visits for recovery should be undertaken.

xi. Follow up Function:

- To ensure the end-use of funds.
- To relate the outstanding to the assets level on a continuous basis.
- To correlate the activity level to the projections made at the time of the sanction / renewal of the credit facilities.
- To detect deviation from terms of sanction.
- To make periodic assessment of the health of the advances by noting some of the key indicators of performance like profitability, activity level, and management of the unit and ensure that the assets created are effectively utilized for productive purposes and are well maintained.
- To ensure recovery of the instalments of the principal in case of term loan as per the scheduled repayment programme and all interest.
- To identify early warning signals, if any, and initiate remedial measures thereby averting the incidence of incipient sickness.
- To ensure compliance with all internal and external reporting requirements covering the credit area.

xii. Supervision Function:

- To ensure that effective follow up of advances is in place and asset quality of good order is maintained.
- To look for early warning signals, identify 'incipient sickness' and initiate proactive remedial measures.

xiii. Monitoring Function:

- To ensure that effective supervision is maintained on loans / advances and appropriate responses are initiated wherever early warning signals are seen.
- To monitor on an ongoing basis the asset portfolio by tracking changes from time to time.
- Chalking-out and arranging for carrying out specific actions to ensure high percentage of 'Standard Assets'.

The *important tasks* associated with the post-sanction stage of credit process is as follows:

xiv. In case of 'Takeover of Loans' from other Banks / Financial Institutions:

- Ensure that all the laid down instructions for taking over of loans from other financial institutions are meticulously followed and there are no deviations.
- Ensure that deviations if any, have been duly approved by the Controllers / Competent authorities.
- Ensure that the account is a standard asset and satisfactorily conducted at the other financial institution.
- Critically examine the reasons why the borrower / unit is switching over to another bank branch from their existing bankers.
- Ensure that the KYC norms have been followed.
- Statement of Accounts evidencing regular and up-to-date Payment of Instalment and Interest.
- Reporting to Next Higher Authorities for Take Over of Loans.
- Fresh up-to-date Non-Encumbrance Certificate and Legal Opinion Report.
- Ensure the obtention of opinion report and NOC from the financial institutions.
- Ensure no adverse remarks against the unit.
- Ensure the availability of Collateral Securities and its encumbrance
- Complete set of Title Deeds and connected Papers with a Forwarding Letter.
- Receipt / acknowledgement for the Cheque / Draft received together with a "No Dues Certificate"

d) Recovery, Supervision & Follow-Up:

Ensuring proper follow-up of advances and observance of systems laid down by the Banks at the operating level. Periodic and random examination of registers, accounts and books at the branch, scrutiny of periodic statements received, control registers and files/records covering the advances will assist this process.

Ensuring that security documents are kept current and that officials concerned observe all related documentation formalities.

Ensuring that the functions at the follow-up level are performed diligently and as per extant instructions of the Bank.

Ensuring that----

- a. Proper arrangements are in place for the recovery of applicable charges / fees / penalties etc. and
- b. Income leakage is checked.

Engaging in ongoing interaction with the officials responsible for follow-up on all critical matters relating to the loans / advances.

Maintaining ongoing contact with borrowers and co-lenders and keeping abreast of developments in borrower entities and business environment.

Scrutiny of ----

- (a) Periodical statements and financials received from the borrowers and
- (b) Control statements / reports prepared on the advances. Ensuring that corrective steps as required are taken and reports to higher authorities, where necessary, are submitted.

Periodic inspection of security at the intervals prescribed for the Credit Officer / Supervisor.

Ensuring that compliance is maintained with instructions laid down regarding systems and procedures; maintenance of books / registers is in order, and action is taken for rectification of irregularities pointed out in the various Audit / Inspection reports.

Conduct periodic assessment of the information thrown up by IRAC reviews and ensure identification of deteriorating assets and initiation of corrective steps.

Exercise control over NPA management and ensure effective follow-up for recoveries / rehabilitation with approvals from concerned / appropriate authority.

Ensure timely reviews / renewals of credit facilities.

Check-list / Important aspects of Recovery, Supervision and follow-up of Credit Process are:

- Ensure the end-use of funds.
- Ensure that the assets created are effectively utilized for productive purposes and are well maintained.
- Ensure recovery of the instalments as per the scheduled repayment programme.
- Monitor the failed Standing Instructions (S. Is) Report and initiate action for recovery.
- Adequate number of Post-Dated Cheques (PDCs) should be obtained, recorded and held in Joint Custody if there is no check-off facility.
- PDCs should be presented for payment on Due Dates.



- Proceedings under Section 138 to 142 of NI Act should be initiated in respect of PDCs returned unpaid.
- Revival Letters, duly signed by both the Borrower and Guarantor, should be kept along with the Loan Documents.
- Proper follow up of non-receipt of instalments on Due Dates to be made.
- Confirm whether salaries for the employees are paid in time in case of personal loans.
- Diarize and ensure the obtention of Revival Letters in time and keep the documents current and in order.
- Ensure, for vehicles financed by us, the charge is noted in the RC Book and a copy of the RC Book is kept along with the documents.
- Ensure Form 29 / 30 and Form No.34 / 35 duly signed by the borrower are obtained and kept on record in case of Vehicle Loans.
- For government employees, irregularity must be intimated to the Head of Department (HOD) / Drawing & Disbursing Officer (DDO) immediately.
- Wherever loans are sanctioned for outright purchase of Houses, plots, flats follow up to obtain the original title deeds and create EM after obtaining TIR.
- Follow-up of and rectification of irregularities pointed out in the various inspection / audit reports.
- Recovery of applicable charges / fees / penalties etc. as per extant instructions. To avoid income leakages.
- Preparation of reviews of IRAC, identification of deteriorating assets / potential NPAs and initiation of corrective action where warranted.
- Account-wise follow-up of NPAs for recovery / rehabilitation, preparation of related recommendations to appropriate authority for approval.
- Send demand notices for accounts where instalments are overdue.
- To identify early warning signals, if any, and initiate remedial measures thereby averting the incidence of incipient sickness.
- Hand over cases to Recovery agencies for recovery under SARFAESI Act, seizure of vehicles etc. and filing of DRT and other suits for recovery of dues with due approval from appropriate authorities.
- To ensure compliance with all internal and external reporting requirements covering the credit area.

e) Non-Performing Assets (NPAs) Management:

The basic strategy underlying the Bank's approach to recovery management is initiation of appropriate preventive / corrective action at the right time. As such, once the problem loans-



existing and potential NPAs are identified, steps will be taken to analyse problems based on facts and circumstances, by means of a review at the branch. Ensure the verification of list Cash Credits, Overdrafts, Demand Loans, Term Loans of all Segments and Probable NPA accounts in the segments or products.

The following are the more important functions of the branch level review:

- i) Diagnose reasons for the deterioration in asset quality, put the unit / account under close monitoring.
- ii) Verify adequacy of cash accruals of the unit / firm.
- iii) Revalidate the assumptions made at the time of credit sanction, particularly in regard to assessment of credit risk.
- iv) Formally bring to the notice of borrower / guarantor(s) the deterioration in asset quality and call upon them to regularize / remedy the same.
- v) Verify completeness and correctness of documentation, including revival position, creation / registration of charges, insurance cover and rectify deficiencies, if any.
- vi) Evaluate the collateral for liquidity, marketability and value, attempt to improve the Bank's collateral position.
- vii) Identify and study primary and secondary sources of repayment and evaluate their adequacy, the opportunity will be used to detect any assets of the promoters / guarantors which have not been taken into account while compiling opinion reports in the initial stage.
- viii) Obtain realistic and time bound commitment from the borrower / guarantor(s) to initiate suitable steps to arrest the deterioration in the loan quality.
- ix) Determine the corrective course of action required to upgrade / recover the loan, after a dialogue with the borrower.
- x) Take corrective steps for regularization of accounts under Special Mentioned Accounts (SMA) category into standard assets.
- xi) Ensure that there are no technical NPAs identified i.e., due keying wrong data in CBS.
- xii) Ensure identification of all the NPA accounts as per the IRAC norms.
- xiii) Ensure no NPA accounts are held in live regular category accounts.
- xiv) Ensure conduct of Recovery Camps, Lok Adalat at District / State Level at regular intervals to maximize the cash recovery.
- xv) Ensure prompt submission of recommendations for transfer of outstanding to NPA Account to Controllers and seek their approval.
- xvi) Ensure timely initiation of legal action, filing of suit in DRT.
- xvii) Ensure obtention of acknowledgement from Panel Advocate while handing over the security documents for filing suit.



- xviii) Ensure NPA status of an account is changed only on recovery.
- xix) Ensure interest rate is zero in NPA accounts.
- xx) Ensure no renewal, new loans sanctioned to the borrowers whose account is already classified under NPA.
- xxi) Ensure all the Documents / Title Deeds / Files of Recalled / NPA Assets are on record.
- xxii) Ensure periodical supervision and follow-up of NPA accounts.
- xxiii) Ensure the follow-up of Court / DRT cases and update the current position.
- xxiv) Ensure the prompt attendance for court / DRT cases.
- xxv) Ensure the list of advocates and the cases handled by them.
- xxvi) Ensure the receipt of Monthly / Quarterly Reports of all the cases from Advocates and appraise the Controller the updated position.
- xxvii) Ensure review of suit filed cases at quarterly intervals and submit the Branch recommendations to the Controllers.
- xxviii) Ensure timely submission of Written of Proposals to controllers to seek their approval.
- xxix) Ensure the initiation of compromise proposals wherever possible.
- xxx) Ensure the asset details of the borrower / guarantor not mortgaged to the bank to the Advocate for filing attachment before judgment.
- xxxi) Ensure proper care for realizable value of securities for Doubtful Assets to protect the bank's interest.
- xxxii) Ensure proper arrangement for sale of the movable assets of the unit at the earliest to avoid security charges / insurance / removable by the owner or others.
- xxxiii) Ensure all out efforts to minimize the portion of loss to the bank to barest minimum after realizing the value of securities.
- xxxiv) Ensure the decrees obtained from the Court / DRT are as per the prayer including rate of interest filed.
- xxxv) Ensure necessary steps for filing Execution Petition for Decree, EP.
- xxxvi) Ensure location of property, landmark, sketch map prepared and kept on record for all the securities for easy identification.
- xxxvii) Ensure supervision and follow-up on Restructured Loans.
- xxxviii) Ensure maintenance of Registers for Suit Filed, Written Off, Compromise Proposal, Cash Recovery etc.
- xxxix) It is the primary duty of the Managers to initiate action for recovery in all NPA accounts irrespective of whether they became NPA during their tenure or otherwise.



- xl) Follow up and collect due instalments settled at Lok Adalat's in time.
- xli) Effective credit management which includes timely renewal / review of facilities, supervision, follow-up and documentation.
- xl ii) Restructuring of facilities when signs of sickness are visible with the approval of controllers.
- xl iii) Timely rehabilitation where feasible.
- xl iv) Where rehabilitation is not possible, compromise to be encouraged.
- xl v) Timely filing of suits and constant follow-up with advocates.
- xl vi) Verification of assets at periodical intervals even where suits are filed.
- xl vii) With the help of external agencies, identify undisclosed properties of the borrower/ guarantors and file for attachment before judgment.
- xl viii) Arrange for seizure of assets hypothecated/pledged for eventual sale without allowing deterioration in quality of assets after seizure.
- xl ix) Initiate SARFAESI process wherever other recovery measures do not yield results.
 - (a) Put recommendations for write-off accounts where absolutely no recovery is possible.
 - (b) Execution of recovery certificates / decrees expeditiously.
 - (c) Initiate recovery in written off accounts

i. Branch Level Review:

An appropriate action plan to regularize / upgrade/ recover the concerned loan account will be developed.

Bank Branches will carry out the above exercise of identifying and reviewing problem loans on an ongoing basis and submit to their controllers a Review Report in a prescribed format.

Bank Branches will implement corrective action for problem loans in line with the directions received from the controllers and submit to the controller's progress reports in this regard at monthly / quarterly intervals.

ii. SARFAESI Act, 2002:

The Act has been amended by the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act 2004. The SARFAESI Act provides for Enforcement of Security Interest for the realization of the dues without the intervention of Courts or Tribunals which is treated as one of the most effective tools for recovery of NPAs under existing laws.

a. Rights of secured creditors under SARFAESI provisions:

The rights of secured Creditor (bank) to enforce this action arises only in respect of debt classified as NPA as per RBI norms. The Security Interest (Enforcement) Rules 2002 is notified



by the Government of India on 20.09.2002. The rules also provide for exercising the rights of the secured creditor under the Act through the Authorised Officer. Under Rule 2a, the Security Interest (Enforcement) Rules 2002. The "Authorised Officer" means an officer not less than a Chief Manager of a public sector bank or equivalent as specified by the Board of Directors to exercise the rights of a secured creditor. The right to exercise the powers to invoke implement and act as a Secured Creditor is vested only with the Authorised Officer of the bank. Once an account is classified as NPA, the bank would issue demand notice to the defaulting borrower and guarantor/s under section 13(2). 'Demand Notice' means the notice in writing issued by a secured creditor or authorized officer, as the case may be, to any borrower pursuant to section 13(2) of the Act (Rule 2b). The notice gives details of dues and calls upon them to discharge their dues to the bank within 60 days from the date of the notice. If the borrower makes any objection on receipt of the notice, the bank should communicate its reply within fifteen days (earlier one week). The communication shall convey the reason for the non-acceptance of the objection or representation. The Secured Creditor may take recourse to one or more of the following measures under Sec 13(4); in case the borrower fails to discharge the liability of the bank demanded under sec 13(2).

Under Sec 13 (4) a: "Take possession of the secured asset of the borrower including the right to transfer by way of lease, assignment or sale."

Under Sec 13(4)b: "Take over the management of the secured asset, provided a substantial part of the business is held as security and or the business is severable, take over whole or part of such business which is relatable to the security for the debt ".

Under Sec 13(4) c: "Appoint any person to manage the secured assets, the possession of which has been taken over by the secured creditor."

Under Sec 13(4) d: "He/ She may require at any time by notice in writing to any person who has secured assets from the borrower and from whom any money is due or become due to the borrower to pay it to the secured creditor." (Powers under sec.13(4)d cannot be exercised until notice under sec.13(2) has been issued and the sixty days period has expired).

The SARFAESI Act prescribes the following procedure for issuance of sale notice when the sale is by way of inviting tenders from the public or by holding the public auction.

1. The sale notice shall be published in two leading newspapers one in the vernacular language having sufficient circulation in the locality by setting out the terms of sale.
2. Every notice of sale is affixed on a conspicuous part of the immovable property and may if the authorized officer deems it fit, put on the website of the secured creditor on the internet.

Further as per Ministry of Finance's direction, all public sector banks, and financial institutions to upload all SARFAESI auction notices in the official website of the Government "tender.gov.in" to give wider publicity with a view of getting the better response.



Application of mind and care is required in the service of notice of SARFAESI Demand Notice, Possession Notice & Sale Notice.

1. **Date of commencement of 60 days-demand notice period:** The 60 days, notice period commences to run only from the date of service of notice/paper publication as the case may be. (Not from the date of the notice).
2. **Service of demand notice when the party is dead:** Notice sent to the dead person is bad in law. The Authorized officer to ascertain the details of all the legal heirs and send notice to them.
3. Effect service of **possession notices** properly by delivering the notice to the parties, affixing the possession notice on the outer door or such conspicuous place of the property and also published in two leading newspapers (one in vernacular language) having sufficient circulation in that locality within 7 days from the date of taking possession. Possession notice should mention correct dues.
4. Effect service of **sale notice**, setting out terms of sale, by delivering the notice to the parties, affixing the sale notice on the outer door or such conspicuous place of the property and also published in two leading newspapers (one in vernacular language) having sufficient circulation in that locality. Sale notice should mention correct dues.
5. The Authorized officer has to carefully **preserve the proof** of service (acknowledgment) of notices and proof for having sent (POD from a courier company, Registered notice receipt, Ack. Due, etc.)

In case of immovable properties, a brief notice about possession of the property should be painted on the outer door/compound walls. In case of actual possession of secured property could not be taken, the bank has to file an application before Chief Metropolitan Magistrate/District Magistrate seeking the order for possession. If the recovery made after enforcing action under the SARFAESI act, is not enough to cover the entire dues, the bank may further file the application before DRT/Court within the limitation period of loan documents. The mailing of a 30 days sale notice copies to the borrower/mortgagor after 20 days of taking possession, is to enable the aggrieved person (as a right) to file the application within 45 days before DRT for the stay of sale transaction of the secured property.

b. Action flow Chart: Special care to be taken while taking possession of movable properties (The authorized officer has to act in the following manner).

1. Take possession and execute Panchanama. (Under Rule 4(1) & 4(2).
2. Take inventory.
3. Keep safe custody of movables by him directly or through agents under rule 4(3).
4. The Authorised officer can immediately sell the movables taken into possession, if it is subject to speedy or natural decay or if expenses for keeping exceed value under Rule 4(3).
5. Take steps to protection, preservation, and insurance Rule 4(4).



6. Obtain estimated the value of movables and fix reserve price in consultation with the appropriate authority of the bank.
7. Can sell to secure the maximum price in one or more lots by obtaining quotations, inviting tenders, holding a public auction or by private treaty under Rule 6.
8. Issue 30 days sale notice to the borrower under Rule 6(2).
9. Issue newspaper advertisements setting out the terms of sale in case of public tender or public auction in two newspapers (one vernacular). The proviso to rule 6(2).
10. Issue sale certificate of sale on receipt of full payment for movables sold.

A few sections relating to registration of security interest by secured and other creditors, the effect of registration of transactions, right of enforcement of securities, and priority to secured creditors were not notified in the said amendment. In view of the foregoing Section 17 to Section 19 of the 2016 Act have been notified by the Ministry of Finance, Department of Financial Services, vide Notification No SO. 4619 (E) dated 26th December 2019 and are effective from 24th January 2020. (Read: **Amendment 2019** which is about the registration process, right of enforcement of securities and priority of secured creditors

The SARFAESI act amendment 2016 changes four laws, namely the "Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)", "Indian Stamp Act, 1899", "Depositories Act, 1996" and RDBFI Act 1993 (DRT act)].

The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016" was introduced in Lok Sabha on May 11, 2016. The object and reasons of the 'Bill' said that it will facilitate expeditious disposal of recovery applications under the SARFAESI act 2002.

Amendments to the SARFAESI Act 2002: The amendment to this law provides that the Courts and Tribunals shall not interfere in Secured Creditors taking possession of the security offered by the borrower/guarantor under SARFAESI Act 2002. The Bill further provides that the District Magistrate has to assist in the recovery process of the secured creditors and complete the above process within 30 days.

The amendment further proposes a hire-purchase and financial lease under the ambit of the SARFAESI Act. It also provides non-institutional buyers besides institutional buyers for investment in security receipts. Once implemented, the act enables the banks to take over the management of a company, by converting outstanding debt into equity shares and holding majority stake (51% or more) in the company. In the amendment, sponsors of the ARCs are allowed to maintain a 100% stake in the ARC. The bill empowers RBI to audit and inspect the business of ARCs and have the power to penalize the ARCs if they fail to comply with any directions issued by it.

Amendments to the Depositories Act, 1996: The Bill seeks to set up a Central database of security interest on property rights, to enable present and future creditors to have a clear

picture of ownership or encumbrance against security offered. The central registry when created would hold integrated records of transactions related to various registration systems like Companies Act, 2013, Registration Act, 1908, and Motor Vehicle Act, 1988. Nevertheless, it is obligatory on the part of the secured creditor to register the security interest in the assets with the central registry to have priority over others in the recovery of dues and also to take possession of the collateral.

Amendment to “Indian Stamp Act, 1899”: The amendment to Indian Stamp Act, 1899 would provide that the stamp duty will not be applicable to transactions carried out for transfer of financial assets (loans and collateral) in favour of asset reconstruction companies (ARCs).

Amendments to the RDDBFI Act: The amendment provides the increase in the retirement age of presiding officers of DRTs from the present 62 years to 65 years. The age of Chairpersons of Appellate Tribunals will be increased from 65 years to 67 years.

Once the Bill becomes ‘Act’, banks will be able to file their cases in DRTs having jurisdiction over the area of the bank branch where the debt is pending instead of filing cases in tribunals having jurisdiction over the defendant’s area of residence or business. The Bill provides the electronic filing of recovery applications, documents, and written statements regarding collateralized assets of the borrower/guarantor. Further, it provides DRT to issue summons to defendants within 30 days of application received by it, directing them to disclose the particulars of properties and assets held by them. The DRT is empowered to pass an interim ex-parte order restraining the defendants from disposing-off the collateralized properties. The Bill makes it obligatory to the applicant bank to specify the collateralized assets of the borrower. It also provides issuance of summons by the tribunals in the electronic form under the Act.

iii. Lok Adalat:

Recovery through award of Lok Adalat is the easiest and fastest mode of recovery. The literal meaning of Lok Adalat is people’s Court. The concept comes under the ‘**Alternative Disputes Redressal Mechanism**’ like arbitration, conciliation etc. The pre-litigation up to ₹20 lacs and suit filed accounts where plaint amount does not exceed ₹20 lacs can be settled through Award of Lok Adalat. The Lok Adalat is constituted under Section 19 of Legal Services Authority Act, 1987. There are different layers of Legal service authorities namely:

1. State Legal Service Authority.
2. Supreme Court Legal Services Committee.
3. High Court Legal Services Committee.
4. District Legal Services Authorities.
5. Taluk Legal Services Committees.

The members of Lok Adalat are from:

1. Serving or retired Judicial Officers.



2. A senior counsel or a lawyer of standing or
3. A senior officer of the Government or
4. A person of repute who is specially interested in the implementation of Legal Services and Programmes or
5. An eminent social worker who is engaged in the upliftment of the weaker sections of the society or a medical or any other expert as deemed fit, by the State Authority.

a. Method of organizing Lok Adalat:

The Manager of the Bank shall contact the borrowers and negotiate with them the terms of settlement. The Manager should convince the borrowers about the benefits of settling the matter via Lok Adalat. The branch office has to take their higher office permission/sanction wherever necessary, with regards to proposed terms of settlement.

The Legal Service Authorities shall be approached by the bank to conduct Lok Adalat along with a list of the accounts where settlement is feasible. The Legal Service Authority fixes the date of Lok Adalat and informs the same to the bank. The bank in turn shall serve notice to all the parties concerned. The concerned branch of the bank should personally contact the borrowers and ensure that all parties be present at Lok Adalat on the date fixed.

The Lok Adalat will be convened on the date fixed and **same day award will be passed**. The award is final and binding on all the parties.

b. Advantages of Lok Adalat:

1. Every award of the Lok Adalat is equivalent to a decree of a Civil Court.
2. OTS (One Time Settlement) can be put through Lok Adalat, so that on default, the award could be executed by the Court (Like execution of decree).
3. No appeal will be entertained against the award of Lok Adalat.
4. No case could be instituted in any Court with regard to case decided by Lok Adalat.
5. Entire Court fee paid for filing suit will be returned back and no lawyer fee is payable.
6. The award can also be passed on a holiday.

iv. Insolvency and Bankruptcy Code (IBC), 2016:

The Insolvency and Bankruptcy Code (IBC) 2016 is the **bankruptcy law** of India, amended as Insolvency and bankruptcy code (amendment) Bill 2017. The new law seeks to consolidate the existing framework by creating a single law for insolvency and bankruptcy. The mounting NPAs in the banking sector and other financial institutions have crippled lending activities of financial institutions in India, more so by public sector banks. The bankruptcy Code is therefore created to overcome this worst situation faced by the Indian economy. The newly created Code envisages a formal insolvency resolution process (IRP) for businesses, either by coming up with a viable survival mechanism or by ensuring speedy liquidation. Thus, the new Code could curb substantially the number of long-pending cases and also ensure quicker resolution of NPA problems of banks.



At present, there are four different legal forums viz. High Courts, Company Law Boards, Board for Industrial and Financial Reconstruction (BIFR), and Debt Recovery Tribunal (DRT) which have overlapping jurisdictions resulting in delays and complexities in the process of recovery of bad debts. In this context, the insolvency resolution process under bankruptcy law seeks to consolidate the existing framework by creating a single law that will ensure the time-bound settlement of insolvency.

The introduction of the Bankruptcy Code (IBC) shall give greater relief to lenders in India as secured and unsecured creditors. The Code provides an order of priority while distributing assets/proceeds during liquidation. The assets will be distributed in the following order

- i. Secured creditors* will receive their entire outstanding amount, rather than up to their collateral value,
- ii. Unsecured creditors have priority over trade creditors, and
- iii. Government dues will be repaid after unsecured creditors.

[*The Secured Creditors are the creditors who have a security interest on the assets of the borrower. security interest means right, title or interest or a claim to the property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes **mortgage, charge, hypothecation, assignment, and encumbrance or any other agreement** or arrangement securing payment or performance of any obligation of any person].

Section 14 of the code provides that the Adjudicating Authority shall by order declare a moratorium on all pending proceedings for a period of 180 days from the date of admission of the application to initiate insolvency resolution proceedings. The stay on pending cases includes execution of judgment and decrees, transferring, encumbering, alienating, or disposing of corporate debtor's assets except for the liquidation process. However, the act shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator. This section of the act also does not apply to the supply of essential goods or services to the corporate debtor as may be specified and that shall not be terminated or suspended or interrupted during the moratorium period.

a. Adjudication of Insolvency Resolution:

The National Company Law Tribunal (NCLT) will be the adjudicating authority that will adjudicate insolvency resolution for limited companies and LLPs. The Debt Recovery Tribunal (DRT) will adjudicate insolvency resolution for individuals and unincorporated entities. The resolution processes will be conducted by licensed insolvency professionals (IPs) who are members of insolvency professional agencies (IPAs). IPAs will also furnish performance bonds equal to the assets of a company under insolvency resolution.

b. Liquidation:

The Code bars the sale of property of a defaulter to such persons who is ineligible to be a resolution applicant during liquidation.



c. Penalties:

The Code inserts a provision to specify that person contravening any provisions of IBC, for which no penalty has been specified, will be punishable with a fine ranging between ₹1 lakh to ₹2 crore.

d. Information utilities (IUs):

Information utilities (IUs) will be established to collect, collate, and disseminate financial information to facilitate insolvency resolution.

e. Insolvency and Bankruptcy Board of India:

The Insolvency and Bankruptcy Board of India which will be set up shortly would regulate the functioning of IPs, IPAs, and IUs.

v. Compromise Settlements:

Compromise settlement refers to a negotiated settlement where a borrower offers to pay and the Bank agrees to accept in full and final settlement of its dues an amount less than the total amount due to the Bank under the relative loan contract. Thus, the settlement invariably involves certain sacrifice by Bank (by way of write-off and / or waiver) of a portion of its dues.

The following principles which are to be kept in view while considering compromise offers:

- Compromise will be a negotiated settlement under which Banks will endeavour to recover its dues to the maximum extent possible, with minimum sacrifice.
- Realizable value of security charged to the Bank as also the Bank's ability to take possession of the security and sell it, will be factors for determining the quantum of compromise amount. While assessing the realizable value of security, proper weightage will be given to the location, condition and marketability thereof. For the purpose, where considered necessary, services of outside approved assessors / valuers will engage at a reasonable cost.
- The latest status of the activity of the borrowing entity which seeks a compromise will be taken into reckoning at the very first stage of the negotiation.
- In case the borrower has other group firms, influence of these firms or the parent firm will be used for a better settlement and / or for getting additional security, pending realization of the entire amount of compromise.
- Normally, an initial deposit of at least 5% to 10% of the outstanding's will be taken from the borrower as evidence of the borrower's intention to pursue the compromise settlement with the Bank.
- It will be the endeavour of the Banks to get the entire compromise amount paid up in a lumpsum. In cases where the amount is agreed to be recovered in instalments, normally at least 40% of the amount (inclusive of 5% to 10% initial payment) would be payable upfront with the balance in instalments spread over a maximum period of 12 months. Interest at an agreed rate will be charged on the instalments due.

- The sources from which the borrower and / or guarantors will raise funds to pay compromise amount will be identified and records, particularly in those cases where the payment is proposed to be made in instalments.
- In the matter of fixing of terms for repayment of compromise amount due, distinction will be made between wilful defaulters and the borrowers defaulting in repayments due to circumstances beyond their control.
- The authority approving the compromise will not be the one who sanctioned the advance in question in his individual capacity.

a. Approach to Compromise:

Banker's approach to compromise as a recovery option will be based on an analysis of the Bank's strengths and / or weaknesses in a given case. The parameters for such an analysis are as under:

- Quality of assets charged to the bank.
- Collateral Cover.
- Means of borrower / guarantor (s) and
- Stage of legal action.

b. Extent of Concessions under Compromise Settlements:

The extent of concession which the Bank may extend while accepting a compromise offer will depend on various factors. The guiding principle will always be to realize maximum so that the Bank's loss is minimized.

Based on the status of the borrowing unit and depending on the merits of each case, any one or more of the following concessions may be considered:

- Waiver, either in full or part, of penal interest, if charged.
- Waiver of or reduction in the rate of interest, if charged.
- Partial or complete waiver of interest charged / accrued after the unit ceased functioning.
- Remission of a part of the principal due in addition to partial or full remission of interest.

All compromise proposals will clearly spell out the basis on which the negotiated amount of settlement has been arrived at.

The quantum of sacrifice per se involved in the compromise offer would not hinder consideration of the offer. The opportunity cost of funds locked up in the loan will be a significant factor. The opportunity cost of funds in hand vis-à-vis that of funds which could be in hand at a later period will be calculated to establish the comparative advantage of "Now or Later".

vi. Writing-Off Bad Debts:

Banks are following the procedure established for identifying accounts which are required to be written off. Normally outstanding's in loan accounts will be written-off if the recovery prospects are bleak and adequate provisions have been made therefor.



Risk Based Internal Audit

Credit Risk-Check List

Credit Risk Management:

(Please note that the Checklist is normally drawn from the Policies, Manuals and Standard Operating Procedures of the individual Banks/Financial Institutions and as such reference has to be made to those documents while drawing the check list.)

Pre-Sanction Process:

1. Appraisal - Value Statement Description:

A. Handling of Loan Applications:

i.

- a) All loan applications, as per standard format, received are entered in the prescribed register and date of processing / sanction / return / rejection are invariably noted in the register. In case of software for Loan Lifecycle Management is already implemented this register can be checked in the system.
- b) Acknowledgements with indication of probable date of disposal.
- c) Supporting documents (Income proof, Approved plan, Quotations etc. are verified with the checklist in application at the time of receipt of application and additional documents required subsequently are advised promptly.
- d) Applications forwarded to Central Process Centre (CPC) for Credit Proposals, wherever applicable. Required supporting documents collected before forwarding to the CPC.
- e) Proposals for re-lending to farmers who have settled their dues under compromise / OTS / write-off have been appraised as per extant instructions in the proposals.
- f) Turn Around Time as per the norms is ensured.

ii.

- a) KYC documents of borrowers / promoters / principal officers obtained and verified.
- b) Details of Land holdings, certificates / certified copies necessary revenue records/ Memorandum / Articles of Association, Partnership Agreement, SME Registration, Corporate Identity Number (as applicable) etc. obtained.

iii.

- a) Pre-sanction reports are held on record. Adverse features observed during pre-sanction visits are commented upon in the appraisal.
- b) Joint Inspections were conducted in case of 'Contract Farming' activity of Agriculture Loans.

**B. Quality of Appraisal:**

- i. Impact of Change in Management / Merger / Acquisition / Exit of partner commented upon in the appraisal memorandum. Continuity Letter from existing and incoming partners and confirmation from guarantor taken in case of exit of partner. No dissensions have been reported.
- ii. Track record of promoters / Applicants including their work experience commented upon in the appraisal.
- iii.
 - a. Credit Information Reports of associates / subsidiaries / JVs / group companies obtained from their bankers / Credit Information Agencies.
 - b. Brief particulars like sales, PAT, TOL/TNW, current ratio, name of banker, borrowing arrangements, IRAC status, conduct, etc., for associates / subsidiaries / JVs / group companies where the promoters / directors have controlling interest furnished in the appraisal memorandum.
 - c. Inherent risks in activity of the borrower are identified and their mitigations discussed
 - d. Pre sanction visit: Primary Security Inspected and its value is sufficient to cover the advance. Collateral Security, if any, Inspected and its value is as per norms
 - e. In case of financing to distressed farmers, necessary certificates from the appropriate authority for declaration of the natural calamities has been obtained.
 - f. In case of Govt. sponsored schemes identification of the borrowers done and viability of the activity is analysed independently (in addition to one done by sponsoring agencies).
- iv. Interlocking of funds, adverse features and NPAs amongst associates commented upon in the appraisal.
- v.
 - a. Opinion reports on borrowers / guarantors compiled / updated periodically. Opinion reports are duly supported by documentary evidence and for units with CRA below are supported by a statement of assets and liabilities in a sworn affidavit format.
 - b. TNW of Corporate Guarantors worked out on basis of latest audited balance sheet.
 - c. CIBIL Report taken on borrowers / guarantors. Status of irregular loans reported in CIBIL report commented upon in appraisal note.
 - d. While extending relief / further funding to defaulter farmers, genuineness of the difficulties faced by the farmers ascertained and recorded properly.

C. Analysis of Balance Sheet:

- i) Audited balance sheets have been obtained within 7-9 months of date of balance sheet.



- ii) Abnormal variations, if any, in estimated / projected sales, level of inventory, receivables and sundry creditors commented upon in the appraisal memorandum.
- iii)
 - a. Analysis of balance sheets carried out and classification of items incorporated in the appraisal memorandum.
 - b. Movement in TNW properly incorporated in appraisal memorandum. Adverse financial ratios commented upon in the appraisal memorandum. Income analysis done and commented upon.
- iv) Genuineness of financial statements submitted by borrowers enjoying fund-based limits of ₹1 crore and above are verified by making an independent reference to the 'CA' who has signed the balance sheet; no false statements have been submitted.

D. CRA and External Rating:

- i) CRA rating has been based on audited financials not older than 9 months and validated as per laid down guidelines.
- ii)
 - a. CRA validation has been carried out independently, prior to or simultaneously with the sanction.
 - b. CRA review carried out at half-yearly intervals for units rated below the bench mark.
 - c. Movement in CRA rating commented upon in the appraisal memorandum.
 - d. Rating by external agencies carried out, wherever applicable.
 - e. CMA information such as Operating Statement and Balance Sheet data captured correctly. Additional Information for Financial Risk Assessment such as average Gross DSCR (Existing or Proposed) and Average Year to Year growth in net sales in last two quarters, industrial average figures for TOL / TNW and CR are captured for calculation of scores under industry average comparison to avert normalization.
 - f. Mandatory information such as Market Segment, Business Description, Demand and Supply, Write-up on Activity and Company history (Under Market Share) and financial year end date captured correctly.
 - g. Banking Arrangement and External Rating details are mandatorily captured in CRA.
 - h. The proposal 'Sent Back to Credit Analyst' by Risk Ratter are dealt with and resubmitted for further processing.

E. Working Capital Appraisal:

- i)
 - a) Working Capital requirements have been computed as per applicable method / as per the scheme, after assessing credit needs / credit worthiness of the borrowers.



- b) In case of ACC, the limits are arrived at as per applicable / enhanced scale of finance. Consumption needs have been taken care of wherever necessary.
- c) Scheme Specific needs, if any under Contract farming have been taken care of.
- ii)
 - a) Memorandum of Understanding (MOU) with the Contact Farming Company (CFC), if any has been vetted by the Law Department.
 - b) Extension Services like Soil testing, improved / Quality Agro. inputs, technology (wherever applicable) was ensured.
 - c) Buy back arrangements of Agri. Produce with facility of payment through bank account is ensured.
- iii) Unrealistic Projections have not been made on a regular basis in order to accommodate request for limits higher than warranted.
- iv) Turnover and profit achieved has been in line with earlier projections.
- v) Assumptions made are co-related with the latest trend in sales, profit, etc.

F. Project Appraisal / Term Loans / Demand Loans:

- i)
 - a) Economic viability and technical feasibility have been looked into (Including projects under NABARD, NHB, Fisheries Projects etc., all Horticultural Projects).
 - b) Quantum of Loan correctly arrived at as per applicable Scheme.
- ii)
 - a) Income proof verified / Expected rental value taken on realistic basis.
 - b) Quantum of loan correctly arrived at taking into account Scoring model, EMI / NMI ratio stipulation (where applicable).
- iii)
 - a) Ware House Receipts (WHR) finance limit is within the overall Asset Based Finance (ABF) of the unit concerned.
 - b) Finance extended under Warehouse Receipts, against CWC / SWC or Private warehouses, are accredited to MCX (NBHC).
 - c) Applicable Exposure Ceilings in respect of Private warehouses accredited / non-accredited and financed by us / not financed by us have been adhered to.
 - iv) DSCR, break-even analysis and sensitivity analysis has been carried out for term-loans.



G. Security:

- i. Accurate description and nature of charge (hypothecation / mortgage) along with ranking of charge (first / second / pari-passu) of both primary and collateral security shown in the appraisal memorandum.
- ii. Valuation report obtained from approved valuer is current (i.e., Not older than 3 years). Realisable / residual value is shown in the appraisal memorandum.
- iii. Reasonableness of value of the properties given by the banks panelled valuer, duly certified by the branch.
- iv. Title Investigation Report (TIR) on standard format obtained confirming genuineness of title deeds / Title deed book duly supported by proof of search (Search fee receipt and certified copies of TD) with appropriate authority obtained.

H. Miscellaneous:

- i) Risk weight of the exposure, Credit Conversion Factor (CCF) have been correctly taken and there are no errors in Capital charge calculations.
- ii) Past sacrifices made by the Bank, if any, including Right of recompense commented upon in the appraisal.
- iii) Concessions in margin, security, pricing, etc., if any, are approved by the delegated authority and are current.
- iv) Is there any platform for monitoring of advances such as Loan Lifecycle Management systems available? If Yes, the compliance of the same to be checked.
- v) Other areas.

2. Assessment - Value Statement Description:

A. Compliance:

- i)
 - a) Proposals conform to Bank's lending policy / RBI / Govt. guidelines and Prudential exposure norms.
 - b) Deviations, if any, have been approved by the competent authority. Regulatory Clearances, where ever applicable, are in place.
- ii) Scale of finance prescribed is current and not beyond one year.
- iii)
 - a) In take-over cases, sanction letter of facilities availed / offered by the other bank obtained along with opinion report.
 - b) Norms stipulated for take-over of the loan / various structured schemes furnished in the appraisal memorandum, wherever applicable. Deviations, if any, commented upon and approval obtained.



- iv) Latest RBI defaulters list, Wilful defaulters list, ECGC caution list, CIBIL Suit filed / Witten-off and Compromised Account list have been referred and incorporated in the proposal for taking credit decision. Justification for deviations obtaining, if any, have been recorded / commented upon and approval obtained.
- v) Accounts have been renewed / reviewed on schedule. Term loans have been reviewed as per laid down norms (The review period not exceeding 12 months with two reviews. Each review not exceeding 6 months).

B. Quality of Assessment:

- i. Non-compliance of earlier terms of sanction and observations are commented upon in the assessment exercise.
- ii. In case of renewals, adverse features like frequent irregularities in the account, non-routing of sale proceeds through the account, devolvement of LCs, Invocation of BGs commented upon.
- iii. Serious irregularities / warning signals / red flags pointed out in earlier audit reports have been commented upon in the appraisal memorandum.
- iv. Comments on adverse features in the Auditors Notes have been incorporated in the appraisal memorandum.
- v. Statutory dues and dues to Financial Institutions / Banks / Associate Concerns / Other Overdue creditors are factored and analysed in the appraisal memorandum.
- vi. Adequate justification for change from existing position in terms of margin, security etc., (Where ever Applicable) provided in the appraisal memorandum.

Sanction Process-Value Statement Description:

- i)
 - a) Laid down delegation of powers is adhered to in all cases of sanction.
 - b) Control return submitted and sanctions / approvals taken on record / noted for control by the appropriate authority.
- ii) Appropriate sanctions / approvals including processing charges, interest rate, margins, repayment schedule and concessions clearly recorded in all cases.
- iii) Administrative clearances have been obtained, wherever necessary.

Post Sanction Process - Value Statement Description:**I. Documentation, Compliance with Terms & Conditions:**

- i)
 - a) Appropriate documents (Including tri-partite agreement), duly executed, have been obtained (including Bank's right to reduce the limit in case of non-utilisation / lower sales level).



- b) Documents are current (revival letters obtained where applicable) and enforceable.
- c) Arrangement Letter conveying all stipulated terms of sanction duly acknowledged by both the borrower and guarantor obtained for all sanctions / renewals / reviews / re-phasing / restructuring of limits and kept on record.
- d) Appropriate Board resolutions are on record, wherever applicable.
- e) Documents adequately stamped.
- f) Consent / Undertaking Letter from appropriate authority, in case of Contract farming, obtained and on record.
- ii) Letter of Authorisation from farmers addressed to the Contract Farming Company (CFC), as per standard Format, authorising the Branch / bank to receive the payment has been obtained in respect of all the applicable cases.
- iii) Documents entered in Loans and Advances Documents Execution Register.
- iv) Guarantees, wherever stipulated, have been obtained.
- v) Documents held in proper custody and made available for verification.
- vi)
 - a) PDCs obtained as per extant instructions (including for all loans beyond ₹.2 lacs sanctioned under ATLs and Government Sponsored Schemes) and held in proper custody.
 - b) ECS / SIs mandate obtained and recorded in CBS as per sanction terms.
- vii)
 - a) Legal opinion obtained from empanelled lawyer on prescribed format confirming genuineness of title deeds and unqualified right of the Bank to enforce the mortgage.
 - b) Supplementary TIR taken in all cases where original title deeds are received subsequent to obtention of the TIR.
- viii)
 - a) All documents mentioned in the TIR / legal opinion taken while creating mortgage. (Including NOC, Lien Confirmation Letter as also Share Certificates from housing societies, wherever applicable are obtained).
 - b) Recital for creation / extension of EM has been recorded and witnessed in the EM / Title Deeds Register.
 - c) Deposit of title deeds with intention to create mortgage obtained on Form A / B received through registered post held on record.
 - d) Registration of EM / Memorandum of Deposit (MOD) / Central Registry (CERSAI) recording has been carried out, wherever applicable.
 - e) Acknowledgement of Tehsildar / Sub-Registrar for noting the Bank's charge is ensured.



- f) Independent verification of ownership done by a Bank official.
- ix) Mortgage of all properties stipulated in the sanction has been created. The description matches with the description in the sanction.
- x) Copies of documents executed by the borrowers / guarantors are handed over to them & acknowledgement for such delivery is held on record.
- xi)
 - a) Charge has been filed with ROC within the stipulated period and Search Report obtained
 - b) Satisfaction of prior charge of other lenders, if any, has been ensured.
 - c) Periodic search reports have been obtained and Bank's charge verified
 - d) In all applicable cases, formalities for creation of second / pari-passu charge have been properly completed
 - e) In case of vehicle / Tractor / Harvester loans, copy of RC book (with Bank's charge noted therein) along with Blank RTO transfer forms have been obtained and held on record.
 - f) For loans against shares, extant instructions in this regard are followed.
- xii)
 - a) Liens have been marked on Deposits held as security, noted in CBS and screen printout kept on record.
 - b) Scrips stipulated in sanction have been obtained and maintained as per extant instructions with lien marked wherever necessary.
 - c) Valuation of collateral securities is carried out at stipulated intervals and independent assessment recorded.
 - d) Assignment of Insurance Policy in favour of the Bank has been carried out.
- xiii)
 - a) Insurance cover for adequate value has been obtained for primary security with Bank's interest noted on them. The insurance cover is current and all risks have been covered. Deviation, if any, have been approved by the appropriate authority. Insurance for all the commodities in warehouse concerned has been obtained and a certificate that adequate cover available is on record.
 - b) Insurance cover for adequate value has been obtained for collateral security with Bank's interest noted on them. The insurance cover is current and all risks have been covered. Deviation, if any, have been approved by the appropriate authority.
 - c) Insurance details are correctly entered in CBS. Customer Insurance Report is scrutinised and followed up.



- d) Insurance Policy is discharged properly / assignment letter obtained from the Insurance Company
- xiv) ECGC cover for pre-shipment / post-shipment credit has been obtained & premia has been paid or waiver of such cover has been approved by the Sanctioning authority.
- xv) Eligible accounts are covered under CGTMSE/ ECLGS/ CGFMU etc is available for all such units.
- xvi) In respect of loans covered under various subsidy schemes for construction of Cold Storage Units / Rural Godown etc., utilisation Certificates were submitted / subsidy claimed promptly.
- xvii) In respect of Govt. Sponsored Schemes Subsidy claims are lodged / received and proper record is maintained.
- xviii) Stipulations / conditions / special observations enumerated in the sanction complied with. Deviations, if any, up to appropriate authority and waiver obtained.
- xix) Terms and conditions stipulated in the sanction have been complied with. Observations on the Control return have been attended to.

II. Early Sanction Review (ESR) – Value Statement Description:

- ESR observations were received and Action Taken Report (ATR) is put up to Higher Authority.
- Approval received from Higher Authority for ATR and the report is closed.

III. Follow Up, Monitoring & Control - Value Statement Description:

a) Setting up of the Account:

- i)
 - a) All particulars like Product code, sub-product code, limit, repayment schedule, date of sanction, moratorium period, repayment schedule, limit expiry date etc., have been correctly entered in CBS.
 - b) Appropriate holiday for NPA monitoring has been entered.
 - c) Input form for setting up the account is held for verification.
- ii)
 - a) Interest rate correctly set in all the loan accounts.
 - b) Information / details on account type, type of Primary / collateral security and its value entered correctly in CBS so that capital adequacy requirement as per Basel II norms is arrived at correctly.
 - c) Classification of BGs in to Financial / Performance guarantees fed into the system.



- iii) Farmers who avail short term production credit above ₹.3.00 lakhs were charged interest @ 7% for the portion up to ₹.3.00 lakhs manually and necessary reversal entries, at the time actual repayment or as per terms of sanction (Maximum within 12 months of date of disbursal) are passed and record thereof is maintained.
- iv) Loan processing fee / Upfront fee has been recovered as per sanction / laid down instructions. Processing fee recovered invariably on the anniversary date of renewal / review.

b) Disbursement:

- i) For limits beyond the stipulated threshold, certificate has been obtained from the borrowers confirming that the funds have been used for the purpose for which it was sanctioned only.
- ii)
 - a) Disbursal of Term Loan / Export Packing Credit has been made as per the terms of sanction & end use of funds ensured.
 - b) Invoices / bills / cash receipts obtained, wherever necessary.
- iii)
 - a) Infusion of equity / quasi-equity as envisaged in the appraisal note has been carried out.
 - b) Evidence to this effect by way of 'CA Certificate' / 'Form A' filing with ROC obtained and kept on record.
 - c) Infusion of capital in corporate concerns verified with MCA Site.
- iv) Details / Data has been submitted in respect of applicable re-finance Scheme. E.g., Export Finance.

c) Monitoring of Operations:

- i)
 - a) Stock / Book debts statements are obtained in the format prescribed at stipulated intervals.
 - b) Drawing Power is computed on paid stocks. Value of Usance LC outstanding has been reduced from the Advance Value of Stocks. Buyers Credit availed for Raw materials has been reduced from DP in all the cases.
 - c) Drawing Power recorded in the Assets Hypothecation Register. DP is updated in CBS and screen print filed.
 - d) Auditor's Certificate of outstanding book debts is obtained, wherever applicable.
 - e) Date of receipt of Stock Statements entered correctly in CBS to ensure that penal interest is levied for delay in submission of stock statement.



- f) Branch maintains a commodity-wise register in respect of Ware House Receipt finance.
- g) Drawing Power as terms of sanction and CBS is the same.
- ii)
 - a) Financial Follow-up Reports / Monthly Statement of Select Operational Data (MSOD)/ Cash Budget / End-use of funds certificate obtained and analysed.
 - b) Monitoring of top-up margin in scheme specific cases are carried out.
- iii)
 - a) Frequent Irregularity in accounts is not allowed.
 - b) Reasons for irregularity clearly brought out.
 - c) Irregularity is not permitted in accounts other than for the permitted purposes.
- iv)
 - a) Irregularity Reports (including reports on LC devolvement, if any), submitted to Controllers promptly at stipulated intervals.
 - b) There are no adverse market reports or cases of Investigation by Govt. Agencies.
- v)
 - a) Confirmation obtained from appropriate authority and held on record.
 - b) Close follow-up for regularisation of account observed.
- vi) In case of LC devolvement / BG invocation fresh LC / BG established after specific approval and reported for control.
- vii) Queries / Controller's Remarks on such reports are complied with / attended to without any exception.
- viii) Periodical review of irregular Term Loan accounts carried out and put-up to appropriate authority. Financial covenants are tested at annual intervals.
- ix)
 - a) Stock audit conducted at stipulated intervals as per applicability. (Exposures ₹5 Crores and above).
 - b) Stock audit reports scrutinised and adverse features if any, taken up with borrower/ unit concerned.
 - c) Improvements are monitored and held on record.
- d) Inspection:**
 - i)
 - a) Inspection is conducted at laid down intervals and remarks recorded in the unit inspection register / unit inspection report. Post Disbursal Inspection has been invariably conducted in all Agri. Term loan accounts within one month of disbursal of the loan.



- b) Inspection Reports are put up on the standard format and adverse findings during the inspection, if any, taken up with the borrowers / units.
- c) There is no evidence of routing sales through other banks without authorisation to do so.

ii)

- a) Activity observed to be at normal levels without any slowing down / cessation
- b) No piling up of stocks was observed
- c) Realisation of Book Debts is regular and there are no instances of bill returned unpaid.

e) Multiple Banking:

i)

- a) Consortium meetings are held at periodic intervals and minutes circulated.
- b) Information is shared amongst consortium members and banks joining under multiple banking arrangements.

f) Software based Credit Monitoring system:

- i. Ensure all parameters for monitoring are fed in the system.
- ii. All the Early Warning Signals generated from the system are thoroughly verified and disposed-off as per the norms.
- iii. Ensure that the escalations matrix is properly followed and system based disposals adhered.

g) Recovery of Instalments:

- i) In case of PDCs returned unpaid, failed ECS prompt follow-up with the borrowers is observed. Returned PDCs are recorded, service charges recovered. Action is initiated under Sec. 138 of NI Act or deferred under approval of the Controllers.
- ii) Failed SI / ECS Report is printed and reviewed daily and borrower contacted promptly. Standby PDCs are presented and if returned, action initiated under Section 138 of NI Act.

h) Miscellaneous:

- i) Branch maintains Manual back up Registers, as per Standard format for recording details of Interest reversed and credited back on account of ----
- a) Limits above ₹.3.00 lakhs and
- b) Benefit of additional interest subvention (incentive) for prompt paying farmers etc.
- ii) NPA Holiday period declared / Not declared data has been verified from the Data Warehouse Portal and necessary corrections are made in the CBS wherever necessary.



- iii) No anomalies are observed in Loan accounts opened and closed during the review period.
- iv) Standard assets are monitored and reviewed periodically.

IV. Bill Financing-Value Settlement Description:

A. Bills Discounted / Inland Bills:

- i)
 - a) Facility is made available against sanctioned limits, Note is prepared and Approval recorded.
 - b) Bills are scrutinised and Discrepancies (vis-à-vis L/C, if applicable), if any are brought to the notice of the Customer.
- ii)
 - a) Bills are entered in Exim Bills / CBS and liability accounts are properly opened.
 - b) Documents are dispatched promptly.
- iii)
 - a) Delays in realisation / reimbursements are followed-up with tracers and record thereof is maintained.
 - b) Overdue interest is recovered wherever applicable.
 - c) Overdue bills are crystallized promptly.
 - d) Periodical balancing of the outstanding under Exim Bills.

B. Interchangeability:

- i) In case of interchange of limits (within overall limits) approved, Limit Tree functionality in CBS is used.

Problem Loan Management-Value Statement Description:

1. Problem Loan Review and Reporting:

- i) Security documents are reverified by an empanelled advocate other than the one who furnished the original TIR.
- ii) Independent valuation of both movable and immovable assets has been carried out by Bank officials to ensure that valuation is reasonable.
- iii)
 - a. SMA reports / Stressed Assets Review Reports are submitted in all cases in time, record maintained and Controller's confirmation obtained.
 - b. Action plan proposed in SMA review implemented.



- c. Names of defaulting companies / Directors have been reported to controllers for placing them in RBI defaulters list / Wilful defaulters list.
- iv)
 - a. Approval has been obtained for holding-on operations from the appropriate authority.
 - b. Letters have been exchanged with borrower advising terms for continuing holding-on operations.
- v)
 - a. Re-phasement / Re-structuring is done in case of genuine requirements (including natural calamities).
 - b. Viability has been examined and rehabilitation proposal approved and implemented, wherever applicable. Progress of implementation is monitored.
- vi)
 - a. Proposals for Compromise offers were expeditiously dealt with and recommendations for sent to the appropriate authority promptly.
 - b. Accepted Compromise offers have been followed-up and loan account closed.
- vii) Written commitments have been obtained from borrowers / Guarantors, seeking time / re-phasement / moratorium.
- viii) Quick mortality aspects have been analysed and staff accountability / Vigilance aspects examined, while accounts are recommended for transfer to Recalled Assets account as the case may be.

2. Handling of Problem Loan Accounts – Value Statement Description:

A. SARFAESI Act:

- i) Approval from appropriate authority has been taken wherever action under SARFAESI Act.
- ii) Action initiated through recovery agent after expiry of notice period.
- iii) Periodic reports are received from the Recovery Agent, wherever applicable and progress monitored.
- iv)
 - a. Notice under SARFAESI Act have been issued without delay.
 - b. Periodic reports are received from the Recovery Agent and progress monitored.

B. Revenue Recovery Proceedings:

- i) Recovery Camps are organised periodically and support of Revenue authorities is obtained wherever necessary.
- ii) Certificates for initiation of Revenue recovery Proceedings were filed promptly and acknowledgements obtained and held on record.



C. Claims:

- i)
- a. ECGC claims have been filed, where applicable and all ECGC queries have been answered.
- b. Claims lodged promptly in respect of credit facilities sanctioned under CGTSME and proper follow-up is made.
- ii) Credit Information Companies, RBI and ECGC notified about borrower as defaulter.

3. Recovery Suits/DRT/IBC -Value Statement Description:

- i) Suit filed register is maintained and updated on an ongoing basis.
- ii)
- a. Suits have been filed with appropriate courts including DRT / NCLT and each suit has a unique number / Approval for waiver / deferment of filing of suit is on record.
- b. The case is followed up with the lawyer / IPs and recovery process monitored closely
- c. Status reports are obtained from Bank's advocates, reviewed and advised to the Controllers on quarterly basis.
- d. Where case has been decreed and recovery certificate issued, EP has been filed and followed up.
- iii)
- a. Branch has been exploring possibilities of settling the dues through Lok / Bank Adalat scheme.
- b. Record of Settlements through Lok / Bank Adalat is held and follow-up is made wherever necessary.

4. IRAC Classification -Value Statement Description:

- i) There is no difference in Asset Classification between CBS data and CIS reports.
- ii) IRAC classification has been done as per RBI guidelines.

5. Reduction of NPAs-Value Statement Description:

- i) Through Compromise proposals.
- ii) Through Write-off.
- iii) Through recoveries /upgrades (other than write-offs).

6. Advances Under Collection Account (AUCA) Recovery & Other written-off Accounts-Value Statement Description:

- i)
- a. Follow up, Recovery and Review mechanism for AUC Accounts is in place.
- b. Post written off follow up is observed.
- ii) Recovery in AUCA.

Growing number of high-profile operational loss events worldwide have led banks and supervisors to increasingly view operational risk management as an integral part of the risk management activity. Management of specific operational risks is not a new practice; it has always been important for banks to try to prevent fraud, maintain the integrity of internal controls, reduce errors in transaction processing, and so on. However, what is relatively new is the view of operational risk management as a comprehensive practice comparable to the management of credit and market risk. 'Management' of operational risk is taken to mean the 'identification, assessment, and / or measurement, monitoring and control / mitigation' of this risk.

Financial institutions are in the business of risk management and hence are incentivized to develop sophisticated risk management systems. The basic components of a risk management system are identifying the risks the entity is exposed to, assessing their magnitude, monitoring them, controlling or mitigating them using a variety of procedures, and setting aside capital for potential losses (including expected losses and unexpected losses).

Deregulation and globalization of financial services, together with the growing sophistication of financial technology, are making the activities of banks and thus their profiles more complex. Evolving banking practices suggest that risks other than credit risks and market risks can be substantial. Examples of these new and growing risks faced by banks include:

- **Highly Automated Technology:** If not properly controlled, the greater use of more highly automated technology has the potential to transform risks from manual processing errors to system failure risks, as greater reliance is placed on integrated systems.
- **Emergence of E-Commerce:** Growth of e-commerce brings with it potential risks (e.g., internal and external fraud and system securities issues).
- **Emergence of banks acting as very large volume service providers:** Creates the need for continual maintenance of high-grade internal controls and back-up systems.
- **Outsourcing:** Growing use of outsourcing arrangements and the participation in clearing and settlement systems can mitigate some risks but can also present significant other risks to banks.
- **Large-scale:** Acquisitions, mergers, de-mergers and consolidations test the viability of new or newly integrated systems.

- **Banks may engage in risk mitigation techniques:** Collateral, derivatives, netting arrangements and asset securitizations) to optimize their exposure to market risk and credit risk, but which in turn may produce other forms of risk (e.g., legal risk).
- Operational Risk has evolved rapidly over the past few years. At first, it was commonly defined as every type of unquantifiable risk faced by a bank. However, further analysis has refined the definition considerably. Operational risk has been defined by the Basel Committee on Banking Supervision as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events”. This definition includes legal risk, but excludes strategic and reputational risk. This definition is based on the underlying causes of operational risk. It seeks to identify why a loss happened and at the broadest level includes the breakdown by four causes:
 - People.
 - Processes.
 - Systems and
 - External Factors.

Manifestations of Operational Risks:

A clear appreciation and understanding by banks of what is meant by operational risk is critical to the effective management and control of this risk category. It is also important to consider the full range of material operational risks facing the bank and capture all significant causes of severe operational losses.

Operational risk is pervasive, complex and dynamic. Unlike market and credit risk, which tend to be in specific areas of business, operational risk is inherent in all business processes. Operational risk may manifest in a variety of ways in the banking industry.

The Basel Committee has identified the following types of operational risk events as having the potential to result in substantial losses:

- **Internal fraud:** For example, intentional misreporting of positions, employee theft, and insider trading on an employee's own account.
- **External fraud:** For example, robbery, forgery, cheque kiting, and damage from computer hacking.
- **Employment practices and workplace safety:** For example, workers compensation claims, violation of employee health and safety rules, organized Labour activities, discrimination claims, and general liability.
- **Clients, products and business practices:** For example, fiduciary breaches, misuse of confidential customer information, improper trading activities on the bank's account, money laundering, and sale of unauthorised products.
- **Damage to physical assets:** For example, terrorism, vandalism, earthquakes, fires and floods.

- **Business disruption and system failures:** For example, hardware and software failures, telecommunication problems, and utility outages.
- **Execution, delivery and process management:** For example: data entry errors, collateral management failures, incomplete legal documentation, and unauthorized access given to client accounts, non-client counterparty mis-performance, and vendor disputes.

BCBS in its guidance note gave the following 11 fundamental principles of Operational Risk Management:

Fundamental principles of operational risk management

Principle 1:

The board of directors should take the lead in establishing a strong risk management culture. The board of directors and senior management⁹ should establish a corporate culture that is guided by strong risk management and that supports and provides appropriate standards and incentives for professional and responsible behaviour. In this regard, it is the responsibility of the board of directors to ensure that a strong operational risk management culture exists throughout the whole organisation.

Principle 2:

Banks should develop, implement and maintain a Framework that is fully integrated into the bank's overall risk management processes. The Framework for operational risk management chosen by an individual bank will depend on a range of factors, including its nature, size, complexity and risk profile.

Governance

The Board of Directors

Principle 3:

The board of directors should establish, approve and periodically review the Framework. The board of directors should oversee senior management to ensure that the policies, processes and systems are implemented effectively at all decision levels.

Principle 4:

The board of directors should approve and review a risk appetite and tolerance statement¹² for operational risk that articulates the nature, types, and levels of operational risk that the bank is willing to assume.

Sound Practices for the Management and Supervision of Operational Risk

Senior Management

Principle 5:

Senior management should develop for approval by the board of directors a clear, effective and robust governance structure with well defined, transparent and consistent

lines of responsibility. Senior management is responsible for consistently implementing and maintaining throughout the organisation policies, processes and systems for managing operational risk in all of the bank's material products, activities, processes and systems consistent with the risk appetite and tolerance.

Risk Management Environment Identification and Assessment

Principle 6:

Senior management should ensure the identification and assessment of the operational risk inherent in all material products, activities, processes and systems to make sure the inherent risks and incentives are well understood.

Principle 7:

Senior management should ensure that there is an approval process for all new products, activities, processes and systems that fully assesses operational risk.

Monitoring and Reporting

Principle 8:

Senior management should implement a process to regularly monitor operational risk profiles and material exposures to losses. Appropriate reporting mechanisms should be in place at the board, senior management, and business line levels that support proactive management of operational risk.

Control and Mitigation

Principle 9:

Banks should have a strong control environment that utilises policies, processes and systems; appropriate internal controls; and appropriate risk mitigation and/or transfer strategies.

Business Resiliency and Continuity

Principle 10:

Banks should have business resiliency and continuity plans in place to ensure an ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

Role of Disclosure

Principle 11:

A bank's public disclosures should allow stakeholders to assess its approach to operational risk management.

Relevance of Operational Risk Function:

Growing number of high-profile operational loss events worldwide have led banks and supervisors to increasingly view operational risk management as an integral part of risk

management activity. Management of specific operational risks is not a new practice; it has always been important for banks to try to prevent fraud, maintain the integrity of internal controls, reduce errors in transaction processing, and so on. However, what is relatively new is the view that operational risk management is a comprehensive practice comparable to the management of credit and market risks.

Operational Risk differs from other banking risks in that it is typically not directly taken in return for an expected reward but is implicit in the ordinary course of corporate activity and has the potential to affect the risk management process. However, it is recognized that in some business lines with minimal credit or market risks, the decision to incur operational risk, or compete based on the perceived ability to manage and effectively price this risk, is an integral part of a bank's risk / reward calculus. At the same time, failure to properly manage operational risk can result in a misstatement of an institution's risk profile and expose the institution to significant losses. 'Management' of operational risk is taken to mean the 'identification, assessment and / or measurement, monitoring and control / mitigation' of this risk.

Organizational Set up and Culture:

Operational Risk is intrinsic to a bank and should hence be an important component of its enterprise-wide risk management systems. The Board and senior management should create an enabling organizational culture placing high priority on effective operational risk management and adherence to sound operating procedures. Successful implementation of risk management process has to emanate from the top management with the demonstration of strong commitment to integrate the same into the basic operations and strategic decision-making processes. Therefore, Board and senior management should promote an organizational culture for management of operational risk.

It is recognized that the approach for operational risk management that may be chosen by an individual bank will depend on a range of factors, including size and sophistication, nature and complexity of its activities. However, despite these differences, clear strategies and oversight by the Board of Directors and senior management; a strong operational risk culture, i.e., the combined set of individual and corporate values, attitudes, competencies and behaviour that determine a bank's commitment to and style of operational risk management; internal control culture (including clear lines of responsibility and segregation of duties); effective internal reporting; and contingency planning are all crucial elements of an effective operational risk management framework.

Ideally, the organizational set-up for operational risk management should include the following:

- Board of Directors.
- Risk Management Committee of the Board.
- Operational Risk Management Committee.
- Operational Risk Management Department.



- Operational Risk Managers.
- Support Group for operational risk management.

Management Information Systems:

Banks should implement a process to regularly monitor operational risk profiles and material exposures to losses. There should be regular reporting of pertinent information to senior management and the Board of Directors that supports the proactive management of operational risk. In general, the Board of Directors should receive sufficient higher-level information to enable them to understand the bank's overall operational risk profile and focus on the material and strategic implications for the business. Towards this end it would be relevant to identify all activities and all loss events in a bank under well-defined business lines.

Business Line Identification:

Banks have different business mixes and risk profiles. Hence the most intractable problem banks face in assessing operational risk capital is due to this diversity. The best way to get around this intractable problem in computation is by specifying a range of operational risk multipliers for specified distinct business lines. The following benefits are expected to accrue by specifying business lines:

- Banks will be able to crystallize the assessment processes to the underlying operational risk and the regulatory framework.
- The line managers will be aware of operational risk in their line of business.
- Confusion and territorial overlap which may be linked to subsets of the overall risk profile of a bank can be avoided.

For the purpose of operational risk management, the activities of a bank may be mapped into eight business lines identified in the New Capital Adequacy Framework. The various products launched by the banks are also to be mapped to the relevant business line. Banks must develop specific policies for mapping a product or an activity to a business line and have the same documented to indicate the criteria. The following are the eight recommended business lines.

1. Corporate Finance.
2. Trading and Sales.
3. Retail Banking.
4. Commercial Banking.
5. Payment and Settlement.
6. Agency Services.

7. Asset Management.

8. Retail Brokerage.

The following are the principles to be followed for business line mapping:

- i. All activities must be mapped into the eight level business lines in a mutually exclusive and jointly exhaustive manner.
- ii. Any banking or non-banking activity which cannot be readily mapped into the business line framework, but which represents an ancillary function to an activity included in the framework, must be allocated to the business line it supports. If more than one business line is supported through the ancillary activity, an objective mapping criterion must be used.
- iii. The mapping of activities into business lines for operational risk management must be consistent with the definitions of business lines used for management of other risk categories, i.e., credit and market risk. Any deviations from this principle must be clearly motivated and documented.
- iv. The mapping process used must be clearly documented. In particular, written business line definitions must be clear and detailed enough to allow third parties to replicate the business line mapping. Documentation must, among other things, clearly motivate any exceptions or overrides and be kept on record.
- v. Processes must be in place to define the mapping of any new activities or products.
- vi. Senior management is responsible for the mapping policy (which is subject to approval by the Board of Directors).
- vii. The mapping process to business lines must be subject to independent review.

The following principles might be relevant for determining mapping of activities into appropriate business lines:

- i. Activities that constitute compound activities may be broken up into their components which might be related to the activities under the eight business lines and these components of the complex activity may be assigned to the most suitable business lines, in accordance with their nature and characteristics.
- ii. Activities that refer to more than a business line may be assigned to the most predominant business line and if no predominant business line exist, then it may be mapped to the most suitable business lines, in accordance with their nature and characteristics.

Operational Risk Management Policy:

Operational risk is a fast-emerging area in banking. Awareness of operational risk as a separate risk category has been relatively recent in most banks. Unlike market and credit



risk, the operational risk factors are largely linked to internal policies and procedures of the bank. There is no mathematical link between individual risk factors and the likelihood and size of operational loss. Losses arising from a bank's operational risks may, on occasion, exceed those stemming from credit losses. It is, therefore, a vital focus for management in ensuring a properly controlled approach to the risks inherent in their business. The processes of identifying and measuring operational risks are at a very nascent stage. The banks are only in the early stages of developing an operational risk management framework.

Banks must put in place suitable risk management policies and procedures to enable them to identify, assess, monitor and control/mitigate operational risk. These policies and procedures should be commensurate with the scale and complexity of the institution's operations. In particular, bank's policies and procedures should cover the following critical elements:

- Operational risk framework.
- Role of board and senior management in overseeing the operational risk framework.
- Responsibility for implementation of the framework.
- Independent control review.
- Collection of operational risk loss event data.
- Monitoring and reporting.

Banks must also ensure that their operational risk framework and arrangements are kept under regular review and amended as necessary, having regard to changes in banks' risk profiles as well as external market developments. Changes in banks' strategies, policies and procedures for operational risk management must be properly reviewed and approved.

The first step towards developing an operational risk framework is to develop a comprehensive operational risk policy. Each bank must have policies and procedures that clearly describe the major elements of the operational risk management framework including identifying, assessing, monitoring and controlling/mitigating operational risk. These policies and procedures should be commensurate with the scale and complexity of the bank's operations.

Definition of Operational Risk:

One of the essential elements of an operational risk policy is the definition of operational risk, including the loss event types that will be monitored. Operational risk is defined as "the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events".

Roles and Responsibilities:

The policy should clearly explain the roles and responsibilities of the independent bank-wide operational risk management function and line of business management. The different roles in an operational risk management function could be the risk committee of the board, executive risk committee, operational risk manager, etc. The responsibilities of these functions should be clearly explained in the policy.

Management Oversight:

The operational risk policy should contain the procedure for top-level reviews of the bank's progress towards the stated objectives. Senior management needs to review the risk exposure and the monitoring mechanisms on a regular basis. The policy needs to define the risk tolerance level for the bank, and break it down to appropriate sub-limits, prescribing reporting levels and breach of limits.

Capture and use of Operational Risk Loss Data:

The methodology for the capture and use of internal and external operational risk loss data including data potential events (including the use of scenario analysis) should be explained in detail. Extensive documentation is required for the process of identifying, capturing, assessing and accepting loss data. Banks must put in place systems enabling them to identify and systematically track all material operational loss events.

Business Environment and Internal Control Factor Assessments:

The development and incorporation of business environment and internal control factor assessments into the operational risk framework is another essential element of operational risk policy. An effective control mechanism is a qualitative factor that will have a great impact in controlling operational risk. The policy should cover a detailed discussion of Risk and Control Self-Assessment (RCSA) and its methodology, the frequency with which it has to be done and the persons involved in the process. The policy should also include a discussion of qualitative factors and risk mitigants and how they are incorporated into the operational risk framework. The key risk indicator identification and assessment methodology has to be described in the policy.

Internal Audit Review and Management Review:

A description of how the operational risk framework needs to be regularly reviewed by independent audit is an important element in operational risk policy. The operational risk management processes and procedures are subject to audit review. In addition to the audit review, management also needs to check compliance with management controls and regularly review the internal control mechanisms.

Indicate the process to be adopted for immediate corrective action when the issues are identified in audit review. There should be a documented procedure for review, treatment and resolution of non-compliance issues. A discussion of the models testing and verification processes and procedures needs to be documented.

Analytical Framework:

The policy should contain a description of the internally derived analytical framework that quantifies the operational risk exposure of the institution. The operational risk policy needs to describe how the operational risk exposure is calculated by using loss data, scenario analysis, risk and control assessments, etc.

Review and Approval Mechanism:

The process for the review and approval of significant policy and procedural exceptions should be incorporated in the operational risk policy.

Banks must ensure that their operational risk framework and arrangements are kept under regular review and amended as necessary, having regard to changes in institutions' risk profiles as well as external market developments. Changes in institutions' strategies, policies and procedures for operational risk management must be reviewed and approved by the board of directors. A documented procedure should exist for approving changes in policies and procedures, the persons responsible for approving changes and the procedure for notifying the changes.

The policy should indicate a system of documented approvals and authorizations and ensure accountability at an appropriate level of management. The roles and responsibilities of the persons responsible for approvals and authorizations have to be clearly mentioned.

Reporting Requirements:

A documented procedure should exist for risk reporting. The board / senior management receives regular reports on critical risk issues facing the bank and its control / mitigations. Management should develop operational loss databases that track loss events on the basis of the mapping approach to event type categories and business lines. Senior management also needs to receive regular reports on risk assessments, control assessments and risk exposure. Operational risk reports will reflect the scope and sophistication of institution's operational risk frameworks. For example, such a report might include information on the level and trend of historical operational losses including, where relevant, a summary of recent operational losses by loss event type, a brief description of the most significant operational losses for the prior quarter and summary of any operational risks identified as a result of an independent internal (or external) review.

Risk Based Internal Audit
Operational Risk-Check List

I. Business Lines-Value Statement Description:

1. Deposits (KYC, AML, Account Maintenance & Pension Accounts):

A. Know Your Customer Norms:

- i. Deposits Accounts Opened:
 - a) Documents obtained originally viz. Proof of ID, Proof of Address and Photograph are held on record.
 - b) Proof of ID, Proof of Address and Photograph are updated, as prescribed / Full particulars of the documents are entered in the CBS correctly.
 - c) Risk categorization (High, Medium & Low Risk) is done correctly. Review of risk categorization done periodically, as prescribed.
 - d) Effectiveness of follow up of KYC non-compliant account.
- ii. Deposits Accounts Opened through Central Processing Centres:
 - a. KYC documents obtained and sent to CPC along with Account Opening Forms on a daily basis.
 - b. Account opening forms returned by CPC for rectification are recorded in a Register and resubmitted after compliance promptly.
 - c. ID Proof / Address Proof / Photographs updated periodically as per RBI norms.
 - d. Risk categorization is done correctly. Review of risk categorization done periodically.
 - e. Workflow software for CPC is regularly used by the Bank Branch.
 - f. Letter of thanks / Cheque book sent by CPC and returned undelivered have been followed-up until, fully compliant; else the account has been blocked.
- iii. Advances Accounts Opened
 - a. Documents obtained originally viz. Proof of ID, Proof of Address and Photograph are held on record.
 - b. Proof of ID, Proof of Address and Photograph are updated. Particulars of the documents entered in the CBS correctly.
 - c. Risk categorization is done correctly. Review of risk categorization done periodically.
 - d. Effectiveness of follow up of KYC non-compliant account.



B. Anti-Money Laundering:

- i. New accounts opened are monitored for high value transactions in the initial period of 6 months.
- ii. Cash withdrawals and deposits for ₹.10.00 lacs and above in deposit, cash credit and overdraft accounts are recorded in a separate register and reported to controlling office every month.
- iii. Hard Copy of the Cash Transaction Reports (CTRs) are preserved at the Bank Branch.
- iv. Threshold limits as per the extant instructions for AML monitoring entered in CBS for all the accounts.
- v. The bank branch has to peruse, updated lists of Politically Exposed Persons (PEPs) and Terrorist Organizations.
- vi. Accounts of Terrorist Organizations / Individual have not been opened.
- vii. All transactions of suspicious nature are recorded and reported.
- viii. All instances of detection of counterfeit currency are recorded and reported to all concerned.
- ix. Proceeds of sale of Gold Coins worth ₹.50,000/- and above was routed through customer's accounts only and copy of duly attested photo copy of PAN Card is being retained with the application form.

C. Account Maintenance:

i. General:

- a) Passbooks / Welcome kits and non-personalized ATM Cards (at the request of the account holders) are handed over to the account holders/ their duly authorised representatives against proper acknowledgement/ authentication.
- b) All requests for issue of cheque books / ATM cards are forwarded through System promptly. Appropriate action taken in cases of cheque books / ATM cards returned undelivered.
- c) Cheque reported lost / stop payment instructions are fed in the CBS promptly and charges recovered. A record of all such instances is maintained.
- d) Frequent return of cheques is followed-up & suitable action is taken in respect of such accounts.

ii. Inoperative accounts:

- a) Communications have been sent to all customers (Whose a/cs have a balance of ₹5000/- & above and where no customer-induced transactions

have taken place for more than a year) for ascertaining reasons for non-operation.

- b) In all inoperative a/cs with balances over ₹.25,000/- all extant guidelines for such cases are meticulously followed (including deceased cases).

D. PENSION A/Cs:

- a) Pension accounts are opened promptly on receipt of written request from pensioners. Applications are sent to the CPPC promptly and record maintained.
- b) All the PPOs are submitted to Central Processing Centres (CPC) (after verification of document) and acknowledgement received & kept on record.
- c) Certificates have been obtained from all pensioners and recorded in the system.

2. Services (Remittances, Collection, Purchases, Clearing House/CPC, Non-Home Transactions):

a) Remittances:

- i. All Inter-Office Instruments (IOIs) like Demand Drafts / Pay Orders / Bankers Cheques etc.) of ₹1,50,000/- and above bear two signatures and holograms have been affixed on all Inter Office Instruments of ₹1 Lac and above.
- ii.
 - a) Extant instructions are followed for issuing duplicate Inter-Office Instruments.
 - b) Details of Inter-Office Instruments lost at the bank branch are fed in CBS.
 - c) Issues relating to Non-credit / delayed credit of NEFT / RTGS remittances attended promptly.

b) Collection:

- i) Short Credits-SCs (Cheque Collection) module in CBS is used for collections at all times.
- ii)
 - a. No delay observed in dispatch of instruments relating to Clearing SCs.
 - b. SCs not realized are followed up for payment.
 - c. Proper record of SCs returned is maintained and disposal noted therein / service charges recovered as per extant instructions.

c) Purchase (Cheques):

- i)
 - a. Stray Cheques purchases beyond discretionary powers are reported to Controllers in the prescribed forms.



- b. Immediate Credit is afforded in the payees' a/c for instruments of other Banks upto ₹25,000/- tendered by the customers.
- c. Proper record of Cheque instruments returned unpaid is maintained and disposal noted therein / overdue interest recovered as per extant instructions.

ii)

- a. Effective steps are taken for reversing entries in Cheque Purchases A/c. (Bills / Cheques).
- b. No delay is observed in dispatch of instruments relating to Cheque Purchases and these are followed up until payment.

d) Clearing:

- i) Clearing module in CBS and CTS is invariably used.
- ii) Clearing Transactions Suspense Account make it NIL Balance on daily basis.

e) Clearing House:

- i) Entries of Clearing house differences are attended to promptly.
- ii) Adverse balances in Clearing settlement a/cs of Banks are settled on the same day.
- iii) Clearing House Charges are recovered promptly.

f) Non-Home Transactions:

- i) All non-home payments are authorised after exercising extra caution.
- ii) Appropriate charges are recovered for Non-Home transactions.

3. Cash/ Currency Chest / Small Coin Depot:

- i) Cash / Currency Chest / Small Coin Depot are to be attended as per extent instructions of the Bank.

4. Safe Custody / Securities / Lockers:

- i) Safe Custody / Security / Lockers are to be attended as per extent instructions of the Bank.

5. Government Business:

- i) Government Business are to be attended as per extent instructions of the Bank.

6. Forex Business:

- i) Operational Aspects.
- ii) Imports & Exports.
- iii) Forward Contracts & Derivatives, FGs, ECBs and Other Areas.
- iv) Remittances.

7. Letters of Credit & Bank Guarantees:

- i. L/Cs and BGs are issued within stipulated limits.
- ii. Application cum Indemnity / Counter guarantees / Omnibus counter-guarantees (as appropriate) duly stamped and signed by the authorised signatory have been invariably obtained.
- iii. The LCs & BGs applied for, do not contain any onerous clauses.
- iv. All LCs and / or BGs have been issued only after due approval & recommendations for issuance contain full particulars including the past record, confirmations of satisfactory conduct, availability of margins, purpose, etc.,
- v. Opinion reports have been obtained (and are updated) on buyers and sellers.
- vi. All cases of devolvement of LCs / Invocation of BGs have been reported to the Controller. Fresh LCs / BGs have been issued on behalf of such customers after prior approval of the sanctioning authority.
 - a. Expired BGs are called for, from the beneficiaries and amounts promptly reversed.
 - b. In case of non-receipt of original copy of expired BGs, notice has been issued with sufficient time before reversing.
- vii. Period Angle Clearance has been obtained in case of all BGs with validity greater than 18 months.
- viii. All commission has been recovered upfront or there is specific approval for recovery in instalments; the latter is diarized and recovered without delay.

8. Trade Bills:

- i. **LSCs (Inland collection - Sight bills) / LBCs (Inland Usance bills received collection / Payment):**
 - i)
 - a. Bank Branch maintains separate record for Bills received for collection and Bills drawn against LCs issued and necessary entries are entered in CBS.
 - b. Bills received are scrutinized (Terms of LC/ Collection advise) and advised to the drawee promptly.
 - c. Discrepancies if any, are advised to the Remitting Banker / Drawer and drawee promptly.
 - d. Drawee's acceptance and acknowledgement of documents from authorised person are kept on record.
 - e. Payments are made on the due dates and Instances of non-payment are dealt with by crystallization / as per the Collection instrument.



ii)

- a. Proper custody of Bills is ensured and periodical balancing with CBS Reports and outstanding is carried out.
- b. Non-payment advises (In case of non-credit bills), invariably contain a clause that the documents are held at the risk & responsibility of Drawer / Drawer's Banker.

ii. Short Credits (Sight) / Bills for Collection (Usance):

i.

- a. Bills, along with the collection instruments are verified by the bank branch for genuineness, which can be ascertained by perusing relative invoices, Railway Receipts (RRs) / Lorry Receipts (LRs) etc. and the transaction is in line with the business of the drawer.
- b. All the bills are entered in the Exim (Export and Import) bills promptly and sent for collection without delay. Bills are sent for collection promptly.
- c. Payments are followed up with tracers.
- d. Periodical Balancing of outstanding of Bills reports (Inland Outstanding Collections Bills) with CBS Reports is carried out.

II. Alternate Channels-Value Statement Description:

1. Automated Teller Machines (Card issue, Undelivered Cards, Complaint Management Cash Replenishment & PWD-Pass Word):

A. Card Issue:

i.

- a. Full details of accounts are entered in the ATM Cards application received Register.
- b. ATM Cards Lost register is maintained.
- ii. Mutilated cards are obtained back and recorded in separate section of ATM cards issued Register.
- iii. Before sending request for duplicate card, the Bank Branch has hot-listed the same through CMS promptly. The ticket number generated by CBS is recorded.

B. Undelivered Cards and Pin Mailers:

- i. Undelivered Cards and Pins and related Registers are always held under separate custody of two authorised persons.
- ii.
 - a. Undelivered cards and Pins are recorded in separate Registers. Signatures of receiving / Delivering officers and subsequent acknowledgement obtained from



customers are recorded in these registers.

- b. Entries in both the registers are periodically verified with the physical possession and such verification is recorded.
- c. Undelivered Cards and PIN mailers are destroyed and recorded under authentication by two officials.

C. Complaint Management:

- i. Complaints are promptly registered with CMS (Complaint Management System) and ticket number recorded.
- ii. Complaints are followed-up and resolved properly and penalty is paid, wherever warranted and advised to Controllers.

D. Cash Replenishment & Password:

- i.
 - a. ATM Cash Replenishment Register is maintained and ATM Cash verified by the Manager, Joint Custodians and Linked Bank Branch Manager at Monthly, Quarterly and Annual Intervals as stipulated.
 - b. Password secrecy is maintained for operating / cash replenishment in ATMs and change of password is carried out whenever there is a change in incumbency / custodians / person(s) handling.
 - c. Mandatory change of Passwords at quarterly intervals.

2. Internet Banking (INB):

- i.
 - a. INB officer has been identified and duties allotted through an office order.
 - b. Copy of application for approval as INB officer is held as a Bank Branch Document.
- ii. Pre-Printed Kits (PPKs) are hand delivered to the customers and not by any other means under authentication.
- iii. PPKs Issued register is maintained properly.
- iv. Board Resolution for availing the Corporate Internet Banking for Companies (CINB) facility and subsequent changes if any, for change of signatories, etc., are obtained, approved and held on record.
- v.
 - a. Two Rule Authorizers (In addition to INB officer) have been identified and duties allotted through an office order-in case of Corporate Internet Banking (CINB)
 - b. Complete set of Application (Details of Customer / Corporate), (Regulator) and (Administrator are available on record).



vi.

a. During the day, unprocessed manual intervention transactions like IOI / Cheque book Issue etc., are checked and attended to promptly.

b. Phishing attacks, if any pointed out by customers are attended to promptly.

3. Mobile Banking:

i)

a. Mobile Banking facility is available to Retail Segment Customers & Others as per extant instructions.

b. Applications on the Standard format are obtained for registration.

c. Registration is approved by an authorised official (Allotted through an office order).

III. Backoffice Operations:

1. Protective Arrangements:

i) The Security Officer has visited the Bank Branch and confirmed the security arrangements. Observations by the Security officer on the bank branch security environment are meticulously dealt with under advice to Controllers.

ii) Security Information Register has been maintained and the Security Officer has commented therein.

iii) Approved locking up arrangement is on record and current.

iv) Key Register is maintained and authenticated.

v) Temporary movement of keys are recorded under authentication.

vi) Arrangement with local police is on record for night patrol and emergency situations. Beat Book is maintained.

vii) Loan documents, important bank branch documents are kept in Fire Resistant Safe. Vouchers are kept overnight inside locked almirahs.

viii) Movement of Cash from Cash Officer to counters and back is done in locked boxes.

ix) All the Single Window Operators (SWOs) drawers / cubicles are locked with automatic locking system.

x) Access into Cash / SWOs' cubicles is not permitted to unauthorized persons / outsiders.

xi) Insurance of Cash and valuables is adequate and current.

xii) The alarm system is in working condition and checked periodically and fact recorded. Automatic Time lock is installed to the strong room door.



- xiii) Right type and adequate No. of fire extinguishers are installed and in working condition. Smoke detectors are tested periodically and a record is maintained.
- xiv) CCTV surveillance system is used round the clock.
- xv) Gun License(s) are current and guards' names are entered as retainers. Gun History Book was produced.
- xvi) Old Cartridges have been disposed-off.
- xvii) Anti-termite treatment is done at periodical intervals.

2. Bank Branches Important Documents (BD):

- i. BD Register is maintained as per instructions in force and authenticated by the authorised officer.
- ii. The following are held as BDs under authentication:
 - a. License from RBI / under Shops & Establishment Act (if applicable) for Bank Branch opening, Off-site ATM etc.
 - b. Passwords Admin, ATM, INB etc.
 - c. All licenses of software used in the Bank Branch.
 - d. Current Annual Maintenance Contracts (AMCs).
 - e. Hire / Lease agreements for vehicles and property etc.
 - f. Memorandum of Understandings (MoUs) / Service Level Agreements (SLAs) with service providers / lawyers / Legal Auditors / Valuers etc.
- iii.
 - a. Documents relating to frauds / law suits / deceased cases and issue of duplicate instruments.
 - b. Specimen Signature sheets of RBI inspecting officials are on record
 - c. 'Aide-Memoire' is recorded.
- iv.
 - a. Handing Over /Taking Over authentications have been recorded invariably.
 - b. Approved and current Emergency arrangements / Disaster Recovery Process (DRP) & Business Continuity Plan (BCP) are on record.
 - c. Digital Signatures of authorised officials are on record.
- v. Documents Destruction / Other compliance Certificates are on record.

3. Stationery & Records:

- a) Vouchers are sorted Cashier / Officer / Teller-wise and kept date wise in Safe custody as per revised instructions for easy retrieval.



- b) Vouchers are moved to record room on T+2 basis duly entered in Record Register.
- c) Manager / Service Manager (Operations) give necessary certificate in Manager Monthly Certificate (BMMC) to their Controllers that movement of vouchers from/ to in record room is taking place after his / her authorization.
- d) Destruction of vouchers / records at prescribed intervals as per prevalent Bank instructions.
- e) Stationery & Registers are obtained from Central Stationery Department (CSD) only and local purchase of stationery items if any, permission obtained and record maintained.
- f) Consumption of stationery has been properly accounted for and Annual Indent placed.

IV. Control Systems:

1. Information Systems (IS) Audit:

- i. Application security.
- ii. Process Controls.
 - a) All Services, Desktops, Laptops and other portable devices should have anti-virus agent installed. Officer-in-charge of System in Bank Branch / Office should ensure that all New Systems including desktops, laptops and servers have anti-virus agent installed and configured as soon as they are connected to the network.
 - b) New signature should be applied to all systems as soon as these are released by anti-virus vendor. Anti-virus application architecture should ensure all systems across the enterprise are updated within 24 hours. The number of anti-virus servers, the location of servers, the server hardware sizing and bandwidth requirements should be designed and implemented to achieve the above objective.
- iii. Network security / Third party access -follow the IS Audit Guidelines of the Bank.
- iv. Configuration Management Bank Branch should endeavor to put in place a centralized identity and Access Management Infrastructure e.g., Directory Services, to provide a controlled and managed working environment for the end users and enforcement of organisational policies in order to ensure effective usage of Bank's infrastructure resources and security.
- v. Operating System Security.
- vi. Monitoring & Incident Management.
- vii. Backup & Disaster Recovery (DRP).

viii. Physical Security & Acceptable usage.

ix. Personnel Security.

2. Frauds and Preventive Vigilance:

i)

a) Frauds reported prior to period under review have been adequately followed-up/ closed.

b) There is no fraud reported during the period under review.

ii) Identification of fraud-prone areas is done & Preventive Vigilance Committee meetings are held, minutes recorded and reported to Controllers. Modus operandi of frauds reported are discussed and deficiencies found at the Bank Branch if any, rectified.

iii) Fraud-prone areas and other critical areas are monitored e.g.:

a) Proper delivery of IOIs (Drafts, Banker Cheques, Pay Orders etc.) to customers.

b) Proper, authenticated Checking of Voucher Verification Reports (VVRs) / System Suspense Accounts in CBS Reports

c) Unauthorised persons do not have access to Records.

d) Proper record of movement, requisition and return of records is maintained

e) Custody of undelivered passbooks / Inter Office Instruments (Bankers Cheques, Drafts, Pay Orders etc.)

f) Monitoring of frequent return of cheques

g) Disproportionate turnover in account.

h) Double signature for IOIs (Pay Orders, Demand Drafts etc.) of above ₹1,50,000.

i) Recording of forged instruments.

j) Prompt attention to Inter Bank Branch Accounts / Caution Memos of unreconciled Accounts.

k) Scrutiny of staff accounts and record of the same.

l) CBS reports regarding irregular / threshold-exceeding staff a/cs scrutinized regularly.

m) Monitoring of high value transactions in newly opened accounts.

n) No outsourcing of core activities such as signature scan, clearing instruments encoding etc., is carried out.

o) Lapses in systems & procedures pointed out earlier have not recurred.

(NOTE: The above list is not exhaustive. If deviations are found in any other areas, which may expose the Banks to the risk of frauds etc. are to be verified)



3. Office Accounts – Follow-Up:

- i)
 - a) Bank Branches maintains Utility, Services and Maintenance Account. Items are properly classified and receipts are kept on record.
 - b) Entries in System Suspense Accounts and Parking Accounts in CBS are perused daily and Zeroized daily.
- ii)
 - a) Follow-up is prompt and effective in respect of outstanding entries in all Sundry Deposit / Suspense / System Suspense Accounts / ATM Suspense A/c Entries.
 - b) All Exception reports in respect of these a/cs are perused, entries accounted for and Zeroized on daily basis.
- iii) There are no Un-reconciled a/c entries outstanding or if outstanding exists, efforts are made to reconcile these are made.
- iv) Clearing Account in CBS zeroized daily.
- v) Follow-up of outstanding entries in Deposit-At-Call / Gift Cheques / Banker's Cheques and other office accounts.

4. Control Functions (Deposits & Advances, Vouchers Verification Report (VVR) Checking, Control Returns & Reporting, Controllers Supervision):

A) Deposit / Advance Accounts-Follow-up:

- i) Deposit Accounts with zero balance are closed after advising the customers, in advance suitably.
- ii) Advance Accounts are properly closed in the system after recovery of dues.
- iii) All applicable Advance accounts are fed with Limit, Date of sanction, Interest Rate, etc., in the system.
- iv) Staff indicator is not existing in any non-staff account.
- v) Advances data purification is attended on priority basis.

B) Voucher Verification Report (VVR) / Bank Branch General Ledger (BGL) Checking:

- i) All VVRs / BGL are checked regularly & records kept. Online allotment / acknowledgement of VVRs is done.
- ii) Checking is confirmed in CBS by the respective allottees and relevant report checked by Bank Branch Head.

C) Control Returns and Reporting:

- 1. Control Returns for all expenses incurred within the Bank Branch are invariably reported for Control and duly reviewed statements are on record.



2. Post-facto sanction for expenses incurred beyond Bank Branch discretionary powers have been obtained in all cases.
3. All discretionary powers related to General Matters, vested with the Bank Branch and exercised (e.g., disposal of assets of deceased constituents without legal representation) are reported for Control.
4. Cases of leave on loss of pay / un authorized absence of staff reported to Controllers and deterrent action taken.
5. Resignation, death of employees is reported to Controllers and Head Office and Human Resource Management System (HRMS).

D) Bank Branch Manager's Monthly Certificate (BMMC) to be Submitted to Controllers:

- i) All the items of certificate are indicated either affirmative or negative.
- ii) False Certification in the BMMC was not observed.
- iii)
- a) BMMC Register is well-maintained.
- b) BMMC covers all the latest mandatory areas and is submitted promptly.
- c) Certificate regarding genuineness of expenditure incurred and debited to P & L Account (Charges A/c) as per delegation of financial powers is included.

E) Controllers' Supervision:

- i) Controllers visit the Unit at stipulated intervals and record their observations in Controllers' Visit System (CVS).
- ii) Bank Branch responses to Controllers' observations are also recorded in the same system.
- iii) Controllers have ensured verification / Scrutiny of back up registers maintained for Interest subvention.

F) Reconciliation (Inter Bank Branch Entries):

- a. Inter-Bank branch items are being put through CBS.
- b. Age-wise break up of entries outstanding beyond 1 month (for values Rs.1 lac and above) and more than 3 months for other entries are maintained and reported to Controllers.

G) Risk History:

Risk History & Operational Risk-Loss Collection Data.

- a. Risk Register (as per Operational Risk Management Department (ORMD) Circular of Head Office) is maintained to record historical perspective of kind of risks / types of losses, potential risk events, near miss history, loss history, etc.,



- b. Entries related to Operational Risk losses have been put through designated Account in CBS.
- c. All Operational Risk loss incidents are reported.
- d. Reporting of legal losses, if any.
- e. Retention of vouchers and documents as per Bank's Policy.

Operational Risk-Near Miss Events.

- a. All incidents of Near Miss Events have been reported.
- b. Formulate & implement new mitigation measures, if any.
- c. Effective implementation of existing mitigation measures.

Operational Risk -Business Continuity Plan (BCP) / Disaster Recovery Plan (DRP)

- a. Updated BC Plan / DR Plan duly approved by controller is in place.
- b. BC Plan / DR Plan is being reviewed annually.
- c. BCP / DRP testing is being conducted annually.
- d. Level of awareness of staff on BCP / DRP.
- e. Invocation of BCP / DRP at the time if disruption.

5. Inward/Outward Mail:

i)

- a) Inward Mail is opened in the presence of an authorised official, entered in Inward Mail Register / Instruments received for collection register, distributed against acknowledgement and disposal is ensured / marked.

ii)

- a) Outward Mail is entered in a register along with full particulars and authenticated.
- b) Courier register / Registered post register / Ordinary post register maintained.
- c) Contents of the envelopes are recorded properly.

- iii) Courier Receipt (duly acknowledged by authorised courier agent) numbers are recorded in the Register.

- iv) Letters returned undelivered are recorded and held in the custody of authorised official.

- v) Proof of Delivery (POD) are collected and Courier bill payment is made only after disallowing bill claimed for the delay in delivery as per terms of agreement.

6. Income Mis-Calculations:

- i) All the income calculation errors detected in earlier audit reports and the current report have been rectified. New service charges of Lockers / Collections / Processing Charges for Loans to be recovered manually are applied.



ii)

- a) All instances of recovery of processing charges / Up-front fees / EM charges / Commitment Charges is maintained and all charges are recovered promptly as per extant instructions and recorded in a back-up Register.
- b) Service charges for Locker registration, Locker rent, Safe Deposits, Collections are being correctly recovered
- c) Penalties (including penal interest) have been recovered for delayed submission of financials, Stock statements, noncompliance of terms of sanction and special stipulations of the Sanctioning Committee
- d) Back-value dated transactions whether manual or through CBS are properly put through with appropriate authentication.
- e) All entries of ₹.1,000/- and above rating to interest adjustments done manually are in order.

iii)

- a) Commission on Issue of LCs / BGs are recovered promptly and correctly.
- b) Fee Module in Trade Bills is entered by the Bank branch, including concessions if any, as per sanction.
- c) All the customers with Forex Exposure rated as per Margin Matrix and the rating has been entered in CBS.
- d) All eligible accounts have been migrated to Concessional Interest Rates like Agriculture / MSME Accounts etc.,
- e) Appropriate rate of interest is charged for all advances.
- f) Reset of interest rate has been done at stipulated intervals for all Fixed-Rate Home Loans / Other Term Loans.
- g) No unauthorised concession is observed in interest applied / service charges (In-charge Officers to verify the Back-up Register for concessions).
- h) Back-up register is maintained for recording all entries passed manually through Interest Expense a/c and Interest Income a/c. All entries are scrutinized and authorised by the competent authority.

V. Customer Service:

1. Customer Service:

i)

- a) Counters are manned 15 minutes before the commencement of office hours.
- b) Uninterrupted customer service is provided during the business hours.



- c) Availability of cash at the counters before Bank Branch working hours is ensured.
- d) All employees wear ID Cards.
- ii) Duties / Role of CROs / SWOs are carried out in full by them.
- iii)
 - a) Drop Box facility is provided and access to customers is available '24/7'.
 - b) Quality of Service as observed from interaction of the IO with a Cross Section of customers is good.
- iv)
 - a) Grahak Mitra (At Reception) facility is in place and fully functional.
 - b) The Facility of NEFT / RTGS remittances is provided and customers encouraged to use this facility.
- v)
 - a. Bank Branch ambience and amenities provided to customers are adequate.
 - b. 'Green Channel-Paperless Transactions' & Internet Kiosks are provided to customers.
 - c. A node with enquiry facility is provided in the customer lounge.
 - d. Mobile Alerts are provided upon request for the facility.
 - e. Customers have access to the Bank's Code for Fair Banking Practices.
 - f. Extracts from Compensation Policy (Banking Services) are provided upon request.
 - g. List of documents for KYC compliance is displayed.
 - h. Display / Issue of tokens.
 - i. Pass Book printing / KIOSK for passbook updation.
- vi) Quality of maintenance and up keep of ATMs is satisfactory.
- vii) Information brochures on Bank's Schemes are replenished at the ATMs and in the banking Hall.
- viii)
 - a. Bank Branch accepts the reporting of lost card from any customer of any Bank branch of the Bank Branches.
 - b. Uniform template for ATM related complaints, as approved by IBA is made available to the customers.
 - c. Requests for duplicate passwords, profile passwords, Mobile No. updation etc., are obtained by written requests and such record is maintained.
- ix) Customer Relations Programme / Customer Service Committee meetings are conducted as stipulated and minutes sent promptly to Controllers.

**2. Complaints:**

- i) All complaints:
 - a. Are promptly acknowledged and recorded in the standard register prescribed.
 - b. Have been resolved disposed-off promptly to the satisfaction of the customer, the fact recorded and the file closed.
 - c. Have been reported to Controllers.
 - d. Causative factors for the complaints do not persist.
 - e. Where complaints relate to misbehavior of Staff, appropriate deterrent action has been taken.
 - f. Availability of Compliant box and Complaint Register.

VI. General Management:**1. Personnel:**

- i) Manager is exercising effective control over the affairs of the bank branch.
- ii) Staff are adequately trained including ongoing on-the-job capsules and e-learning to meet emerging needs of the business environment.
- iii) Staff are punctual and adhere to leave discipline.
- iv) Detailed screening exercise has been done in respect of all staff as per extant guidelines on 'Know Your Employee' (KYE).
- v) Flexibility and adaptability to the changing business environment in the Bank Branch and no restrictive practice observed.
- vi) Employees at the Bank branch are conversant with the various products and are effectively marketing them. The customer needs are understood / assessed and courteous service rendered.
- vii) Job rotation is carried out as stipulated.
- viii)
 - a. Awareness of business goals, house-keeping, customer service and other important aspects of Bank functioning is observed amongst Staff.
 - b. Mandatory leave is availed by the staff.
- ix) Regular meetings (apart from mandatory meetings such as Customer Service Committees etc. amongst staff are held for bonding for better teamwork.

2. General Administration:

- i) Missing voucher(s), if any, are entered in a register and after proper examination, duplicate voucher(s) are prepared.



- ii) All security forms are properly accounted for in CBS Module. Security Forms received from Central Stationery Department is acknowledged in the system.
- iii) Proper control is exercised over Petty Cash Payments.
- iv) Postage Register / Courier is maintained properly and periodical verification done by the authorised official.

3. Charges & Establishment and Outsourcing Arrangements:

- i)
 - a. All Salary & allowances & other expenditure incurred are authorised as per eligibility & reasonable (Prior sanction obtained wherever applicable).
 - b. Salary Register generated by Human Resource Management System (HRMS) is received, printouts taken, scrutinized and held on record.
 - c. No salary / arrears / regular payment is made outside the HRMS.
 - d. Controllable expenses are reduced / maintained at same level / unusual increase not observed.
 - e. Monthly return on Bank Branch Expenditure (Charges) is sent promptly to their Controllers.
- ii) Extant instructions with regard to engaging service providers, confidentiality and security, monitoring their performance standards, business continuity preparedness, due diligence reviews, etc., are complied with.

4. Premises & Furniture:

- i)
 - a. Fixed Assets Register / Ledgers are maintained properly and depreciation entries passed as per Bank Head Office guidelines. All furniture & fixtures are numbered, accounted for.
 - b. A proper record of fixed assets and furniture supplied to official's residences is maintained. All items supplied adheres to eligibility norms. Annual possession certificate is obtained in all cases.
 - c. Formalities relating to disposal of old and discarded furniture / fixed assets are meticulously followed.
 - d. Annual verification of Fixed Assets items is carried out.
 - e. Formalities regarding renewal of lease (and registration of lease deed-where applicable) complied with.
- ii)
 - a. Fixed Assets Balance in CBS balanced with Fixed Assets Register at monthly intervals.
 - b. Bank Branch layout and ambience of premises is customer-friendly.

5. Dealing with Audit Reports:

- i) Closure status and adherence to time frame – RBI Audit.
- ii) Closure status and adherence to time frame – Head Office Audit.
- iii) Closure status and adherence to time frame - Statutory Audit.
- iv) Closure status and adherence to time frame – Income Leakage / KYC etc. Audits.
- v) Compliance Remarks for the last Risk Based Internal Audit was properly submitted and the Report was treated as Dealt with.
- vi) All the residual irregularities listed in the letter conveying the 'dealt with' were properly attended to within the time frame and confirmation submitted to controller / appropriate authority as the case may be. No instances of false compliance certification were observed.
- vii) Quality and extent of rectification during the course of inspection.
- viii) Adverse remarks / observations, if any, made in the Head Office Audit reports have been attended to.

Irregularities pointed out in any Audit Report have not recurred.

6. Concurrent Audit:

- i)
 - a. The Concurrent Auditor (CA) has been regular in attendance and has covered all prescribed areas of scrutiny.
 - b. The CA has scrutinized more than 90% of accounts on an on-going basis.
- ii) The Bank branch has maintained a compliance level of more than 90% on an on-going basis.
- iii) The Income leakage detected by the Risk Based Internal Auditor is less than 10% of the Income Leakage detected by the CA from the date of last Audit to Current Audit.

VII. Budget Performance & Broad Basing -Value Statement Description:**1. Performance Review:**

- i)
 - a. The Bank branch conducts review of its performance, say at least once a quarter and assesses the position and arrives at suitable strategies for achieving the targets.
 - b. Controllers have reviewed, periodically, the performance against the budget settled.
 - c. Action points emanating from performance review meetings / comments on



the Performance Report are acted upon by the auditee and monitored by the Controllers.

2. Clientele & Broad basing:

- i) The Bank Branch has broad-based its clientele as reflected in the number of new accounts opened during the period under review.
- ii) Bank Branch is active in Third Party Selling products of Life Insurance, General Insurance, Credit Cards, DEMAT Accounts, Mutual Funds and others and encouraging technology products like Mobile Banking etc.

3. External Compliances:

External Compliances: RBI / GOVT. GUIDELINES

- i)
 - a. Notice boards indicating the name and address of the designated officer under RTI Act, is displayed.
 - b. Other mandatory notices viz., Comprehensive Notice Board, Scale of Finance for various crops, Latest Interest Rates, Service Charges, Features of Genuine Notes, Exchange of soiled notes etc., as per the latest RBI Circular are displayed.
- ii)
 - a. All the staff wear identity cards displaying photo and name.
 - b. Customer Counters are not left unattended and uninterrupted service is provided.
 - c. Transactions are monitored in all newly opened accounts during the initial period of 6 months.
 - d. Transactions of suspicious nature are monitored regularly and reported to Controllers. Financial records reported to Controllers under `suspicious transactions are retained at the Bank Branch, as stipulated, after the transaction date (STRs).
 - e. All High value cash transactions (as defined) are noted in the Cash Transactions Monitoring Register at the Bank Branch and reported fortnightly to Controllers.
- iii)
 - a. Brief, lucid particulars are recorded in pass books / statement of account.
 - b. Proper custody of passbooks kept overnight is ensured and unclaimed passbooks are dispatched as per extant instructions.
- iv)
 - a. Inoperative Accounts are revived and operations permitted only after proper authorisation, verification of addresses, signatures & identity of the customer.
 - b. Customers are not inconvenienced in any way, just because the account has



been rendered inoperative.

v)

- a. Term deposits are freely transferred as per customer's request.
- b. Bank Branch is sending maturity advices well in time.

vi)

- a. Declaration from Current A/c. holders regarding credit facilities enjoyed elsewhere, is obtained.
- b. In case of a prospective customer, who is a corporate or large borrower enjoying credit facilities from more than one bank, branch exercises due diligence and informs the consortium leader, if under consortium, and the concerned banks, if under multiple banking arrangement.

vii)

- a. Nomination facility is obtained invariably in all accounts opened in single name, where the customer prefers not to nominate a specific mandate is obtained without exception.
- b. Nomination Register is maintained and updated.

viii)

- a. Drop Box is deployed at the Bank Branch and opened at periodic intervals in the presence of two employees.
- b. All instruments in the Drop Box are segregated and recorded in a register before presentation.
- c. No delay observed in presentation of clearing instruments.

- ix) Any remittance of funds by way of IOI / RTGS / NEFT or any other mode and issue of travelers' cheques for value of ₹.50,000/- and above is effected by debit to the customer's account or against cheques and not against cash payment.

x)

- a. Counterfeit currency notes detected, if any, are promptly reported as per extant instructions.
- b. Small denomination notes from the customers are accepted.

- xi) ATMs contain information for Complaints, Helpline / Contact persons telephone number and uniform template etc. Disputed ATM transactions are settled within the time frame of RBI guidelines.

- xii) Record of Subsidy from State / Central Governments received is properly maintained, account balanced periodically and reconciled with respective loan accounts.



xiii)

- a. TDS is recovered in all applicable cases including rent paid on lease premises, hiring of Taxies, etc.
- b. TDS has been deposited into the Govt. account as per regulation and within the stipulated time
- c. TDS returns has been filed with the respective Govt. departments
- d. GST are collected in all applicable cases and remitted to respective Govt. departments.
- e. In case of owned premises, property tax is paid upto date.
- f. All payments of ₹.20,000/- and above are done through accounts or crossed Demand Drafts/ Cheques.
- g. All the payments are made by electronic means (and not by cheque) through vendor system in CBS.

xiv) Instructions from RBI / Govt. are recorded in the prescribed register and implementation is ensured.

xv)

- a. Guidelines on Fair Practices Code for Lenders are followed.
- b. Code for Fair Banking Practice copies are retained and handed over to Customers on demand.
- c. Guidelines of RBI for relief measures in areas affected by natural calamities were adhered to, by the Bank Branch.

xvi)

- a. Official Language Policy implemented as per guidelines.
- b. All the available printed material is available in Hindi as well as Regional language & English.
- c. Cheques / withdrawal forms written in Hindi are also accepted.

xvii) Ghosh / Jilani Committee recommendations relating to frauds / malpractices are complied with. Mitra committee (on legal aspects of Bank Frauds-legal compliance certificate) is complied.

xviii) Outsourcing arrangements, if any, are made with the approval of appropriate authority and the agreements are entered in Bank's approved format (Cleaning, Security etc.)

4. **Self-Audit:**

- i. Self-Audit has been carried out at half-yearly intervals and is meaningful by the Bank Branch Heads.



- ii. Self-Audit scores have been validated by the Controller. Meaningful validation is observed.
- iii. Risk Based Internal Audit score is a minimum of 95% of the validated Self-audit score of Branch Heads.

Information Systems (IS) Audit

While Business Enterprises' Reliance on IT Systems Continues to Increase, IT Systems are facing an increasing variety of Threats.

In the global trend of Strengthening Industry Supervision and Internal control, IT is increasingly playing an important role. IT not only needs to provide a guaranteed environment for Business Risk Control, but its own risk control is also receiving much attention. IT risk also becomes part of Business Risk. IT Risk refers to the process of information processing and the application of Information Technology, which may become various uncertain factors that affect the realization of organizational goals.

IT risks include Information Technology Risks at the organizational level, information technology risks at the general control level, and information technology risks at the business process level.

The Continuous Integration of IT and Business is putting more and more Chief Information Officers (CIOs) under unprecedented pressure. On the one hand, any disturbances in IT may have an impact on IT-Dependent Businesses, which makes CIOs must pay extra attention to any potential risks of IT.

On the other hand, as business processes are gradually solidified by IT systems, some risks that originally belonged to other departments began to be transferred to IT departments and CIOs. In order to alleviate this pressure, the CIO must discover any potential risks in the IT System as much as possible, because once these risks evolve into accidents, the CIO must take responsibility and pay a price for this.

One of the important responsibilities of the Information System Audit is to help the CIO discover these Potential Risks. Therefore, the reason why IT Audits is becoming more and more important in Enterprises because of Business Stability and IT Risk Considerations.

In terms of responding to IT Risks, the Importance of IT Audits includes two levels:

- **The First is to Prevent Risks:** IT Audits can help companies identify and prevent risks in the IT systems that support the business, and can also help companies audit IT systems avoid possible risks from external compliance.
- **The Second is to Co-operate with the CIO to effectively manage the risks found in the audit and make risk prevention better.** IT Auditing first appeared in the FINANCIAL INDUSTRY with deeper IT Applications, and then gradually expanded to other industries.

The Goal of IT Audit is to Assist the organization's Information Technology managers to effectively fulfil their responsibilities to achieve the Organization's Information Technology



Management Goals. The Organization's Information Technology Management Objectives are to ensure that the Organization's Information Technology strategy fully reflects the Organization's Business Strategic Objectives, Improve the Reliability, Stability, Security, and Data Processing Integrity and Accuracy of the Information System on which the Organization Depends, and Improve the Effectiveness and Efficiency of the Information System Operation ensure that the Operation of the Information System Complies with the relevant requirements of Laws, Regulations, and Compliance.

Having regard to risks emanating from adoption of technology, there is a need to introduce IS Audit.

The following guidelines with regard to IS audit Information Systems Audit Policy for the Banking and Financial Sector:

The specialized nature of the Information Systems (IS) auditing and the skills necessary to perform such audits require standards that apply specifically to IS auditing. Such standards will require to be internationally accepted standards only. This will ensure that the IS auditor performs auditing, conforming to the minimum level of acceptable performance and meeting the required professional responsibilities.

- The IS auditing Standards define the mandatory requirements for IS auditing and reporting.
- The IS auditing Guidelines provide the guidance for the application of the IS auditing standards.
- The IS auditor should take care of how to achieve the implementation of the Standards, the use of professional judgement in the application of the Standards and should also be prepared to justify any departure / deviation therefrom in the IS auditing work.

The IS auditor shall prepare the procedure including the information on how to meet the Standards while performing the IS auditing work. However, the procedure shall not set the requirements for IS auditing.

IS auditing should be performed by personnel with the required expertise and skills such as Certified Information Systems Auditor, Certified Information Systems, Security Professionals etc.

The profitability and the future viability of the organizations in the banking and financial sector increasingly depend on the continued, secured and uninterrupted operations of the Information Systems. Therefore, it is essential for the IS auditors to be conversant with various aspects of Information Technology and the developments taking place in this area. The role of the IS auditors is to see that the organization's assets are protected and suitable internal controls are in place to protect its information and information resources.

IS audit being responsible for providing an organization with independent and objective views on the level of security that should be applied to the Information Systems. Computer Security on the other hand is responsible for implementing security in the computerized



environment. The IS auditor will learn to co-exist with the Computer Security function and work together for the benefit of the whole organization ensuring that professional standards are maintained at all times.

Major areas, which will require to be IS audited, are broadly as under:

- 1) Safeguarding of Assets.
- 2) Data Integrity.
- 3) System Effectiveness.
- 4) System Efficiency.
- 5) Organization and Administration.

IS auditing of the above areas at the **Micro Level** are as under:

- 1) **Safeguarding of Assets:** The IS auditors will require to concentrate on the following areas to ensure that the Information Systems Assets of the organization are safeguarded:
 - a. Environmental Security.
 - b. Uninterrupted Power Supply.
 - c. Electrical Lines.
 - d. Data Cables & Networking Products.
 - e. Fire Protection.
 - f. Insurance of Assets.
 - g. Annual Maintenance Contract.
 - h. Logical Security & Access Control - Operating System Level.
 - i. Logical Security & Access Control – Application System Level.

The IS auditor shall be required to verify / inspect the following points in respect of the areas mentioned above.

a. **Environmental Security:**

Checking: Central Server Level. The IS auditors should verify whether:

- There is separate room for the server.
- Server room has adequate space for operational requirements.
- Server room is away from the basement, water / drainage systems.
- Server room can be locked and the key being under the custody of the authorized persons (System Administrator) only. Any failed attempts or system tampering as also unscheduled movement in restricted areas, glass breakage or the opening of doors will require to be logged and immediately reported to the Control Staff at the site. Log to be maintained for persons accessing the server room (who, when, for how much time, purpose of accessing server room).



- Server is not in close proximity to the UPS room.
- Access to server room is restricted to authorized persons and activities in the server room are monitored. IS auditors should check whether physical access for third parties is documented and granted based on their respective maintenance contracts or agreements?
- Air-conditioning system provides adequate cooling (i.e., Air-conditioning and humidity controls).
- Storage devices to keep stationary and other such items are not kept inside the server room.
- Smoking, eating and drinking are prohibited in the server room to prevent spillage of food or liquid into sensitive computer equipment.
- Briefcases, handbags and other packages are restricted from the server room, tape library and other sensitive computer area to prevent unauthorized removal of data held on removable media as also to prevent entry of unacceptable material into the area.
- Server room is neat and clean to ensure dust free environment.
- Scanners are kept in safe custody and access is restricted.

b. Uninterrupted Power Supply:

Checking: Central Server Level and Bank Branch / Department Level. In addition to the availability of the Generator facility at the site, the IS auditor should verify whether:

- There is a separate enclosure and locking arrangement for the UPS.
- Maintenance agency provides battery service regularly.
- There is a regular contract for maintenance of the UPS and the preventive maintenance is carried as per the contract.
- The record of the tests undertaken is maintained to verify the satisfactory functioning of the UPS.
- UPS cabin has adequate ventilation to take care of acid fumes emitted by the Lead Acid batteries.
- Capacity of the UPS system is sufficient to take care of the electricity load required for computers installed.
- UPS is free of the electricity load relating to the tube-lights, fans, water coolers etc.
- UPS functions properly when electricity fails.

c. Electrical lines:

Checking: Central Server Level and Bank Branch / Department Level. The IS auditors should verify whether:

- Power supply to computer equipment is through UPS system only.
- The electrical wiring looks concealed and is not hanging from ceiling or nodes.
- The circuit breaker switches exist in locked condition only.

d. **Data Cables:**

Checking: Central Server Level and Bank Branch / Department Level. The IS auditors should verify whether:

- A map of the cable layout is kept in a secure place with proper authority. This is helpful in timely and fast repairs of LAN cable faults.
- Cabling is properly identified and recorded as fiber optic, co-axial, unshielded twisted pair (UTP) or Shielded Twisted Pair (STP).
- Electrical cable and data cable do not cross each other to avoid possible disturbance during data transfer within the network.

e. **Fire Protection:**

Checking: Central Server Level and Bank Branch / Department Level. The IS auditors should verify whether:

- Fire alarm system is installed.
- Smoke detectors are provided in the server room and in the other areas of computer installations.
- Smoke detectors are tested on a regular basis to ensure that they work.
- Gas type (Carbon dioxide, Halon etc.) fire extinguishers are installed at strategic places like server room, UPS room and near the nodes and printers.
- Dry powder or foam type extinguishers should not be used as they tend to leave deposits.
- Staff knows how to use the fire extinguishers.
- Fire extinguishers are regularly refilled / maintained.
- An evacuation plan is documented and rehearsed at regular intervals for taking immediate action in the case of the outbreak of fire.

f. **Insurance:**

Checking: Central Server Level. The IS auditors should verify whether:

- All the computer equipment's are covered under the appropriate electronic equipment insurance policy with a reputed insurance firm.
- A record of the original policy is maintained with the detailed list of the equipment covered under the policy.
- Information regarding shifting of computer equipment to or from or within the department/ office is conveyed to the insurance firm.



- Adequacy of the insurance cover should be verified as per the policy of the organization.

g. Annual Maintenance Contract:

Checking: Central Server Level and Bank Branch / Department Level. The IS auditors should verify whether:

- Stamped agreements for maintenance contract are executed and available. Verify the process for evaluation and feedback on vendor competency at the time of awarding contract.
- Activities carried out during maintenance have been reported in the registers and duly authenticated. IS auditors should check that whether all activities performed on the network of the organization (servers, network equipment) are logged where possible and reviewed to ensure traceability. Ideally the use of technology that allows real-time monitoring and auditing of the activities of the third-party contractors is preferred.
- Contract renewal rates are maintained in the register.
- Access for maintenance purpose is granted only on verifying the identity of the service person.
- The maintenance staff support is available in time.

h. Logical Security & Access Control – Operating System

Checking: Central Server Level, Dept. of Information Technology Level and Bank Branch / Department Level. The IS auditors should verify whether:

- Access to the systems is only through password protected user IDs.
- Operating System (OS) allots unique user identity (ID) for all users.
- OS provides for different levels of access rights to volumes, directories and files.
- OS prompts for change of the user password after the lapse of specified periods.
- OS ensures secrecy and security of the user passwords and the access rights granted to a user. Verify the existence of user level password policy and its verification.
- Unrestricted access to the systems is provided only to the System Administrator. Verify the policy / procedure for approvals for allowing such access and review mechanism from time to time.
- Administration level access is restricted to authorized and limited persons.
- All the security features available in the OS are enabled / taken advantage of as far as possible for ensuring better security.
- Administration access should not be available to the officials who are under notice period, retiring shortly, under disciplinary action etc.
- OS provides for loading of virus prevention software and is implemented.

- Record is maintained and authenticated regarding the installation of the Operating System, its up-gradation, re-installation and maintenance.
- A register is maintained in respect of all the OS level users, giving the details such as the date of creation, suspension, cancellation, access rights granted, purpose of creation etc.
- Users created for audit / maintenance purpose are disabled immediately after the work is over. Verify the procedure for creation / removal of temporary access.
- The department reviews the number of the OS level users periodically.

i. **Logical Security & Access Control – Application System**

Checking: Dept. of Information Technology Level and Bank Branch / Department Level. The IS auditors should verify whether:

- System provides for unique user IDs and password for all users. IS auditors should check that whether the system of changing the initial passwords supplied to users are done during initial logon?
- System provides for different levels of access. IS auditors should check whether remote access credentials are secure and unique for each user.
- System prompts for change of user password after lapse of specified period.
- System ensures secrecy and security of the user passwords and the access rights granted to users. IS auditors should check whether users or system automatically emails them their password.
- Unrestricted access to the entire application system menus is provided only to a Super User. IS Auditors should check whether Super User credentials / accounts i.e., administrator accounts are not shared accounts.
- Super User access in application level is not given to staff who is under notice period, retiring shortly, under disciplinary action etc.
- The application system user list is periodically reviewed.
- The access privileges granted in the system are in accordance with the designation / duties performed.
- None of the staff members has multiple level or duplicate access ID in the system.
- Allocation of the suspended, disabled user ID to new users is avoided.
- Active user IDs of the transferred, retired, suspended or dismissed employees are not present in the system. IS auditors should also check whether all remote access to network and systems are terminated or not.
- There is no dummy user ID created in the system. It is permitted to use remote control tools for maintenance and support, however you must retain control over the connection



i.e., IS auditors should check whether there is any system to validate the identity of the person connecting, approving and terminating the connection, as well as monitoring any activities performed.

- The user ID of staff on long leave, training etc. is suspended.
- System logs out automatically if the user is inactive for a specified time (or user consciously logs out when he / she leaves a terminal).
- System does not allow concurrent login to a single user ID from different nodes. IS auditors should also verify whether handheld devices and tablets are protected by the use of user passwords or OTP or code to prevent unauthorized users gaining access to information.
- Users, created for maintenance purpose, are cancelled on completion of the job.
- The system does not allow user to cancel his / her own user ID.
- Authority periodically reviews the user login status report.
- Users do not share their passwords.
- Passwords of alphanumeric characters are used.
- Users do not write their passwords on wall, desk diary etc. and are aware of the need for the secrecy of their passwords.
- System automatically locks the user ID after unsuccessful login attempts.
- User log indicating date, time, node, user ID, transactions performed etc. are generated by the system and evaluated by the System Administrator. IS Auditor should the process review of access log system at defined frequency or not.

2) **Data Integrity:**

Checking: Central Server Level and Dept. of Information Technology Level. The IS auditor will require to address, among others, the following areas under IS auditing:

- a) Data Input Controls.
- b) Data Processing Controls.
- c) Patch Programs.
- d) Purging of Data Files.
- e) Backup of data.
- f) Restoration of Data.
- g) Output Reports.
- h) Virus Protection.

- a) **Data Input Controls:** The organizations in the banking and financial sector undertake diverse activities relating to the receipt of deposits, advancement of credit, investment



of funds etc. Further, the areas of operation and the level of economic activities could also be different. All these activities, the transactions resulting therefrom, the data inputs required therefor including the data input controls to be in place in the organization will require to be judiciously addressed.

However, illustratively, such data input controls may relate to the following areas of activity and the IS auditors will require to verify the same.

- The entire stock of cheque books is fed to the system.
- The cheque books issued are entered and confirmed in the system on day-to-day basis.
- The data fed in to various accounts including the customer accounts is accurate and correct. IS Auditor should verify the system of mandatory and non-mandatory fields are logically defined or not.
- Clear administrative guidelines exist regarding the access to live data.
- Data Owner (DA) and Database Administrator (DBA) are independent of both the systems development and operational activities.
- The roles of DA and DBA are clearly defined in respect of, among others,
 - i. Definition, creation & retirement of data.
 - ii. Database availability to Users.
 - iii. Information and services to Users.
 - iv. Maintenance of database integrity and
 - v. Monitoring and performance.

b) **Data Processing Controls:** The IS auditor should verify whether:

- The designated / authorized officials do start-of-day process.
- The operating staff pay attention to the error messages displayed on the screen and initiates corrective action.
- Entries are cancelled only by the appropriate authority. IS Auditor should check the list of persons authorised for such cancellation and review the access log for such transaction at defined frequency.
- Cash entries are not deleted from the system.
- Prescribed reports are generated at the end-of-day process.
- Printouts are scrutinized and preserved.
- Proper record is maintained in respect of the corrections made in database under authentication.
- Master data printouts are preserved carefully.
- Use of the scanner is monitored and controlled.



c) **Patch Programs:** The IS auditors should verify whether:

- Check the existence of policy and procedure system for patch management.
- The application programs are exactly identical with the standard list of approved programs in respect of file name, file size, date and time of compilation. IS auditors to verify whether a procedure of "System Backup" is in place prior to applying patches.
- Only approved programs have been loaded in the system. IS auditors to check whether there is a system is in place to test and confirm in an UAT environment that the patches and upgrades that have been applied will not impact the operations.
- There are programs other than the approved ones.
- There is a record of the patch programs used and the reason thereof under authentication. IS auditors to verify whether patching of systems is being done based on their risk and criticality - starting with low-risk devices, then medium risk, then high risk.

d) **Purging of Data Files:** The IS auditors should verify whether:

- Purging activity is recorded and maintained in a register.
- Purged backup media is kept properly under safe custody.
- Access to purged data is restricted.

e) **Back up of Data:** The IS auditors should verify whether:

- All the floppies / CDs / tapes, purchased, pertaining to the OS software, application software and utility programs, drivers etc. are recorded in a register and properly stored.
- Hardware, software, operating system, printer manuals are properly labelled and maintained.
- Latest user manuals of the application software and other end-user packages running on the system are available for guidance. Check whether a documented backup procedure is defined for each system i.e., application, servers, data etc. For example: employees responsible for backup, restore process / type of backup that must be performed i.e., full Back up, incremental, differential / what data should be in the scope for backup (full system data, application data, configuration files) / the frequency of backup / location of backup (on-site / off-site) / schedule for testing backup.
- Daily / weekly / monthly and quarterly back-up of data is taken without fail and is available (as per requirement). IS auditors to check whether backup procedure (including restore procedures) is a part in the contingency plan.
- Backup tapes are properly labelled and numbered.
- Proper storage procedures and facilities are in place for backup copies.
- There is offsite storage of one set of the backup data.
- Backup tapes are verified / tested periodically by restoring the data and record



maintained. IS auditors to check whether recovery from backups is tested and personnel are trained once a year to keep competence and ensure data is properly restored.

- Back up media is verified periodically for readability.
 - Record is available in respect of such verification.
 - Backup media are phased out of use after a specified period.
 - Backup register is maintained wherein all the events pertaining to the backup including the procedure of backup are recorded.
 - Physical and fire protection is provided to backup media.
- f) **Restoration of Data:** The IS auditors should verify whether:
- The instructions for restoration of the back-up data have been compiled.
 - The data integrity is verified after the restoration work is over.
 - Activities carried out during the restoration work are recorded indicating date, time, reason for restoration and size of the data restored.
- g) **Output Reports:** The IS auditors should verify whether:
- The audit trail report generates the user ID of the operator and the official for any addition / modification / deletion of the transaction data effected in the database.
 - List of the cancelled entries is scrutinized and reasons for cancellation are recorded.
- h) **Virus Protection:** The IS auditors should verify whether:
- Anti-virus software is loaded in the system.
 - Anti-virus software is regularly updated to cover software updates against the latest viruses.
 - All extraneous input devices are checked for virus carried by the IS auditors.
- 3) **System Effectiveness:**
- Checking:** Bank Branch / Department Level. The IS auditors should verify whether:
- Computerized operations provide better customer service in terms of time and quality.
 - Staff serves a larger number of customers during the day than prior to the introduction of online operations.
 - Customer information is provided timely and accurately.
 - The system reflects any improvement in the overall quality of products and services offered.
 - System has improved the tasks accomplishment capacity of its users by enabling them to be more productive.
 - Users are satisfied with the performance of the system.



- System is user friendly and takes less effort.
- The users are putting the software to frequent use, which requires less effort and is easier to use and the users are satisfied with the performance of the software.

4) **System Efficiency:**

Checking: Dept. of Information Technology Level, Central Server Level, Bank Branch/ Department Level & Central Office Level. The IS auditors should verify whether:

- Department / Office ensures the use of every computer asset.
- Department / Office utilizes every computer asset to its optimum capacity.
- Periodical maintenance of the hardware asset ensures its uninterrupted service.
- The online operations help complete day's workload on the same day consuming less time than the time taken for the respective manual operations.
- The online operations provide accurate, complete and consistent data at each stage of processing.
- Department / Office takes consistency check of balances daily to aid in the detection of errors or fraud.
- Department / Office uses the hardware peripherals such as printers, nodes etc. efficiently.

5) **Organization and Administration:**

Checking: Dept. of Information Technology Level and Bank Branch / Department Level & Central Office Level. The IS auditors should verify whether:

- There is an Information Systems Security Programme for the entire organization, approved by the Board of Directors.
- There is a Corporate Information Systems Security Policy, well defined and documented and implemented including Information Systems Awareness Programme.
- There is an established hierarchy in the organization with a Senior Executive in charge of the implementation of the Corporate Security Policy with Information Systems Security Officials at various levels in an Office.
- Identified System Administrator for each computerized Office / Department, as required.
- Job description for each level is prepared and implemented (including System Administrator).
- Training is imparted to all staff members in turn for better results and output.
- Dual control aspect is implemented for the important operations.
- The functions of initiating, authorizing, inputting, processing and checking of the data are separated to ensure that no person has complete control over a particular function. Therefore, abuse of that function is not possible without collusion between two or more individuals.

- Rotation of duties is carried out at regular intervals.
- System Administrator is supervised and controlled with respect to the creation of user ids at the OS level and Application Software level.
- There are at least 2 persons for key functions of operations to take care of absenteeism.
- Department / Office ensures to bring up the servers into operation readiness sufficiently in advance before the commencement of the business hours.
- Computers are covered to keep them free from dust, rain water etc.
- Clear communication from the Management of the organization to the effect that each member of the staff is responsible for maintaining security in the organization, as per the Security Policy.

All Regulatory Circulars and Guidelines are Adhered by the IT Department. And these are implemented or not to be verified by the IS Auditor.

CARE: Kindly Note the above Scope is Indicative and **NOT** Exhaustive.

Cloud Computing Management Audit

Initially, banks were considered the economic tools to lend money and accept deposits from the public. The banking sector has been critically acclaimed for achieving economic stability. The need to strengthen the banking system was more realized only after India introduced the LPG policy in 1991. The then Finance Minister, Dr Manmohan Singh, opened the floodgates of trade opportunities by introducing liberalization, privatization, and globalization policy in India. Hence, as a result, for better public service experience, private banking was introduced in India vide establishing Axis Bank, ICICI Bank, and HDFC Bank from 1993 to 1994.

This was one of the major developments in the banking sector post-Independence era and the banking sector has kept developing since then. The invincible development came in terms of the adoption of new-age technologies incessantly over time. Due to this, traditional banking processes have given place to the most cutting-edge technological advancements. Among these, the implementation of CORE (Computerized Online Real-time Exchange) Banking in India was a watershed moment. Now-a-days, the common public doesn't need to visit the banks physically due to the advent of net banking, digital payments, smart cards, mobile banking, kiosk banking, etc. Banking processes are now considerably faster and more trustworthy, resulting in improved consumer relationships with banks. The next phase of banking sector development is the introduction of AI and Machine Learning. This is crucial, as the technology advances, fraudsters find it more opportune to commit forensic fraud. Machine Learning has already proved to be a very efficient tool in credit card management by banks. With the deployment of modern technologies, India's banking industry is poised for a revolutionary space.

Due to the sensitivity of the banking operations and dealing with public funds, banks are subject to strict regulation and governance. Despite their cautious approach, the market



volatility forces banks to look for ways to cut operating costs and introduce innovative products that would give better market coverage and a faster return on investment. In terms of product and service offerings, India's corporate banking sector is still in its infancy as compared to developed economies. So, to have efficient and cost-effective operations, banks should consider cloud banking. Cloud computing is a technical innovation that is transforming the banking business. According to a recent IDC report, nearly 80% of corporate banks in India are expected to operate their trade finance and treasury workloads on Cloud technology by 2024.

When cloud computing was first introduced, cloud maturity levels were low and banks were hesitant to implement it since they are bound by standards, data protection, and regulations. The cloud environment has matured significantly, and most banking rules and regulations have been changed to support cloud computing. The cloud is a crucial part of the service delivery architecture as it allows banks to tap into new delivery channels and business opportunities. Banks can reduce data storage costs by saving on capital and operating expenses while assuring client data security by utilizing cloud-based services. Cloud computing also encourages secure online payments, digital money transfers, wallet transactions and more.

While few Urban Co-operative Banks and Regional Rural Banks were early adopters of cloud technology, we should expect larger institutions to gravitate toward cloud services now. As a start, YES Bank has implemented cloud computing and has been an early adopter of cloud-based banking services. But using more technology means dealing with more big data. Millions and trillions of transactions occur every passing minute and it is becoming difficult for banks to manage the data efficiently. Banks need to spend more on IT solutions, networking, hardware, and software to meet various stakeholder's demands. Due to increased capital expenditures, banks find it difficult to attain the desired level of IT implementation. Cloud computing offers to assist the banks in reducing capital IT infrastructure expenses. Hence, banks are rapidly trying to adopt cloud-based IT solutions.

Cloud technology enables banks to adopt a new paradigm for delivering creative channels, reducing time to market new offerings, satisfying customer expectations, and complying with regulatory rules at a cheaper cost. System administrators can remotely build, install, configure, and deploy virtual resources to run a business solution using cloud computing. Furthermore, cloud IT infrastructure can be scaled up or down at any time based on predicted usage and requirements. Banks are quickly realizing that with cloud banking, they can store data and quickly access it. The cloud has appeared to be a superior data management tool providing banks with agility, scalability, and security. Faster deployment of financial services, lower costs of new applications, and greater flexibility are just a few of the reasons why banks are choosing cloud over traditional IT infrastructure.

Key benefits in switching to Cloud Banking:

- 1) Banks don't need to invest heavily in infrastructure costs. The saved money can be invested in running the operations smoothly.



- 2) Gone are those days when people feared the breach of security while using Internet-based solutions. Some of the world's most well-known brands own public cloud servers as it is more secure.
- 3) Banks can reach out to a large customer base through various mobile and app-based features. Many banks have started AI-based WhatsApp banking.
- 4) Cloud technology can make the banks swifter in operations by enabling banks to deploy newer services to customers.

What has refrained banks from switching to cloud technology so far? Here are some of the reasons. The systems with older programming languages or connectivity constraints may find it difficult to move to cloud technology. Furthermore, many financial institutions struggle to establish which systems can be moved to the cloud and which must remain on-premise. Leaders may be confused about whether or not shifting a system to the cloud will expose them to regulatory risk. Banks should compare the expenses of hosting data on-premises and maintaining their own servers against the price of moving to the cloud. Migrating can be costly if banks don't have proper resources and technological know-how. Networking is also a mini barrier when using a cloud-based approach. As per RBI regulations, banks must operate in rural and semi-urban areas in India wherein network latency can be a barrier. If fraud occurs, investigators will have to rely on a large amount of data scattered across various locations, making their task difficult.

Banks require technology that makes migration smooth and rapid. The actual transition period does not have to be onerous, provided IT teams have the appropriate technology in place and a risk team on hand to review security measures. Modern technology solutions are available in the market that allows banks to deploy cloud applications in two to three months rather than years.

Banks should invest in cloud migration. Financial institutions will gain increased agility to rapidly and effectively respond to changing customer needs. Banks need to confront the issues and invest in apt solutions to reap the benefits of migrating to the cloud.

There are many different ways of viewing cloud computing. It's a technology, a collection of technologies, an operational model, a business model; just to name a few. It is at its essence, transformative and disruptive. It is a new operational model and set of technologies for managing shared pool of computing resources. Computing services ranging from data storage and processing to software, such as email handling, are now available instantly, commitment-free and on-demand. Since we are in an era of tough competition, this new economic model for computing has found fertile ground and is seeing massive global investment.

In simpler terms, cloud is a set of resources, such as, processors and memory, which are put in a big pool. As per the requirement, cloud assigns resources to the client, who then connects them over the network. Further, clouds are multitenant by nature, i.e., multiple different consumers share the same pool of resources but are isolated and segregated from each other. It is important to note that cloud computing can refer to several different service

types, including Application/Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS). The risks and benefits associated with each model will differ and so will the key considerations in contracting for this type of service.

Cloud computing has become a great solution for providing a flexible, on-demand, and dynamically scalable computing infrastructure for many applications. Cloud computing also presents a significant technology trend, and it is already obvious that it is reshaping information technology processes and the IT marketplace. For cloud computing to reach the full potential promised by the technology, it must offer solid information security.

Outline the regulatory requirement that needs to be addressed, based on the underlying requirements, along with other questions that Organizations and Regulators globally often expect to be addressed. Every financial institution and every cloud services project is different. Tailor and build on the guidance provided to develop responses based on financial institution and its proposed use of cloud services.

A. Overview: General Overview of the Cloud Services.

1. Who is the service provider?
2. What cloud services are you using?
3. Provide the background on why organization has decided to outsource the service(s).
4. What activities and operations will be outsourced to the service provider?
5. What type of cloud services would organisation be using?
6. Whether the organization has reported to the relevant regulatory authority in case the Service Provider is a group entity of the organization?
7. Does the Service Provider have any conflict of interests with organization?
8. Is the outsourcing arrangement a cloud computing arrangement?
9. What data will be processed by the service provider on behalf of the financial institution?
10. How is the issue of counterparty risk addressed through Bank choice of service provider?

B. Offshoring:

11. Will the proposed outsourcing require offshoring? If so, from which territory(ies) will the outsourced cloud services be provided?
12. Has organization performed a risk assessment of this outsourcing arrangement? Please elaborate the key risks and threats that have been identified for this outsourcing arrangement and the actions that have been or will be taken to address them.



13. What other risks have been considered in relation to the proposed offshoring arrangement?

C. Compliance within the Organization: Financial institutions should have internal mechanisms and controls in place to properly manage the outsourcing. Although this is a matter of each financial institution. Ultimately this will need to be tailored for Financial Institution to reflect its compliance practices.

14. The financial institution must be able to demonstrate that, in assessing the options for outsourcing a material business activity to a third party, it has undertaken certain steps by way of due diligence (as set out in the next column). How does the financial institution comply?
15. Have you established and applied a set of objectives, measurable Service Provider selection criteria? Provide details.
16. If the Service Provider is a listed company, have you reviewed its filings to the relevant authorities (e.g., the relevant stock exchanges or market regulators)? If yes, how is the Service Provider dealing with the threats and vulnerabilities it has declared in its filings?
17. Is there a vendor management process to monitor the performance of the Service Provider?
18. Does the financial institution have a policy, approved by the Board, relating to the outsourcing?
19. Has the Board or relevant Committee of the Board been apprised of and acknowledged the risks presented to them?
20. Does Bank senior management or Board have oversight of the outsourcing operations?
21. Does the financial institution have access to adequate, independent information in order to appropriately monitor the cloud service provider and the effectiveness of its controls?
22. How does the financial institution ensure that it maintains ultimate responsibility for any outsourcing?

D. The need for an Appropriate Outsourcing Agreement:

23. Are the outsourcing arrangements contained in a documented legally binding agreement that is signed by all parties and addresses the required matters set out in the Outsourcing Guidelines?
24. Does the outsourcing agreement include a clause that allows the Regulators to access documentation and information relating to the outsourcing arrangement?
25. Does the outsourcing agreement provide a guarantee of access to the minimum IT assets required to operate under a disaster scenario?



26. Does the outsourcing agreement also include reporting mechanisms that ensure adequate oversight of IT security risk management by the service provider?
27. Is the outsourcing agreement sufficiently flexible to accommodate changes to existing processes and to accommodate new processes in the future to meet changing circumstances?
28. In the event of termination, do transitional arrangements address access to, and ownership of, documents, records, software and hardware, and the role of the service provider in transitioning the service?

E. Technical and Operational Risk: Under various requirements, including business continuity management and IT security risk requirements (which are not specific to outsourcing but should be considered nonetheless in the context of the outsourcing) financial institutions need to have in place appropriate measures to address IT Risk, Security Risk, IT Security Risk and Operational Risk.

29. Does the service provider permit audit by the financial institution and / or the regulators?
30. Are the provider's services subject to any third-party audit?
31. Does Bank organization have a process to audit the Service Provider to assess its compliance with Bank policies, procedures, security controls and the requirements in this checklist?
32. What security controls are in place to protect the transmission and storage of confidential information such as customer data within the infrastructure of the service provider?
33. How is the financial institution's data isolated from other data held by the service provider?
34. How are the service provider's access logs monitored?
35. What policies does the service provider have in place to monitor employees with access to confidential information?
36. How are customers authenticated?
37. What are the procedures for identifying, reporting and responding to suspected security incidents and violations?
38. How is end-to-end application encryption security implemented to protect PINs and other sensitive data transmitted between terminals and hosts?
39. Are there procedures established to securely destroy or remove the data when the need arises (for example, when the contract terminates)?
40. Are there documented security procedures for safeguarding premises and restricted areas? If yes, provide descriptions of these procedures.

41. Are there documented Securely procedures for safe guarding hardware, software and data in the datacenter?
42. If the outsourcing arrangement requires system connectivity between organization and the Service Provider, how does organization protect Bank networks and systems from the potential threats arising from the system connectivity?
43. How are privileged system administration accounts managed? Describe the procedures governing the issuance (including emergency usage), protection, maintenance and destruction of these accounts. Please describe how the privileged accounts are subjected to dual control (e.g., password is split into 2 halves and each given to a different staff for custody).
44. Is access to sensitive files, commands and services restricted and protected from manipulation? Provide details of controls implemented.
45. If the outsourcing arrangement involves the processing or storage of any sensitive information at the Service Provider, how does Bank organization address the risk of unauthorized disclosure as well as intentional or unintentional leakage of this information? Please provide details of the preventative and detective measures in place, if any.
46. Does the Service Provider employ a system architecture that involves data comingling for the outsourced service(s)? If so, how are the associated risks addressed?
47. Are the outsourced operations using hardware (i.e., servers/network devices) dedicated to the organization?
48. What remote access controls are implemented?
49. Where is the datacenter(s) of the Service Provider located? Indicate the datacenter(s) in which Bank organization's sensitive data would be stored and/or processed.
50. What physical and environmental controls are available at the datacenter(s)?
51. Does the service provider have a disaster recovery or business continuity plan? Have you considered any dependencies between the plan(s) and those of Bank financial institution?
52. What are the data backup and recovery arrangements for Bank organization's data that resides with the service provider?
53. How frequently does the service provider conduct disaster recovery tests?

F. Privacy:

54. Does the Service Provider have a privacy policy providing details on handling sensitive personal data or information?



55. Does the Service Provider obtain consent from the customers or employees of Bank organization if it is directly collecting sensitive personal information?
56. Does the Service Provider provide customers or employee whose data is being collected or processed by it, an opportunity to review, delete or modify SPI, if requested?
57. Have you addressed the following points?
 - Discuss and agree on the instances where customer data shall be accessed and the user groups who will have access to the same.
 - Access to a bank's data should be strictly on a need-to-know basis.
 - Ensure that service provider employees are adequately aware and informed on the security and privacy policies.

The Indian financial markets, in the last few years have seen wide ranging changes due to the deregulation of interest rate and foreign exchange markets. Intense competition for business coupled with increasing volatility in the domestic interest rates as well as foreign exchange rates have brought pressure on banks to maintain a balance among spreads, profitability and long-term viability. Banks have to base their business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. Further, the Core Principles for Effective Banking Supervision (Principles 11, 12 and 13 of the Basel Committee on Banking Supervision (BCBS)) of the Bank for International Settlements (BIS) mandate that Supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling credit, market, operational, country and transfer risks. It is thus essential that the banks adopt a more structured and comprehensive approach to Market Risk Management.

Market Risk Management provides a comprehensive and dynamic framework for measuring, monitoring and managing liquidity, interest rate, foreign exchange and equity and commodity price risks of a bank that needs to be closely integrated with the bank's business strategy. Accordingly, the Reserve Bank of India (RBI) vide circular (DBOD. No. BP.BC.8/21.04.098/99) dated February 10, 1999 has issued guidelines on the implementation of the Asset-Liability Management (ALM) system in banks. These guidelines were implemented effective April 1, 1999. This was supplemented with detailed operative Guidelines on Risk Management Systems issued in October 1999, covering broad contours for management of credit, liquidity, interest rate, forex and operational risks. These guidelines, together with the ALM guidelines were purported to serve as a benchmark to those banks, which have not established integrated risk management systems.

Market Risk may be defined as the possibility of Loss to a Bank caused by Changes in the Market Variables.

The BIS defines market risk as "the risk that the value of on-or off-balance-sheet positions will be adversely affected by movements in equity and interest rate markets, currency exchange rates and commodity prices". Thus, Market Risk is the risk to the bank's earnings and capital due to changes in the market level of interest rates or prices of securities, foreign exchange and equities, as well as the volatilities of those prices.

Market Risk Management of a bank thus involves management of interest rate risk, foreign exchange risk, commodity price risk and equity price risk. Besides, it is equally concerned about the bank's ability to meet its obligations as and when they fall due. In other words, it should be ensured that the bank is not exposed to Liquidity Risk.

Treasury operations is one of the most important functions of a bank, responsible for the processing of all financial market transactions and usually much more, including a crucial role in managing risk. Treasury comprises of two main components-Investments (comprising transactions related to domestic investments and money market operations) and Forex & Derivatives. In a well-functioning risk management system, banks broadly position their balance sheet into Trading and Investment or Banking Books. While the assets in the trading book are held primarily for generating profit on short-term differences in prices / yields, the banking book comprises assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity. Thus, while the price risk is the prime concern of banks in trading book, the earnings or economic value changes are the main focus of banking book.

Core Functions of Treasury Operations in Banks

The core areas of treasury operations in a bank can be functionally divided into the following broad compartments:

- Front Office Operations (Dealing room operations);
- Middle Office Operations (Market Risk Department / Product Control Group); and
- Back Office Operations (Deal Confirmation, Settlement, Accounting and Reconciliation).

Some of the main functions of Front Office, Mid-Office and Back-office operations are detailed below:

a) Front Office (Dealing Room)

Dealing in

- Money and fixed income dealings.
- Forex
- Treasury Sales.
- Equities.
- Primary Dealers.
- Derivatives.
- Integrated Treasury

b) Mid Office (Risk)

- Identification, measurement and monitoring of risk.
- Monitoring counter party, product and dealer limits.

c) Back Office

- Settlement and follow up.
- Reconciliations.
- Accounting.
- Valuation.

Increasing regulatory and compliance requirements and the need for risk management have made 'treasury front and back-office efficiency' as one of the most critical factors in ensuring the well-being of any bank today. This is certain to continue as the operations of treasury becomes more onerous while financial products become increasingly complex, despite streamlining of processing systems.

1. Front office Operations:

The front office operations consist of dealing room operations wherein the dealers transact deals with the various approved counterparties subject to Policy limits. Deals are transacted by dealers on various anonymous order matching platforms such as NDS-OM, CROMS, NDS-CALL, FX-CLEAR, FX-SWAP, E-Kuber and over communication platform such as Reuters', Bloomberg, telephonic conversation with counter party or through empanelled brokers.

The dealers are primarily responsible to check for counterparty exposure limits, eligibility, and other requirements of the Bank before initiating any deal. Dealers must ensure that all risk / credit limits are available before transacting a deal. Also, the deal must not contravene the current regulations regarding dealing in INR with overseas banks / counterparties. All counterparties, while transacting in Derivatives, are required to execute the International Swaps and Derivatives Association ('ISDA') agreement as well as pass a board resolution allowing them to enter into derivative contract. As soon as the deal is struck with counterparty, the deal details are noted in a dealers' deal pad and captured in front office system of the Bank which gets queued in for authorization by back office.

2. Middle office Operations:

Middle office is responsible for online risk measurement, monitoring and management reporting. Mid Office is independent of Treasury and is controlled by Risk Management Department. The functions of Mid-Office are:

- Limit setting and monitoring exposures in relation to limits.
- Assessing likely impact of market movements based on internal assessments and external/ internal research.
- Evolving hedging strategies for assets and liabilities.
- Interacting with the bank's Risk Management Department on liquidity and market risk.
- Monitoring open currency positions.
- Calculating and reporting Value at Risk (VaR).
- Stress testing and back testing of investment and trading portfolios.
- Risk-return analysis.
- Marking open positions to market to assess unrealized gain and losses.

3. Back-office Operations:

The mainstream role of the back office is to provide direct support to the dealing room or front office. The role include checking of deal input details, verification by confirmation



from counterparty, settlement, verifying existence of a valid and enforceable International Swap Dealers Association ('ISDA') agreement and reconciliation of positions and NOSTRO accounts.

The deals are settled through straight-through processing (STP), also called 'hands-off' processing. This has been made possible through improved technology and real time online input in the trading platform, which in turn has meant that the back office can authorise / confirm deals pending for authorisation in the trading platform. The authorized deals are then matched with the deal confirmations received from the Counterparties and put through STP for settlement.

One of the basic tenets for the treasury department in a bank is the strict segregation and allocation of duties between the front, middle and back office, the latter controlling confirmations, settlement and accounting of transactions. These are even more important in an era of straight-through processing where the checks are automated and must essentially be independent.

However, while this is straight forward for the processing functions, the independent monitoring and management of complex trading risks can be much more problematic, requiring the ability and market knowledge to understand how the trades and hedges in the dealer's book are structured.

Functions of Back Office:

i. Input and completion:

The first core function of the back office is to extract details of the deal either through the input system or by accessing the online platform and authorise/ confirm the same after verifying the deal details with external evidence i.e., print of deal concluded on various dealing systems - Reuters' / Bloomberg's conversation, broker notes. Deals input through front-end data capture or agreed on one of the proprietary trading systems are subjected to numerous systems checks to ensure that the transaction details are technically correct. Some deals will require settlement instructions to be added, but for straightforward foreign exchange and derivative deals done with other banks and large corporates, standard settlement instructions (SSIs) may have already been added as per the agreement. This could also be true for derivatives transactions in the larger treasuries. However, these types of transactions generally need more checking and manual intervention because of the wide variety of their use. Bank normally releases its own confirmation to the counterparty, particularly for over the counter ('OTC') deals.

ii. Counterparty confirmation:

The second core function for the back office is to verify the deal from the counterparty at the earliest after the transaction has been done. For bank-to-bank trading, the verification can take the form of a confirmation of a deal done through Reuters conversation or trading systems, or a broker's confirmation if the deal has been done through a broker. Telephone confirmations are also sought for immediate authorisation. Further, the banks



have entered into bilateral agreement with counterparty banks who are members of CCIL whereby exchange of confirmations for Forex Interbank deals (matched on CCIL) have been discontinued.

Deals done with customers (non-banks) will normally be confirmed by email, with instructions swapped on the telephone, depending on the arrangement. Increasingly, however, corporate customers are using automatic confirmation-matching services. It is essential that the deal is confirmed independently of the trader before any kind of value is given or payment is made.

F-TRAC (FIMMDA Trade Reporting and Confirmation) System

It is to be noted that all entities regulated by RBI, IRDA and PFRDA have to mandatorily report secondary market Corporate Bond trades on F-TRAC.

Other entities regulated by SEBI or any other regulators have been mandated to report OTC secondary market Corporate Bond on F-TRAC, or any other SEBI authorised reporting platform. All entities have to report CP's & CD's only on FTRAC.

iii. Settlement:

The third core function in the processing chain is that of settlement. This can take the form of a clean currency payment/receipt at the bank's accounts or through the medium of CCIL. The CCIL settlement process is a multilateral netting system for Inter-bank transactions that will net the member's payment and receipts in a currency, even if they are due to or due from him from different counterparties and settles the net position in both legs of the transaction.

iv. Reconciliation:

Operations areas are typically involved in a number of reconciliation processes, including the reconciliation of dealers' overnight positions, NOSTRO accounts and brokerage payments. This can also mean reconciling positions for margin calls in futures trading or reconciling custody accounts to the underlying securities in securities trading. However, the basic reconciliation function is to agree or reconcile the entries that have passed over an account with correspondent bank against those that have been passed internally in the books of the bank to a NOSTRO account. After reconciliation, the unmatched items in both accounts then represent those that have not been responded to in either the books of the bank or its correspondent and therefore requires to be investigated.

Integrated Treasury:

The Treasury Management (or treasury operations) can be explained as the management of the best possible use of surplus funds, maintain liquidity, reduce the overall cost of funds, and mitigate operational and financial risk.

Traditionally, banks used to have two separate departments for treasury operations of a bank namely the domestic treasury/investment operations of a bank and foreign exchange treasury operations. Fundamentally they used deal with arranging the funds whenever the



bank needs the funds and to deploy the surplus funds for profit. The treasury dealings are normally short-term funds-flow of the bank. However, in case of SLR requirement, investment in some securities is held to maturity exceeding one year. As a risk management function, they cover underlying assets and liabilities across short, medium and long-term maturities.

Domestic Treasury:

The domestic treasury operations were essentially meant for management of reserve ratios, i.e., CRR and SLR (which are basically the govt. securities) and Fund Management. Over the period, the treasury operations evolved as independent profit centres of the banks as these operations indirectly contributes to revenue generation of the banks. Every bank would have designated certain portion of the investment into held to maturity and a part as held for trading portfolio to exploit profit from trading. Raising funds by issuing several liability instruments and investing them by taking up different items of asset products are the other activities of the treasury.

When the bank lends at money market or bond market, those assets become treasury assets of the bank. On the other hand, once a bank borrows money from the money market or bond market, it is said to have undertaken a treasury liability. We have to remember that the deposits received from bank customers are not treated as treasury liability as deposits accepted by the banks are not market borrowing. Similarly, loans and advances made to customers are not treasury assets. In the other words, when a particular asset or liability is created through a transaction in the inter-bank market and if it can be negotiated or sold in the market, it becomes a part of the treasury portfolio of the bank.

Forex Treasury:

The treasury (foreign exchange division) dealing in funding and managing foreign currency assets and liabilities. Their main task is to provide a 'cover' to the customers of the bank in respect of their foreign currency exposure on account of their merchant transactions, viz., exports, imports, remittances, etc. In addition to that the dealing room of the banks engages in providing different hedging and derivatives products to manage the-interest rates and exchange risks of the customers of the bank and accordingly they do cover operations in the inter-bank market. One of the main profit generating area of the Forex Treasury is Trading activity in the spot/forward markets of various tradeable currency pairs. They also exploit profit through arbitrage operations (simultaneous purchase or sale of same currencies of similar maturity but at different prices, usually in different markets).

Integrated Treasury, in a banking set-up, refers to integration of domestic and foreign exchange operations. The integration of the forex dealing and domestic treasury helped the banks in consolidating outflow and inflow of money both from domestic and foreign exchange operations and deploying/borrowing in/from the appropriate market. In the integrated scenario, banks no longer distinguish between Rupee cash flows and foreign currency cash flows. Further, the integrated treasury has direct access to the various segments of the market, viz., money market, capital market, forex market, etc. and it has an overview of the bank's total funding needs. They have multiple accesses to foreign currency funds



through their off-shore operations, FCNR (B), RFC, and EEFC and float funds from external commercial borrowings (ECB) of corporate customers for funding needs. Further, banks look for interest arbitrage across the currency markets and are in a position to move quickly from one market to the other. Banks can also source funds in global market and swap the funds into domestic currency, or vice versa, depending on the market opportunities. For example, banks can make placement of Rupee inflow from Certificate of Deposit (CD) borrowing to lending in USD in global interbank market with proper hedging.

Integrated Treasury therefore is in a position to operate across the sectors and across the currency markets, either in search of higher returns, or in order to mobilize low-cost funds for liquidity needs. Integrated Treasury is also fully involved in risk management, in particular, management of market risk, often using derivative products.

Classification of Investments:

Banks are required to classify their entire investments portfolio (including SLR securities and non-SLR securities) into three categories: "held-to-maturity", "available-for-sale" and "held-for-trading".

i. Held-to-maturity (HTM):

This category would comprise securities acquired by the bank with the intention to hold them up to maturity.

ii. Held-for-trading (HFT):

The investments classified under HFT would be those from which the bank expects to make a gain by the movement in interest rates/market rates. These securities are to be sold within 90 days.

iii. Available-for-sale (AFS):

This category will comprise securities, which do not qualify for being categorised in either of the above categories, i.e., those that are acquired neither for trading purpose nor for being held till maturity.

Non-Performing Investments (NPI):

In respect of securities included in any of the three categories where interest / principal is in arrears, banks should not reckon income on the securities and should also make appropriate provisions for the depreciation in the value of the investment. Banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

An NPI, similar to a non performing advance (NPA), is one where:

- (i) Interest/ instalment (including maturity proceeds) is due and remains unpaid for more than 90 days.



- (ii) The above would apply *mutatis-mutandis* to preference shares where the fixed dividend is not paid. If the dividend on preference shares (cumulative or non-cumulative) is not declared/paid in any year it would be treated as due/unpaid in arrears and the date of balance sheet of the issuer for that particular year would be reckoned as due date for the purpose of asset classification.
- (iii) In the case of equity shares, in the event the investment in the shares of any company is valued at ₹1 per company on account of the non-availability of the latest balance sheet in accordance with the instructions contained in paragraph 3.5.5 of the RBI Master Circular no. RBI/2015-16/97DBR No BP.BC.6 /21.04.141/2015-16 dated July 1, 2015 on Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks, those equity shares would also be reckoned as NPI.
- (iv) If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities, including preference shares issued by the same issuer would also be treated as NPI and vice versa. However, if only the preference shares are classified as NPI, the investment in any of the other performing securities issued by the same issuer may not be classified as NPI and any performing credit facilities granted to that borrower need not be treated as NPA. The Auditor should review the mechanism adopted by the Bank for classifying the investments as NPI where the credit facility has been classified as NPA and vice versa and test the effectiveness of the mechanism followed particularly the timeliness of such classification.
- (v) The investments in debentures / bonds, which are deemed to be in the nature of advance would also be subjected to NPI norms as applicable to investments.
- (vi) In case of conversion of principal and / or interest into equity, debentures, bonds, etc., such instruments should be treated as NPA *ab initio* in the same asset classification category as the loan if the loan's classification is substandard or doubtful on implementation of the restructuring package and provision should be made as per the norms. Further movement in the asset classification of these instruments would also be determined based on the subsequent asset classification of the restructured advance.
- (vii) When a Bank restructures credit facilities in accordance with RBI circular no. DBR.No.BP. BC.45/21.04.048/2018-19 dated June 7, 2019 dealing with Prudential Framework for Resolution of Stressed Assets, the investments made by the Bank in the instruments of such borrowers will also be dealt with in accordance with these guidelines.

Investment Fluctuation Reserve (IFR) - Market Risk & Investment:

- 1. Reserve Account (IRA):** The RBI had specified the following guidelines with respect to IFR and IRA.
- 2. Investment Fluctuation Reserve:**
 - (i) Banks were advised to build reserves towards investment fluctuation, of a minimum 5% of the investment portfolio within 5 years period.

- (ii) To ensure smooth transition to Basel norms, banks had been advised to build adequate reserve towards capital charge for market risks in a phased manner over a two-year period as follows:
 - a) In respect of securities included in the HFT category, open gold position limit, open foreign exchange position limit, trading positions in derivatives and derivatives entered into for hedging trading book exposures; and
 - b) In respect of securities included in the AFS category.
- (iii) As advised by RBI in October, 2005, Banks maintaining capital of at least 9 per cent (At present 11.5% - 9%+2.5%) of the risk weighted assets for both credit risk and market risks for both HFT (of items-open gold position limit, open foreign exchange position limit, trading positions in derivatives and derivatives entered into for hedging trading book exposures) and AFS category were permitted to treat the entire balance of IFR as Tier I capital, transfer the balance in the IFR 'below the line' in the Profit & Loss Appropriation account to statutory reserve, general reserve or balance of Profit and Loss Account.

Investment Policy:

The Reserve Bank of India issues guidelines for the investment portfolio of the banks, keeping in view the developments in the financial markets and taking into consideration the evolving international practices. Circulars also issued by the Reserve Bank of India on prudential norms for classification, valuation and operation of investment portfolio by banks.

Banks should frame Internal Investment Policy Guidelines and obtain the Board's approval. The investment policy may be suitably framed / amended to include Primary Dealer (PD) activities also. Within the overall framework of the investment policy, the PD business undertaken by the bank will be limited to dealing, underwriting and market-making in Government Securities. Investments in Corporate / PSU / FI bonds, Commercial Papers, Certificate of Deposits, debt mutual funds and other fixed income securities will not be deemed to be part of PD business. The investment policy guidelines should be implemented to ensure that operations in securities are conducted in accordance with sound and acceptable business practices. While framing the investment policy, the following guidelines are to be kept in view by the banks:

- Banks may sell a government security already contracted for purchase, provided:
 - The purchase contract is confirmed prior to the sale,
 - The purchase contract is guaranteed by Clearing Corporation of India Ltd. (CCIL) or the security is contracted for purchase from the Reserve Bank and,
 - The sale transaction will settle either in the same settlement cycle as the preceding purchase contract, or in a subsequent settlement cycle so that the delivery obligation under the sale contract is met by the securities acquired under the purchase contract (e.g., when a security is purchased on T+0 basis, it can be sold on either T+0 or T+1



basis on the day of the purchase; if however it is purchased on T+1 basis, it can be sold on T+1 basis on the day of purchase or on T+0 or T+1 basis on the next day).

For purchase of securities from the Reserve Bank through Open Market Operations (OMO), no sale transactions should be contracted prior to receiving the confirmation of the deal / advice of allotment from the Reserve Bank.

In addition to the above, the Scheduled Commercial Banks (SCBs) (other than RRBs and LABs) and PDs have been permitted to short sell Government securities in accordance with the requirements specified by RBI.

Further, the NDS-OM members have been permitted to transact on 'When Issued' basis in Central Government dated securities, subject to the guidelines specified by RBI.

- Banks successful in the auction of primary issue of Government Securities may enter into contracts for sale of the allotted securities in accordance with the terms and conditions as per RBI Guidelines.
- The settlement of all outright secondary market transactions in Government Securities is being done on a standardised T+1 basis effective May 24, 2005. Settlements on T+2 basis is permitted for outright secondary market transactions in Government Securities undertaken by FPIs and reported on NDS-OM, subject to following conditions:
 - All sale and purchase transactions in Government securities, where at least one of the parties is an FPI, will be settled only on T+2 basis. These will include deals between a domestic entity and an FPI, deals between two FPIs of different custodians, deals between a custodian and its FPI Gilt Account Holder, and deals between two FPI Gilt account Holders of the same custodian.
 - All other trades not involving an FPI will continue to settle on T+1 basis.
 - Custodian bank of the FPI selling the security or the counterparty entity selling the security to the FPI will have to report the deal on trade date itself within the prescribed reporting time.
 - Custodian bank of the FPI buying the security can report the deal till next business day upto prescribed reporting time. Guidelines on DVP III settlement issued vide [circular IDMD.PDRS.05/10.02.01/2003-04 dated March 29, 2004](#) and as updated from time to time shall continue to apply for such transactions settled on T+2 basis.
- All the transactions put through by a bank, either on outright basis or ready forward basis and whether through the mechanism of Subsidiary General Ledger (SGL) Account or Bank Receipt (BR), should be reflected on the same day in its investment account and, accordingly, for SLR purpose wherever applicable. With a view to bringing in uniformity in the methodology of accounting for investments in Government securities, banks should follow 'Settlement Date' accounting for recording purchase and sale of transactions in Government Securities.
- The banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on behalf of brokers.

- Any instance of return of SGL from the Public Debt Office (PDO) of the Reserve Bank for want of sufficient balance in the account should be immediately brought to the Reserve Bank's notice with the details of the transactions.
- Banks desirous of making investment in equity shares/ debentures should observe the following guidelines:
 - Build up adequate expertise in equity research by establishing a dedicated equity research department, as warranted by their scale of operations;
 - Formulate a transparent policy and procedure for investment in shares, etc., with the approval of the Board; and
 - The decision in regard to direct investment in shares, convertible bonds and debentures should be taken by the Investment Committee set up by the bank's Board. The Investment Committee should be held accountable for the investments made by the bank.
 - Banks should clearly lay down the broad investment objectives to be followed while undertaking transactions in securities on their own investment account and on behalf of clients, clearly define the authority to put through deals, procedure to be followed for obtaining the sanction of the appropriate authority, procedure to be followed while putting through deals, various prudential exposure limits and the reporting system. While laying down such investment policy guidelines, banks should obtain the approval of respective Boards and strictly observe Reserve Bank's detailed instructions on the following aspects:
 - (i) STRIPS.
 - (ii) Ready Forward (buy back) deals in G-Sec.
 - (iii) Transactions through Subsidiary General Ledger A/c.
 - (iv) Use of Bank Receipts.
 - (v) Retailing of Government Securities.
 - (vi) Internal Control System.
 - (vii) Dealings through Brokers.
 - (viii) Audit, Review and Reporting.

Interest Rate Risk (IRR):

The management of Interest Rate Risk should be one of the critical components of market risk management in banks. The regulatory restrictions in the past had greatly reduced many of the risks in the banking system. Deregulation of interest rates has, however, exposed them to the adverse impacts of interest rate risk. The Net Interest Income (NII) or Net Interest Margin (NIM) of banks is dependent on the movements of interest rates. Any mismatches



in the cash flows (fixed assets or liabilities) or repricing dates (floating assets or liabilities), expose banks' NII or NIM to variations. The earning of assets and the cost of liabilities are now closely related to market interest rate volatility.

Interest Rate Risk (IRR) refers to potential impact on NII or NIM or Market Value of Equity (MVE), caused by unexpected changes in market interest rates. Interest Rate Risk can take different forms:

Types of Interest Rate Risk:

Gap or Mismatch Risk:

A gap or mismatch risk arises from holding assets and liabilities and off-balance sheet items with different principal amounts, maturity dates or repricing dates, thereby creating exposure to unexpected changes in the level of market interest rates.

Basis Risk:

Market interest rates of various instruments seldom change by the same degree during a given

period of time. The risk that the interest rate of different assets, liabilities and off-balance sheet

items may change in different magnitude is termed as basis risk. The degree of basis risk is fairly high in respect of banks that create composite assets out of composite liabilities. The Loan book in India is funded out of a composite liability portfolio and is exposed to a considerable degree of basis risk. The basis risk is quite visible in volatile interest rate scenarios. When the variation in market interest rate causes the NII to expand, the banks have experienced favourable basis shifts and if the interest rate movement causes the NII to contract, the basis has moved against the banks.

Embedded Option Risk:

Significant changes in market interest rates create another source of risk to banks' profitability by encouraging prepayment of cash credit / demand loans/term loans and exercise of call/put options on bonds / debentures and / or premature withdrawal of term deposits before their stated

maturities. The embedded option risk is becoming a reality in India and is experienced in volatile situations. The faster and higher the magnitude of changes in interest rate, the greater will be the embedded option risk to the banks' NII. Thus, banks should evolve scientific techniques to estimate the probable embedded options and adjust the Gap statements (Liquidity

and Interest Rate Sensitivity) to realistically estimate the risk profiles in their balance sheet. Banks should also endeavour for stipulating appropriate penalties based on opportunity costs to stem the exercise of options, which is always to the disadvantage of banks.

**Yield Curve Risk:**

In a floating interest rate scenario, banks may price their assets and liabilities based on different

benchmarks, i.e., TBs yields, fixed deposit rates, call money rates, MIBOR, etc. In case the banks use two different instruments maturing at different time horizon for pricing their assets and liabilities, any non-parallel movements in yield curves would affect the NII. The movements in yield curve are rather frequent when the economy moves through business cycles. Thus, banks should evaluate the movement in yield curves and the impact of that on the portfolio values and income.

Price Risk:

Price risk occurs when assets are sold before their stated maturities. In the financial market, bond prices and yields are inversely related. The price risk is closely associated with the trading book, which is created for making profit out of short-term movements in interest rates. Banks which have an active trading book should, therefore, formulate policies to limit the portfolio size, holding period, duration, defeasance period, stop loss limits, marking to market, etc.

Reinvestment Risk:

Uncertainty with regard to interest rate at which the future cash flows could be reinvested is called reinvestment risk. Any mismatches in cash flows would expose the banks to variations in NII as the market interest rates move in different directions.

Net Interest Position Risk:

The size of non-paying liabilities is one of the significant factors contributing towards profitability of banks. When banks have more earning assets than paying liabilities, interest rate risk arises when the market interest rates adjust downwards. Thus, banks with positive net interest positions will experience a reduction in NII as the market interest rate declines and increases when interest rate rises. Thus, large float is a natural hedge against the variations in interest rates.

Measuring Interest Rate Risk:

Before interest rate risk could be managed, they should be identified and quantified.

Unless the quantum of IRR inherent in the balance sheet is identified, it is impossible to measure the degree of risks to which banks are exposed. It is also equally impossible to develop effective risk management strategies/hedging techniques without being able to understand the correct risk position of banks. The IRR measurement system should address all material sources of interest rate risk including gap or mismatch, basis, embedded option, yield curve, price, reinvestment and net interest position risks exposures. The IRR measurement system should also take into account the specific characteristics of each individual interest rate sensitive position and should capture in detail the full range of potential movements in interest rates.



There are different techniques for measurement of interest rate risk, ranging from the traditional Maturity Gap Analysis (to measure the interest rate sensitivity of earnings), Duration (to measure interest rate sensitivity of capital), Simulation and Value at Risk. While these methods highlight different facets of interest rate risk, many banks use them in combination, or use hybrid methods that combine features of all the techniques.

Generally, the approach towards measurement and hedging of IRR varies with the segmentation of the balance sheet. In a well-functioning risk management system, banks broadly position their balance sheet into Trading and Investment or Banking Books. While the assets in the trading book are held primarily for generating profit on short-term differences in prices/yields, the banking book comprises assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity. Thus, while the price risk is the prime concern of banks in trading book, the earnings or economic value changes are the main focus of banking book.

Risk Based Internal Audit

Market Risk-Check List

Audit Approach:

While innovative products and ways of trading create new possibilities for earnings for the bank, they also introduce novel and sometimes unfamiliar risks that must be identified and managed. Failure to do so can result in losses entailing financial and reputational consequences that linger long after the loss has been recognized in financial statements. Hence, the Auditor should assess controls as part of audit work.

It is imperative that the Auditor obtains a complete overview of the treasury operations of a bank before the commencement of the statutory audit. After conducting appropriate risk assessment of the treasury processes, the audit program needs to be designed in a manner that it dovetails into not just the control assessments of the treasury process but there is an assurance that the figures appearing in the financial statements as well as the disclosures are true and reflect fairly the affairs of the bank's treasury operations.

Audit Programming and Procedures:

The Reserve Bank of India prescribes concurrent audit /internal audit for a 100% verification of treasury transactions. Hence, the selection of samples can be influenced by the nature, extent and timings of concurrent/internal audit function including the compliance mechanism of the Bank.

The following paragraphs illustrate the audit procedures / approach that may form part of the audit program.

Product Program and Policy:

The Auditor should obtain the approved product policy and procedures of the Bank relating to foreign exchange and derivative business and review them for adequacy and

coverage and check whether the policy is commensurate with the nature of operations and adequately covers all the activities of the Bank.

Further, in accordance with the Comprehensive Guidelines on derivatives, the Auditor should obtain and verify full particulars of the model used for valuation and the documented algorithms used by the Bank through its Valuation Policy and operating procedure manual for valuations.

Customer / User Suitability and Appropriateness Policy:

The Auditor should obtain approved 'Customer / User Suitability and Appropriateness Policy' and verify that such policy is in line with the Comprehensive Guidelines on derivatives and is approved by the Board.

The Auditor should also verify the process followed by the bank for classification of customers into different grades/classification and the customers have been permitted to deal in the products applicable to their respective grades.

a. Credit limits:

For the selected samples, the Auditor should check whether appropriate credit limits are in place for foreign exchange and derivative transactions. Additionally, the Auditor should:

- Check whether the name of the counterparty is in the approved counterparty list for the purpose of treasury transactions.
- Check whether the deals are input into the system within the stipulated time period.
- Check whether the credit limits (both pre settlement and settlement) are set for different customers and they are adhered to in a consistent manner and for any limit breaches, appropriate sanctions / ratifications are in place.
- Check whether the counterparty exposure limit reports for all brokers, lenders, etc., are generated and monitored on a regular basis.
- Check whether the limits are properly entered in the bank's system.
- Check dealer limits-Maximum amount a dealer can transact without seeking higher-level approval and sanctions / ratifications for any breaches. It includes individual deal (deal ticket) size limit and open position limit for a dealer as well.
- Check product limits- Maximum exposure the entity should have in a particular instrument or product.
- Check sector limits-Maximum investment in a particular sector (for example, exposures to companies incorporated with limited liability in India).
- For the selected samples, confirm and review signed and authorized ISDA agreement, signed and authorized collateral agreement, credit risk assessment of the customer and confirm, whether credit positions are within established limits for each customer.
- Check whether the above limits are entered into the software system being used by the Bank Branch for conducting the said transactions.



b. Deal Initiation and Recording:

For deal initiation and recording, the Auditor should check the following:

- For the selected samples, the Auditor should check whether deals carried out by the front office are appropriately recorded in the deal slips and whether the same is correctly entered in the front office deal recording system.
- For the selected samples check whether the deal ticket is complete and accurate with respect to all transaction details like counterparty name, contract rate, notional amount, transaction date / maturity date, value date / settlement agent and buy / sell date.
- Check the flow of transaction from initiation of deal to the verification and approval.
- Check whether deal tickets are generated automatically by front office systems, or trader should use sequentially numbered deal tickets.
- Check whether the dealers use dedicated calling lines and all the telephone lines are linked to a voice recording machine.
- Verify the adherence to the voice recording mechanism.
- Check whether the proper back-up of voice recordings is being maintained.
- Verify whether user IDs of dealers left / transferred / on leave is deactivated / suspended on timely basis.
- Verify whether, the Use of Mobile Phones is restricted in the Dealing Room and the mechanism for ensuring adherence thereto.
- Verify the recordings for few of the selected samples to ascertain that the recording machine is working in order.
- Check whether there is access of unauthorized persons in the dealing room. If yes, whether proper approvals have been taken.
- Check whether dealers entering the deals have signed the code of conduct for respective segment in which trades dealt in (e.g., FIMMDA, FEDAI, FX Global etc).

c. Deal Authorisation:

Following audit procedures may be followed by the Auditor while checking the procedures for deal authorisation:

- Check the process flow of authorizations of deals in the system and check areas of manual intervention in the system.
- Check whether proper authorization levels are set for treasury operations and observe and verify whether the prescribed procedure is followed.
- For the selected samples, check whether deals entered in front office system are authorised by the back-office team after verifying the deal details with external evidences like Reuters' conversation, telephonic conversation with customers' back office, etc.



- Examine the selected deals from the front office and establish that they are confirmed by the back-office operations.
- Check that all sample deals are authorised at the proper levels of authority against the deal slip.
- Check whether alterations and cancellations on deal slips are duly authorised.
- Check whether bank is preparing trade amendments sheets and whether the reasons for such amendments are mentioned in the sheet.
- Check whether any exceptional reports are being generated.

d. Segregation of Duties:

For this aspect, the audit procedure may include:

- There will be complete segregation between Dealing room, Market risk group and Back office.
- Checking and ascertaining that segregation of duties is in place. Under no circumstances staff involved in initiating deals should be involved in checking or receiving deal related documents.
- Verify whether there is any overlapping of duties.
- Verify that there is clear segregation, functionally and physically, between the front office, back office and middle office in respect of all transactions.
- Check that there is segregation between functions of authorisation, execution and recording of transactions.
- In cases where management override has taken place, ascertain that satisfactory reasons for doing so were recorded and produced for audit verification.
- Check whether treasury personnel have availed minimum mandatory leave during the financial year.
- Check whether any duties have been outsourced to/from external parties.

e. Counterparty confirmations:

For this aspect, the Auditor would inter alia:

- Understand the process of sending and tracking the confirmations including follow-up procedures.
- Exchange of deal confirmations is mandatory. The counterparties should exchange the rate fixing notices. However, in the case of an OTC Overnight Index Swap (OIS) the trades are reported to CCIL. If the counterparties have a bilateral agreement waiving the requirement to exchange of confirmations, then exchanging of physical confirmations may not be required for such IRS deals.
- Understand the process of MIS reporting to the senior management in respect of the non-receipt of counterparty confirmations.

- Verify that confirmations from Bank to counterparty are sent within a reasonable time and there exists a mechanism for follow-ups for pending counterparty confirmations.
- Determine the status of any missing / pending confirmations (currently in the Confirmation Tracking List) and assess whether there are any provisioning concerns on the trades.
- Check whether the format of the counterparty confirmation is as approved by the Local Legal Counsel of the Bank from time to time.
- Verify controls implemented by the bank to ensure completeness of all deal confirmations.
- Check whether there is any persisting non-receipt of Counterparty confirmation.
- Inquire of any exception report or other mechanism of tracking missing confirmations.

f. Customer Complaints:

As per the Comprehensive Guidelines on Derivatives, while undertaking derivative transactions with or selling structured derivative products to a user, a market-maker should establish internal procedures for handling customer disputes and complaints. They should be investigated thoroughly and handled fairly and promptly. Senior management and the Compliance Department/Officer should be informed of all customer disputes and complaints at a regular interval. For this, the Auditor should verify controls over recording and handling of customer disputes and complaints and ensure the Bank's adherence to RBI requirements.

g. Underlying document:

The audit procedures for this aspect include:

- Understanding the process and policy of the Bank in respect of the underlying documents.
- The Auditor should ensure that the bank should obtain the original documents from the client and/or certified document by the person who is authorised to do the derivative deal. The Auditor should check the details in client master page by checking the board resolution.
- Understand the process of MIS reporting to the senior management in respect of the non-receipt of underlying documents.
- The Auditor should ascertain whether the bank has a mechanism whereby, if the documents are not submitted by the customer within 15 days, the contract gets cancelled, and the exchange gain, if any, is not passed on to the customer. The primary responsibility for ensuring this remains with the Bank and the Auditor should verify controls around the same.
- The Auditor should ensure that the Bank has a mechanism to ensure that if the underlying is not provided three times a year; then the client will have to produce upfront underlying and the 15 days grace will not be allowed to the client.
- For the selected samples, review and check the underlying documents duly received by the bank.



- In cases, where the underlying documents with regard to the forex transactions are maintained at Bank branches, then, the Auditor may obtain confirmation from such Bank branches about existence of the underlying documents and review sudden spurt in foreign exchange transactions of any Bank branch in a particular month/period, if any, and test adherence to the RBI guidelines relating to merchant transactions.
- The Auditor should check whether any transaction was undertaken without execution of one-time documents and approval for deferral of the same is held on record and said documents were received before the expiry of such deferral approval.
- Auditor should check whether the Bank has process of tracking deferrals.

h. Accounting of transactions in the general ledger:

The audit procedures for this aspect include:

- Checking whether there is a direct hands-off between front end system and the accounting system for passing accounting entries in the general ledger.
- Checking whether correct accounting entries are recorded in the general ledger and the back office regularly reviews the accounting entries passed in the general ledger.
- Checking whether the treasury department generates a daily P&L (Desk-Wise) and the same has been reviewed and compared with the general ledger to identify any mismatches.
- Understand the accounting scheme for the various products. Further, inquire about the routine and non-routine accounting entries with the bank.
- Check whether any exceptional reports are being generated by the system.
- For the selected samples, verify the accounting entries passed.

i. Position Reconciliation:

The audit procedures include:

- Checking whether daily position reconciliations are performed between front office deal positions and back-office deal positions by the treasury back office and position differences if any are appropriately enquired into.
- Checking whether the Bank maintains customer wise, currency wise and deal wise positions on a daily basis in-order to monitor customer limit breaches and sectoral limit breaches.
- Checking whether the inter-Bank branch reconciliations between the Treasury Branch and the Authorised Bank Branches are carried out on a periodic basis and there are no old and long outstanding items uncleared.

j. Deal Settlements:

The audit procedures include:

- Checking whether there exists effective mechanism for settlement of deals on due date and whether deals due for settlement are generated on a daily basis by back office.
- Examining whether customer intimations are sent across as soon as the deal is settled and the respective customer accounts are debited / credited.
- Check whether separate responsibilities are in place between authorization and release of settlement.
- Examining whether the Settlement desk ensures proper settlement of funds through CCIL / RTGS /SWIFT networks. Any deal rejected by CCIL should be examined and settlement through any other means should be taken up only after thoroughly examining the deal / deal confirmation as in most of the cases the rejection is on account of improper deal entry.
- Examining whether deal is settled / cancelled in case no confirmation is received from customers till expiry dates.
- Check whether any settlements defaults were made.

k. Realised Profit / Loss on Derivative Transactions:

The audit procedures include:

- Recalculating the profit or loss for sample trades selected and tally with the general ledger.
- Test the general and IT application controls for automated computation of profit or loss.
- Vouch to cash settlement in the case of realized gains and losses.
- Verify if the bank is reckoning only the NOSTRO balances for adjustment of the profit / loss revealed in mirror account or did it also consider the outstanding forward transactions as at the date of valuation.
- The increase / decrease in profit is in line with increase / decrease in volume of transactions.
- Check marking-to-market of risk exposures and reconciliation of risk positions and profit/loss between the front and back offices.
- Verify preparation of management reports, including daily profit/loss results and gross and net risk positions.
- Verify exceptional reports showing details of deals resulting in exceptional profits and losses.
- In case of early termination/cancellation of contracts, check whether amount of profit/loss is properly arrived at and paid to /recovered from customer as per Bank's policy.

l. Valuation of FX contracts and Derivatives:

The audit procedures for valuation of FX contracts and Derivatives include:



- For 'spot' and 'tom' contracts checking whether correct FEDAI rates are used by the Bank for marking them to market. In case of automatic feed of FEDAI rates, verifying whether the rates are correctly uploaded into the system. At the end of the reporting period, sight the process and verify the process of downloading rates from external source and the process of uploading of rates in the system by the middle/back office for all FX contracts and derivatives.
- Process of computation of net present value of rates.
- Re-performing and checking on a sample basis the accuracy of the MTM gain / loss booked by the bank on the outstanding forex contract.

In case of valuations of swaps, options and other derivative products most of the banks have proprietary valuation models developed by them or standard valuation software installed. In case of proprietary valuation models, a model validation coupled with checking of input parameters would provide reasonable comfort on valuations. In case of standard valuation models, the Auditor can resort to checking of input parameters along with limited reperformance of derivative valuations. In such cases, the Auditor should also check system controls and if deemed necessary, consider involving an expert to check the integrity of the system logic. Further, the Auditor can select certain samples as per the methodology or depending upon the nature, timing and extent for getting it revalued from the valuation expert. The Auditor should also obtain the understanding of rate upload process and verify the timing of rates upload in the system for valuation of derivative contracts. The Auditor should carry out the valuation of the samples selected in a spreadsheet and compare the end results with the valuation as provided by the software system. Sometimes the software systems are not capable of valuing certain treasury products such as partly redeemable perpetual bonds, Security Receipts etc., for which the Bank has to value such products manually and the Auditor should gain sufficient knowledge to understand and confirm their valuation.

m. To Arrive Fair / Market Value:

As a general rule, for an instrument that is actively traded on a recognized public exchange, the price quoted by the exchange, where the instrument is traded, is used as an appropriate valuation price to arrive at the fair value of the instrument.

In case of instruments that are actively traded over the counter, the quoted bid price for long positions and quoted offer price for short positions is used as an appropriate indicative valuation price. These may be obtained through relevant market makers or brokers.

In case of infrequently traded instruments/non-traded OTC derivatives, various techniques are used to determine the best estimate of market price. This synthetic market price may be derived through the use of market data (such as interest/ exchange rates) in appropriate models/systems designed for this purpose.

In the case of the following instruments, fair value can be arrived at using the market data as mentioned there against:



FX Spot / Forwards	Prices as published by Foreign Exchange Dealers Association of India ('FEDAI'). These are further required to be adjusted for arriving at the net present value.
Exchange traded interest rate futures	Prices quoted on the relevant exchange.
Commodity Futures	Prices quoted on the relevant exchange.
OTC derivatives:	
Options	Black Scholes Merton Method.
Swaps / Forward Rate Agreements	Discounted cash flows using the applicable Interest Curves (ROI can be taken from FIMMDA / NSE / Reuters' site based on the nature and currency of the product).

Valuation of derivatives is based on exchange rate and the swap rate prevailing on the valuation date. Various banks use different in-house / vendor developed model for valuation of their derivative products. However, the general benchmarks used for valuation are OIS / MIBOR, MIFOR, MITOR, LIBOR and INBMK as per the end of the day quotes appearing on the Bloomberg or Reuters page.

In case of hedge swaps, the income / expense is accounted for on an accrual basis except the swap designated with an asset or liability that is marked to market or lower of cost or market value in the financial statements. In that case, the swap should be marked to market with the resulting gain or loss recorded as an adjustment to the market value of designated asset or liability.

Whereas, the trading swaps are marked to market as per the instructions contained in the RBI circular NO. Ref. No. MPD. BC. 187/07.01.279/1999-2000 dated July 7, 1999 on "Forward Rate Agreements/ Interest Rate Swaps". Circular no. FMRD.DIRD.19/14.03.046/2018-19 dated June 26, 2019 has been issued in supersession of the above circular and has consolidated the instructions issued earlier.

The marked to market gain / loss on forward financial derivatives contract is derived from the difference between the agreed-upon contract price of an underlying item and the current market price (or market price expected to prevail) of that item, times the notional amount, approximately discounted. The notional amounts, sometimes described as the nominal amount, is the amount underlying a financial derivatives contract that is necessary for calculating payments or receipts on the contract. This amount may or may not be exchanged.

In the specific case of a swap contract, the market value is derived from the difference between the expected gross receipts and gross payments, appropriately discounted; that is, its net present value.

The market value for a forward contract can therefore be calculated using available information -market and contract prices for the underlying item, time to maturity of the

contract, the notional value, and market interest rates. From the viewpoint of the counter parties, the value of a forward contract may become negative (liability) or positive (asset) and may change both in magnitude and direction over time, depending on the movement in the market price for the underlying item. Forward contract settled on a daily basis, such as those traded on organized exchanges - and known as futures - have a market value, but because of daily settlement it is likely to be zero value at each end-period.

The price of an option depends on the potential price volatility of the price of the underlying item, the time to maturity, interest rates, and the difference between the contract price and the market price of the underlying item.

For traded options, whether they are traded on an exchange or not, the valuation should be based on the observable price. At inception the market value of a non-traded option is the amount of the premium paid or received.

Subsequently, non-traded options can be valued with the use of mathematical models, such as the Black-Scholes formulae, that take account of the factors mentioned above that determine option prices. In the absence of a pricing model, the price reported for accounting or regulatory purposes might be used. Unlike forwards, options cannot switch from negative to positive value, or vice versa, but they remain an asset for the owner and a liability for the writer of the option.

It may be mentioned that counter party wise netting is only allowed where specific legally enforceable bilateral netting arrangement such as International Swaps and Derivative Association (ISDA) master agreement, etc., exists.

n. Examples for the Calculation of Market or Fair Values of Derivative Contracts:

The following examples indicate how to calculate the market or fair value of various derivative contracts.

For a forward, a contract to purchase USD against EUR at a forward rate of say, 1.00 when initiated has a positive market value if the EUR/ USD forward rate at net present value at the time of reporting for the same settlement date is lower than 1.00. It has a negative market value if the forward rate at net present value at the time of reporting is higher than 1.00, and it has a zero-market value if the forward rate at the time of reporting is equal to 1.00.

For swaps, which involve multiple (and sometimes two-way) payments, the market or fair value is the net present value of the payments to be exchanged between the counter parties between the reporting date and the contracts maturity, where the discount factor to be applied would normally reflect the market interest rate for the period of the contract's remaining maturity. Thus, a fixed / floating swap which at the interest rates prevailing at the reporting date involves net annual receipts by the reporter of say, 2% of the notional principal amount for the next three years has a positive marked to market (or replacement) value equal to the sum of three net payments (each 2% of the notional amount), discounted by the market interest rate prevailing at the reporting date. If the contract is not in the reporter's favour (i.e., the reporter would have to make net annual payments), the contract has a negative net present value.

Unlike forwards or swaps, OTC options have a market or fair value at initiation which is equal to the premium paid to the writer of the option.

Throughout their life, option contracts can only have a positive market or fair value for the buyer and a negative market or fair value for the seller. If a quoted market price is available for a contract, the market value to be reported for that contract is the product of the number of trading units of the contract multiplied by that market price. If a quoted market price is not available, the market or fair value of an outstanding option contract at the time of reporting can be determined on the basis of secondary market prices for options with the same strike prices and remaining maturities as the options being valued, or by using option pricing models.

In an option pricing model, current quotes of forward prices for the underlying (spot prices for American options) and the implied volatility and market interest rate relevant to the option's maturity would normally be used to calculate the market values. Options sold and purchased with the same counter party should not be netted against each other, nor should offsetting the bought and sold options on the same underlying be resorted. RBI vide its Circular DBOD. No.BP.BC.76/21.04.157/2013-14 dated December 09, 2013 has issued operational Guidelines on "Novation of OTC Derivative Contracts".

o. Rate Scan:

The audit procedures for this would include:

- Checking whether for the selected deals, the rates taken are the prevailing rates in the market at the time of striking the deal. In doing so the Auditor needs to assess the process of advising card rates to customers, through its Bank branches or relevant operating departments.
- Checking whether in outright deals the back office checks the rate scans for the veracity of the rate at which the dealer has struck the deal. Any deviation should be enquired into for compliance with AS-11.
- Check whether any exceptional reports are being generated in this respect.
- In case of deviations, reasons should be obtained and check whether the same have been reported to the senior management.

p. Margins held with Exchanges / Margins held under Credit Support Annex ('CSA'):

The forward contracts in banks are now a days increasingly being collateralized using Customer Support Annex (CSA) margins which form part of the ISDA agreement. The audit procedures for this would include:

- Sending independent third-party confirmations to confirm the balances held as at the reporting date.
- Agreeing the balances to underlying supporting such as margin statements.
- Check whether margin statements are being sent to the clients and check the correctness of the same.

**q. Assessment of Controls:**

The audit procedure may include verifying and assessing controls including:

- Existence of comprehensive treasury policy and operating procedures manual (SOP).
- Review of the policies and procedures document and assess comprehensiveness of the same.
- Determining whether the above document addresses, in granular detail, the framework within which the treasury business and operations have to be conducted.
- Inquiring on the procedures the bank has when there is a change over or new appointment to a 'review' role within the treasury function.
- Check whether proper system of rotation of dealer is in place.
- Understanding the level of detail in which the process of handover of responsibilities operates.
- Check whether mandatory leave policy is being compiled in the bank.
- Inquiring whether there has been any change in responsibilities in the current period and in case there are changes, verifying whether there is an appropriate training mechanism and whether signoffs have been regularized after the new superior has taken over the responsibilities.
- On a test check basis, verifying whether the review process and controls were working effectively during the transition period.
- Obtaining and reviewing on test check basis, the daily Profit and Loss prepared for MIS purpose and assessing the granularity and exhaustiveness of the same.
- Assessing whether such Profit and Loss is granular enough to provide desk wise, product wise and various price component wise Profit and Loss.
- Assessing whether gross position reviews are undertaken and also whether such Profit and Loss are prepared and reviewed at a gross trade level.
- Reviewing the Bank's policy on valuation. On a test check basis, verifying whether the material valuation adjustments are reviewed, authorized and are appropriate.
- Verifying whether these valuation adjustments are disclosed / visible in the reconciliation.
- Assessing whether there is an independent 'Valuation Control' team.
- Checking whether dealers have access to adjust or modify trade values.
- Checking whether the reconciliations are prepared on a timely basis and the un-reconciled items are independently inquired by the back office.
- Reviewing the ageing and quantum of the un-reconciled items and inquire for the high value and long outstanding reconciling items.



- Assessing whether the escalations are done in a timely manner for the large / unusual / recurring reconciliation items.

r. Market Risk System:

- Reviewing the key market risk reports generated and verifying that these reports are in sync with risk attributes of the products being traded and convey the risk positions appropriately.

Cancelled / Amended / Late (C/A/L) booking of futures trades into the Front Office risk system.

- Reviewing the policy of the bank as regards the cancelled / amended / late booked trades and whether there is a clear policy describing the Front office supervisor's responsibility in respect of reviewing and signing off on these instances.
- Reviewing whether these instances are reported to the senior management as per the policy and are ratified.
- Verifying whether the system is capable to capture the C/A/L and obtaining a complete inventory of these instances.
- Reviewing the frequency of such instances during the period and verifying on a test check basis whether there is a justification of such cancellations / amendments / delays.
- Checking the process relating to late trades-how does these get captured in risk reporting's (if there is a time cut off when such reports are generated).
- Check the approval and control process of the said transactions.
- Sample check of the same can be done by making dummy entries for verification purpose.
Fictitious trades with deferred settlement dates and/or at off-market prices and subsequent amendments.
- Reviewing the controls over cancellation of trades before reaching settlement dates and checking whether these are ratified by the authorized personnel with appropriate justifications.
- Reviewing the "Rate scan" process performed by mid-office and whether the exceptions noted in the rate scan are inquired and reasons are obtained for the same.
- Reviewing the Day-1 Profit or Loss assessment process and verify whether the Day-1 Profit or Loss is sufficiently assessed and explained.
- Verifying whether the change in pricing / pricing / another criterion is approved and confirmed with the counterparty.

s. Breaches of the Net Delta Limits:

- Verifying whether the breaches of the delta limits set by the Bank are monitored on a

frequent basis and whether the breaches (if any) are ratified by the authorized personnel and the reason is recorded for such breaches.

t. Failure to identify and escalate risk issues:

- Verifying whether a process is in place to educate employees about escalation mechanism to report any events that represent a risk to the institution and is embedded in the code of conduct. This may include directly reporting the incidences to the highest authorities on a no name basis, hotline numbers etc.

u. Quality of supervision:

- Assessing and determining the nature of comments and queries that are posed by the reviewer on any reconciliation breaks, long unexplained balances, exceptional trades, follow up on responses, etc.
- Determining and assessing whether the review function is not a mere sign off and it is conducted with appropriate supervisory intent.
 - Verification of training sessions conducted by the bank.

v. Temporary discontinuance of a process or control:

- Verifying that the controls identified and tested have been operational throughout the period and where there has been a temporary discontinuance (for any reason) verifies whether there were alternative controls.

w. Rewards and recognition policy not in sync with ideal 'Risk and Control' culture:

- Reviewing the remuneration policy and independently assessing how and to what degree it addresses matters relating to risk and compliance with control policies as part of the employee remuneration for treasury staff members.

x. Outsourced / Hubbed process:

- Reviewing the Service Level Agreements (SLAs) and agreements with such agencies and verify the robustness of the controls that reside in house in the bank to review and understand the work undertaken at outsourced / hub locations.
- Reviewing and verifying the documentary evidence of the communication the bank has with these agencies on a regular basis. The forward contracts in banks are now a days increasingly being collateralized and using Customer Support Annex (CSA) margins, which form part of the ISDA agreement. The Auditor should devise audit procedures required to be performed for verification of these margin balances as per the underlying agreements.

y. NOSTRO and VOSTRO Accounts:

A fundamental feature of foreign exchange transactions is that the useful possession of any currency can be had only in the country in which it is a legal tender or countries in which it is circulated (e.g., US Dollar is widely circulated in Russia, CIS countries) - There are nine



member states of the Commonwealth of Independent States. These CIS states are **Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, and Uzbekistan**. This organization promotes cooperation across the member states in economics, military, and political aspects. Therefore, in order to be able to put through foreign exchange transactions, banks normally maintain stocks of foreign currencies in the form of bank accounts (usually current accounts) with their overseas Bank branches / correspondents. Such a foreign currency account maintained by a bank at an overseas centre is usually designated by it as 'NOSTRO Account' (i.e., "Our Account with You"). Thus, banks in India may maintain a pound-sterling account with its London office/correspondent; such account would be called by it as NOSTRO Account. Conversely, if a foreign bank is to deal in a local currency of another country, it would maintain a 'VOSTRO Account' (i.e., 'Your Account with Us') with the local bank, e.g., a bank in England may maintain a 'VOSTRO Account' in Indian Rupee with a correspondent bank in India. A VOSTRO account is in substance no different from any other account in the local currency.

z. NOSTRO / VOSTRO Reconciliation:

In respect of old unreconciled entries in NOSTRO Accounts, the RBI vide its Circular DBOD No.BP.BC.67/21.04.048/99 dated July 1, 1999 has allowed, as onetime measure, a netting-off procedure.

The Auditor may consider the following aspects in respect of NOSTRO reconciliation:

- Whether a system of periodical reconciliation is in place and is up to date.
- Whether the reconciliation process followed ensures matching of each item and not for overall matching of total amount.
 - o Whether logs are generated for any change made in entry and whether maker checker is implemented for authorising changes made in entry, if any, for reconciliation.
 - o Whether confirmations from the foreign banks are obtained on a periodic basis. This may be through physical confirmations, swift messages, emails, etc.
- Whether information to the controlling office is sent on a timely basis.
 - o Whether long outstanding are taken up and cleared.
- Random check of the method of reconciliation.
 - o Debits outstanding in the NOSTRO accounts are to be verified and recommended for provision wherever necessary.
 - o Set off the credit against debits only at the permission of the head office for long outstanding entries.
 - o Whether payments are promptly advised and effected and receipts are suitably recorded in the "Nostro" account.
 - o Whether large balance has been held in an inoperative account, for a long period

and if so, the reasons thereof.

- Whether bank has been submitting the BAL Statements periodically to RBI.

RBI's circular no. DBOD.BP.BC.16/21.04.018/2001-02 dated August 24, 2001 on "Reconciliation of Nostro Accounts - Old Outstanding Credit Entries" has also clarified that the balances carried in "Sundry Debtors/ Unclaimed Deposits Accounts" under NOSTRO Accounts, represent unreconciled entries which may be large in a few cases and hence susceptible to frauds:

- i. The net credit balance arising out of the netting of entries pertaining to the period prior to April, 1996; and credit entries originated on or after April 1, 1996 and remaining.
- ii. Unreconciled in NOSTRO / mirror accounts for more than three years.

Further, the balances in the Blocked Accounts will be reckoned for the purposes of maintenance of CRR/ SLR.

Any adjustment from the Blocked Accounts should be permitted with the authorisation of two officials, one of whom should be from outside the Bank branch concerned, preferably from the Controlling Bank branch/ head office if the amount exceeds ₹.1 lakh. Further, vide Circular no. DBOD.BP.BC.No.133/ 21.04.018/2008-09 dated May 11, 2009, the RBI has advised accounting treatment for old outstanding entries in NOSTRO Mirror accounts. It further stated that Banks are advised to minimize the number of Nostro accounts to have a better control over reconciliation and put in place a system of fast reconciliation and close monitoring of pending items in Nostro accounts by top management at short intervals. Banks are also advised to leverage technology to avoid building up of such unreconciled balances.

The audit considerations for this aspect include:

- Examining whether currency wise NOSTRO reconciliation is performed on a day-to-day basis and check for long outstanding items.
 - Checking whether there exists a policy of following up for outstanding reconciliation items with the counterparties or with the respective banks.
 - Outstanding debit items over 90 days attract provisioning under RBI provisioning norms.
 - Examining whether the statement of account is sent to the Vostro account holder and periodic confirmation is obtained and discrepancies, if any, is properly dealt in the books of accounts.
 - To verify the bank submitted statement of Nostro / Vostro account balances on monthly basis to RBI.
 - Verify if reconciliation is done by separate department and not by treasury department which operates Nostro accounts.
 - Check for write off any un-reconciled item / number / amount and see if details are sent to RBI for approval.

- Whether MIS of unreconciled entries of NOSTRO account is being sent to senior management periodically and does the senior management review the same.

aa. Evaluation of Internal Audit / Concurrent Audit:

The audit considerations for this aspect include:

- Examining whether treasury transactions are separately subjected to concurrent audit by internal Auditors / external Auditors and monthly reports containing their findings are submitted to the management for corrective action.
- Obtaining the monthly concurrent audit reports of the treasury operations and check whether deficiencies if any, mentioned in the report are rectified or noted for corrective action by the management.
- In internal audit reports, examining whether major control weaknesses are highlighted and a management action plan to remedy the weaknesses are agreed with a timeframe.
- Check whether any persisting irregularities are being highlighted in the audit reports.

The Management should periodically monitor newly implemented systems and controls to ensure they are working appropriately. Failure of management to implement recommendations within an agreed timeframe should be reported to the Audit Committee.

ab. Risk Management:

The audit considerations for this aspect include:

- Checking whether the bank has adequate risk management process, sound risk measurement procedures, sound information systems, continuous risk monitoring and frequent management reporting for treasury operations.
- Examining whether the mid-office monitors the exchange and gap positions for cut loss limits, overnight limits, daylight limit, liquidity, counterparty exposure limit and aggregate gap limit fixed in the banks trading policy/ guidelines.
- Reviewing the adequacy and effectiveness of the overall risk management system, including compliance with policies, and procedures.
- Investigating unusual occurrences such as significant breaches of limits, unauthorized trades and unreconciled valuation or accounting differences.
- Inquiring whether there is a 'New Product Approval' process prior to undertaking transactions in new or structured derivative products and verifying whether the 'New Product Paper' for all new derivative products is approved and signed-off by the Chief Compliance Officer of the bank.
- Obtaining the 'Risk Management Policy' of the bank and verifying whether risk management pertaining to derivative transactions is an integral part of the policy.
- Verify whether the Policy is updated on a periodic basis in line with the dynamic market and regulatory changes.



- The Board should have overall responsibility for management of risks and should decide the risk management policy of the bank and set limits for liquidity, interest rate, foreign exchange and equity price risks and verifying that the policy inter alia covers the following aspects:
 - i. Defines the approved derivative products and the authorized derivative activities.
 - ii. Details the requirements for the evaluation and approval of new products or activities.
 - iii. Ensures appropriate structure and staffing for the key risk control functions, including internal audit.
 - iv. Establishes management responsibilities.
 - v. Identifies the various types of risks faced by the bank and establishes a clear and comprehensive set of limits to control these.
 - vi. Establishes risk measurement methodologies which are consistent with the nature and scale of the derivative activities.
 - vii. Requires stress testing of risk positions.
 - viii. Details the type and frequency of reports for monitoring risks which are submitted to the Board (or committees of the Board).
 - ix. Typical risks and commonly used risk limits in respect of derivative transactions.
 - x. It is essential that banks have interest rate risk measurement systems that capture all material sources of interest rate risk and that assess the effect of interest rate changes in ways that are consistent with the scope of their activities. The assumptions underlying the system should be clearly understood by risk managers and bank management.

ac. Information Technology ('IT') Controls:

The audit considerations for this aspect include:

- Check controls over creation of all masters Like counterparty, broker, limit, dealer, etc.
- Check the integration of various treasury application with Core Banking Application.
- Check interface controls between various applications used in treasury department (viz. SWIFT and CBS, Treasury systems and CBS, etc.).
- To verify the integration of CBS, including Trade Finance and / or aligned software / modules, with SWIFT system and status of automation thereon.
- The Auditor should specifically verify whether any special privileges or rights are given for operating SWIFT system allowing direct initiation of transactions through SWIFT without initiating the transactions through CBS. And whether such transactions are reflected correctly in CBS.
- Obtain IT related information from the bank for treasury operations and review, as appropriate, minutes of any committees responsible for overseeing and coordinating IT resources and activities to determine user involvement and organizational priorities.



- Check functional separation in the system.
- Verification of limit system and determination and reconciliation of positions and results.
- Check whether there were any changes in EDP systems.
- Review organizational charts, job descriptions, and training programs to ascertain that the bank has sufficient number of technology personnel and that these personnel have the expertise the bank requires.
- Review MIS reports for significant IT systems and activities to ascertain that risk identification, measurement, control, and monitoring are commensurate with the complexity of the bank's technology and operating environment.
- Evaluate the separation of duties and responsibilities in the operation and data processing of treasury functions.
- Evaluate the adequacy of input / output controls and reconciliation procedures for batch capture and image capture systems.
- Review controls and audit trails over master file change requests (such as address changes, due dates, commission / interest rates, and service charge indicator) and also consider individuals authorized to make changes and potential conflicting job responsibilities and documentation / audit trail of authorized changes and procedures used to verify the accuracy of master file changes.
- Assess adequacy of controls over changes to systems, programs, data files, and PC-based applications and consider procedures for implementing program updates, releases, and changes.
- Check if controls are in place to restrict and monitor use of data-altering utilities and adequate process management to select system and program security settings (i.e., whether the settings were made based on using sound technical advice or were simply default settings).
- Check whether controls are established to prevent unauthorized changes to system and programs security settings.
- Evaluate the effectiveness of password administration for employee and customer passwords considering the complexity of the processing environment and type of information accessed and consider confidentiality of passwords - (whether only known to the employee/customer), procedures to reset passwords to ensure confidentiality is maintained, frequency of required changes in passwords, password design (number and type of characters), security of passwords while stored in computer files, during transmission, and on printed activity logs and reports.
- Check whether any system audit has been conducted by the bank.
- Determine whether the bank has removed/reset default profiles and passwords from new systems and equipment and determine whether access to system administrator level is adequately controlled.



- Check whether the "data hands off" process from one product processor to another or to any other system is conducted under a secure environment and without or with least but controlled manual intervention.
- Check whether proper backup of records is being maintained.
- Whether any dealer/employee has accessed the dealing room on holidays. If yes, verify the reasons and approvals for the same.
- Check whether mandatory leave policy has been adhered to.
- Check BCP details of the bank in relation to Treasury activities.
- Check whether the voice recording systems are periodically tested by the operations team and process to tag trades and corresponding unique voice records. Concurrent Auditors are also required to verify this at periodic intervals.
- Check whether proper cyber security measures are put in place in the treasury systems. Check the breaches, if any, and the rectification of the same.
- Check compliance with Internal Control Guidelines issued by RBI vide FE.CO.FMD. No. 18380 /02.03.137/2010-11 February 3, 2011.

ad. Asset Liability Management (ALM):

The Management of banks has to base its business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. Banks are exposed to several major risks in the course of their business - credit risk, interest rate risk, foreign exchange risk, equity / commodity price risk, liquidity risk and operational risk. It is, therefore, important that banks introduce effective risk management systems that address the issues related to interest rate, currency and liquidity risks. Banks need to address these risks in a structured manner by upgrading their risk management and adopting more comprehensive Asset-Liability Management (ALM) practices than has been done hitherto. ALM, among other functions, is also concerned with risk management and provides a comprehensive and dynamic framework for measuring, monitoring and managing liquidity, interest rate, foreign exchange and equity and commodity price risks of a bank that needs to be closely integrated with the banks' business strategy. It involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.

Banks should give adequate attention to putting in place an effective ALM System. Banks should set up an internal Asset-Liability Committee (ALCO), headed by the CEO/CMD or the ED. The Management Committee or any specific Committee of the Board should oversee the implementation of the system and review its functioning periodically.

In order to capture the maturity structure of the cash inflows and outflows, the Statement of Structural Liquidity should be prepared. Also, in order to enable the banks to monitor their liquidity on a dynamic basis the statement of Short-term Dynamic Liquidity should be prepared.



The ALM process rests on three pillars:

- ALM Information Systems
 - Management Information Systems
 - Information availability, accuracy, adequacy and expediency
- ALM Organisation
 - Structure and responsibilities
 - Level of top management involvement
- ALM Process
 - Risk parameters
 - Risk identification
 - Risk measurement
 - Risk management
 - Risk policies and tolerance levels.

Banks are required to disclose the maturity pattern of Deposits, Advances, Investments, Borrowings, Foreign Currency assets, Foreign Currency liabilities as on balance sheet date. The maturity pattern needs to be disclosed in several time buckets.

Measuring and managing liquidity needs are vital for effective operation of commercial banks. By assuring a bank's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system. Banks management should measure not only the liquidity positions of banks on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions. Experience shows that assets commonly considered as liquid like Government securities and other money market instruments could also become illiquid when the market and players are unidirectional. Therefore, liquidity has to be tracked through maturity or cash flow mismatches. For measuring and managing net funding requirements, the use of a maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates is adopted as a standard tool.

ae. Auditor's Approach:

The approach of the Auditors should be as under:

- Auditors should obtain the Board approved policies for Asset Liabilities Management (ALM), Liquidity Risk Management and Liquidity Coverage Ratio (LCR)/ Net stable Fund Ratio (NSFR).
- Auditors should examine the process manuals across risk management units and ALM/ALCO functionaries.
- Auditors should carry out complete process walkthrough.

Auditors should obtain and examine all the key ALM, ALCO and Risk Management Committee meeting details and analyse the minutes of meetings.

Note: The following information provided to the readers based on “Systems and Procedures” followed by Different Banks on Deposits / Advances / Miscellaneous Bank Business Products.

These Guidelines / Systems and Procedures are not static and it may differ from Bank to Bank.

In our view, most of the Guidelines are common with some or little bit variation.

The Terminology / Nomenclature may also differ from Bank to Bank.

Below are the few Value Statements / Practices that are followed by the different Banks and in our opinion to Mitigate the Credit Risks and Operational Risks in the Bank Branches, these are useful. However, the Readers are advised to be follow the Individual Banks Credit Policy, KYC Policy, Investment Policy, Risk Management Practices and also Systems and Procedures Booklets developed etc. by the Banks for various Bank Products (Deposits, Advances & Miscellaneous Products etc.)

The Banking sector has a crucial role to play in the development of an economy. It is the key driver of economic growth of the country. In India, the banking sector is very strong at the present but at the same time, banking is considered to be a very risky business. Most often than not root cause of a financial turmoil is inefficient risk management practices adopted by the financial institutions. Banks must thus see risk management as an ongoing and valued activity as it is directly linked to financial system stability of the country.

RBI defines Credit Risk as “The possibility of losses associated with diminution in the credit quality of borrowers or counterparties. In a bank’s portfolio, losses stem from outright default due to the inability or unwillingness of a customer or counterparty to meet commitments concerning lending, trading, settlement, and other financial transactions. Alternatively, losses result from a reduction in portfolio value arising from actual or perceived deterioration in credit quality.”

In simple terms, banks experience credit risk when assets in a bank’s portfolio (borrowed loans) are threatened by loan defaults. Credit Risk is a sum of default risk and portfolio risks.

Default Risk happens due to the inability or unwillingness of a borrower to return the promised loan amount to the lender. Whereas, portfolio risks depend upon several internal and external factors. Internal Factors can be bank policy, absence of prudential limits on credit, lack of a loan review mechanism within the Bank, and more.

External Factors may include the state of the Economy, Forex Rates, Trade Restrictions, Economic Sanctions, and more.

The presence of credit risk deteriorates the expected returns and creates more than expected losses for banks.

Now, banks can experience five major types of credit risks:

- During the repayment period, i.e., when the borrower does not repay the amount.
- When selling-off a secured asset does not yield expected returns.
- In case when a series of repayments stop due to some unexpected reasons.
- Credit risk due to loss of funds while settling acquired securities.
- Risks while payment to offshore organizations when they are under sovereign jurisdiction.

Credit Risk Management Practices:

The Reserve Bank of India has issued a framework of the Rules / Regulations / Instructions for the Scheduled Commercial Banks relating to credit exposure limits for Single / Group borrowers and credit exposure limits in specific industries and credit exposure of banks in the Capital Market.



a. Credit Approving Authority:

Banks can create a multi-tier credit approving system where officers review the loan before sanctioning it. It can help reduce the chances of any new credit risk. To maximize this benefit, banks can create a grid of officers, and they can operate on multiple levels of the organization i.e., Regional Offices, Zonal Offices, Head/Corporate Offices, etc.



Additionally, the Grid / Committee could oversee the sanction of high-value loans by carefully assessing borrower creditworthiness. To ensure the best quality of credit decisions, banks must review them periodically.

Banks can also use new-age Lending CRMs like Lead Squared to conduct pre-screening checks and analyse credit profiles while onboarding prospective borrowers. Not only will this accelerate the screening process but will also maintain borrower credibility.

b. Prudential Limits:

Banks can set up prudential limits on various KPIs such as debt-equity and profitability ratio, debt service coverage ratio, and other important ratios. Further, they must ensure that the loan policy mentions the most permissible deviation that can be allowed from these KPIs. Based on the concentration risk, banks can also reduce their credit exposures to individuals who enjoy credit facilities excess of their Capital Threshold.

Even while lending to industries, banks can set limits for every sector. Based on the stress on each segment, banks can adjust the exposure and lend with reduced risk. Banks can do this by limiting new advances against assets that can experience high price volatility and, hence credit risk. While lending to distressed sectors, banks must adequately back their credit by collaterals and strategic considerations. Prudential limits must be reviewed periodically. It will factor in other market-related issues and improve credit risk management.

c. Risk Rating:

Most Indian Banks have set up an intensive risk rating system that clearly defines their acceptable rating thresholds and reviews the ratings periodically, thus helping to estimate the expected profit / loss for the period.

Rating borrower creditworthiness is standard practice across all financial institutions. However, banks can also create a separate risk scoring / rating method for internal purposes. It will give loan officers a clear understanding of the risks involved as time passes on.

Risk rating will help banks understand individual credit behaviour better and the overall risk within their portfolio. The rating can be designed on various quantitative and qualitative factors such as:

1. Financial Analysis.
2. Projections.
3. Financial Ratios; and
4. Other Operating Parameters.

Banks can improve their rating mechanism by weighing these ratios based on years. It will give a higher degree of importance to near-term developments and make ratings more accurate. In addition to this, separate scales for rating can be devised for different borrowers to personalize risk assessment and improve the system's flexibility. To ensure that these rating models remain relevant and consistent, they should be rechecked and revised. It will enable



banks to identify variations that could cause any future credit losses and address them quickly.

d. Risk Pricing:

Banks are found to price the loans based on the risks perceived to be associated with the borrower. High-risk category borrowers are being priced high as compared to the low-risk category borrowers. Capital is allocated to absorb the unexpected losses which are projected based on the historical data on default losses. Such banks are known to follow RAROC (Risk Adjusted Return on Capital) framework.

Pricing the loan products based on risk categories of borrowers is important to curb credit risks. Generally, borrowers having less than average credit history or weak financials are categorized as high-risk individuals and subjected to high interest rates.

To ensure higher accuracy, banks should price credit risks based on the expected probability of default. Internationally, large banks have implemented the Risk-Adjusted Return on Capital (RAROC) Framework, which adjusts the interest rates based on the expected loss on loans from the start itself. The Banks then allocate some capital to cover up the losses incurred on the prospective loan.

The RAROC framework helps banks in effective credit risk management and provides better loan pricing to borrowers.

e. Analytics for Risk Detection and Control:

Through Artificial Intelligence and Machine Learning, banks can now analyse customer credit history to foresee changes in their credit behaviour. Banks can detect any change in the risk profile of the customer and make effective credit decisions.

This real-time insight into customer behaviour will allow banks to take proactive measures. It will help them design effective credit frameworks and install policies to reduce credit risks. Data analytics can also be applied to simulate stressful environments for lending processes and to find out credit weaknesses.

f. Portfolio Management:

Indian banks have realised the importance of optimizing the benefits obtained by diversification and the necessity of reducing the potential adverse impact of concentration of exposures to a particular group or industry. Thus, limits on aggregate exposure to specific high risk rating categories, distribution of borrowers in various industries and business group are maintained. The banks periodically review the loan portfolio and introduce changes as and when required.

Appropriate risk Rating / Pricing can enable better portfolio management. Banks must identify patterns in the migration of borrowers based on the change in their credit quality. The data will provide banks the insights they need to identify the quality of their loan books and take corrective actions if necessary. Additionally, banks can also:



- Create Credit Ceilings based on borrower ratings to limit credit exposure.
- Understand the Rating-wise distribution of borrowers in various Industries.
- Limit Exposure to segments based on the pros, cons, and current financial state. In case the industry is going through a period of stress, banks can increase the quality standards required to borrow from them.
- Design and undertake stress tests to identify weaknesses in their credit administration, policies, and tools to improve their credit risk management process.

g. Loan Review Mechanism (LRM):

Banks have established multi-level loan review process and constitution wise delegation of authority. Superior delegated powers and preferential time schedule for loan review / renewal are bestowed over to the better-rated customers. Threshold for fresh exposures and periodicity for renewal are formulated. Banks employed "Credit Audit" that covered review of sanction process, compliance and risk rating. It also tapped the warning signals and recommended corrective action with the objective of improving credit quality.

An LRM is a great tool to understand the quality of loan books and bring qualitative improvements in credit-related decision-making. LRM can help banks identify large value loans that can potentially develop credit weakness and create a proactive approach to credit risk management. Additionally, LRMs are also very helpful in:

- Identifying adequacy of and adherence to loan policies, procedures.
- Checking compliance with government laws.
- Supporting existing credit risk management infrastructure.

How Credit Risk is Measured?

- a. **Credit Risk Measurement:** Credit risk arises when a bank borrower or counter- party fails to meet his obligations according to specified schedule in terms of predetermined agreement either due to genuine problems or wilful default. Banks are using two broad methodologies for computing their capital requirements for Credit Risk as per Basel guidelines.

First method is Standardized Approach and Second Method is Internal Rating Based approach.

- b. **Standardised Approach (SA):** The term standardized approach (or standardised approach) refers to a set of credit risk measurement techniques proposed under Basel Capital Adequacy rules for banking institutions. Under the SA, the Banks use a risk-weighting schedule for measuring the Credit Risk of its assets by assigning risk weights based on the rating assigned by the External Credit Rating Agencies.
- c. **Internal Rating Based Approach (IRB):** Under this approach, banks are allowed to use their own estimated internal risk parameters calculating counterparties and exposures for

the purpose of regulatory capital. Under IRB Approach, the accord has made available two broad approaches viz.

- Foundation approach and
- Advanced approach.

- d. **Under Foundation Approach or Foundation IRB:** F-IRB, as a general rule, banks provide their own estimates of PD (Probability of Default) and rely on supervisory estimates for other risk components. However, Foundation Approach is not available for Retail Exposures. For Retail Exposures Banks are required to use their own estimates of the IRB Parameters Probability of Default (PD), Loss Given Default (LGD), Credit Conversion Factors (CCF) subject to approval of the Banking Regulator. Then total required Capital is calculated as a fixed percentage of the estimated Risk Weighted Assets (RWA).
- e. **Under the Advanced Approach or Advanced IRB:** A-IRB, Banks provide for more of their own estimates of PD, LGD and EAD (Exposure at Default) and their own calculation of Maturity (M), Subject to meeting minimum standards approved by Local Regulator. Then total required capital is calculated as a fixed percentage of the estimated RWA. The IRB approach allows a finer differentiation of risk for various exposures and hence delivers capital requirements that are better aligned to the degree of risks.

How Operational Risk is Measured?

Basel Committee on banking supervision has adopted a common industry definition of operational risk. Operational risk is defined as the risk of direct or indirect loss resulting from breakdowns in internal procedures, people, system and external events. Examples of operational risk are frauds, system failure, error in financial transactions, failure to discharge demand of contractual obligations due to insufficient funds etc. The revised BASEL framework offers the following three approaches for estimating capital charges for operational risk:

- a. **The Basic Indicator Approach (BIA):** The Basic Indicator Approach is an approach to calculate operational risk capital under the Basel Accord. Based on the original Basel Accord, banks using the basic indicator approach must hold capital for operational risk equal to the average over the previous three years of a fixed percentage of positive annual gross income. In case of annual gross income is negative or zero for any year that should be excluded from both the numerator and denominator while calculating the average. This approach sets a charge for operational risk as a fixed percentage ("alpha factor") of a single indicator and uses the bank's total gross income as a risk indicator for the bank's operational risk exposure. The fixed percentage 'alpha' is typically 15 percent of annual gross income.
- b. **The Standardised Approach (SA):** The standardised approach is a set of operational risk measurement techniques proposed under Basel capital adequacy rules for banking institutions. Basel requires all banking institutions to set aside capital for operational risk into eight standard business lines. The capital charge for each business line is calculated



by multiplying gross income of that business line by a factor (denoted beta) assigned to that business line.

- Corporate Finance (18%).
- Trading & Sales (18%).
- Retail Banking (12%).
- Commercial Banking (15%).
- Payment & Settlement (18%).
- Agency Services (15%).
- Asset Management (12%) and
- Retail Brokerage (12%) are Eight Standard Business Lines.

The beta assigned to each business line shown in the bracket.

- c. Advanced Measurement Approach (AMA):** The Advanced Measurement Approach is a sophisticated approach used under Basel by banks and financial institution to use internally generated models to calculate operational risk capital requirement. The AMA leads to the suitable incentives to reduce exposure to operational risk. This approach allows the bank to use internally generated models to calculate their operational risk capital requirements. AMA models will no longer be used for Pillar 1 for a reason. As the Basel Committee puts it, "inherent complexity, and the lack of comparability arising from a wide range of internal modelling practices, have exacerbated variability in risk-weighted asset calculations, and eroded confidence in risk-weighted capital ratios". In India, at present the banks have been advised to adopt the BIA to estimate the capital charge for operational risk.

How Market Risk is Measured?

The 'Market Risk' is an umbrella term used for multiple types of risk associated with adverse changes in market variables that include Liquidity Risk, Interest rate risk, foreign exchange rate risk and equity price risk. Market risk causes substantial changes in income and economic value of banks. The Bank of International Settlements (BIS) defines market risk as "the risk that the value of 'on' or 'off' balance sheet positions will be adversely affected by movements in equity and interest rate markets, currency exchange rates and commodity prices". Basel Framework offers a choice between two broad methodologies in measuring market risks for the purpose of capital adequacy viz.,

- 1) The Standardised Measurement Method.
 - 2) The Internal Models Approach (IMA).
- a. Standardised Measurement Method:** In January 2016, the Basel Committee on Banking Supervision (BCBS) published revised standards for minimum capital requirements for market risk (Standards). The Standards replace the existing requirements for market risk.

The Standardised Approach (SA) comprises three main blocks viz. the sensitivities-based method (SBM), the default risk charge (DRC) and the residual risk add-on (RRAO). Each block covers specific types of risk that are relevant in the context of market risk. A risk charge is computed for each of the three blocks, the sum of which is the overall risk charge for market risk under the SA. No diversification benefits are allowed across the three blocks.

- b. **The Internal Models Approach (IMA):** IMA is the alternative methodology which allows banks to use risk measures derived from their own internal market risk management models. The permissible models under IMA are the ones which calculate a Value-At-Risk (VaR) based measure of exposure to market risk. VaR-based models could be used to calculate measures of both general market risk and specific risk. As compared to the Standard Measurement (SMM), IMA is considered to be more risk sensitive and aligns the capital charge for market risk more closely to the actual losses likely to be faced by banks due to movements in the market risk factors. This method is subject to the explicit approval of the supervisory authority.

Specimen of Risk Based Internal Audit'

&

Planning to Face RBIA by Operating Units of the Bank (Branches)

(These are Suggestive and it will vary from Bank to Bank)

Bank Branches are subjected to various kinds of Audit throughout the year. The Audit is meant for guiding the Operating Staff and also to ensure that the Systems and Procedures laid down by the Bank are adhered to by the Bank branches. The main focus of the present-day Audit is on the evaluation of the Risk.

Bank Branch Officials and other Operating functionaries should be equipped properly for preparing to face the Audit to ensure that they get a rating proportionate to their performance of the Bank branches.

There are many areas that are focused by the Auditors, however thought that Risk Based Audit is more Important and Critical.

1. Why RBIA?

In every organization, Internal Audit is done to ensure that the laid down systems and procedures are followed correctly and organization is moving in the right direction towards well settled Goals to achieve the corporate objectives of the Bank. It is like our body health check-up at regular intervals to ensure that the body systems are working satisfactorily. In Banks various Audits are conducted to ensure the systems and procedures are followed correctly. RBIA, Statutory Audit, Govt Audit, Currency Chest Verification, Spot Audit, Credit Audit, Pension Audit etc. Though all these Audits are conducted for various purposes, RBIA Audit is treated as Total Audit covering all aspects of Banking.



Earlier Days Audit was to cover both Business as well as Internal House-keeping, and used to identify the deviations prevailing in various systems and procedure. Risk Based Internal Audit is a type of Audit not only identifies various deviations, it quantifies percentage of deviations and apparent risk involved in it by classifying High Risk and Low Risk deviations. This classification of High Risk / Medium Risk / Low Risk gives Bank Branch functionaries / Controllers the directions towards which they should work to mitigate these deviations. Now all Bank branches of Banks are migrated to Core Banking system. The RBIA audit also covers CBS audit.

The Risk Based Internal Audit is conducted to ensure that---

- Books and records are maintained as per Bank's instructions.
- The record of Bank Branch Assets and Liabilities are accurately shown.
- The assets physically exist, are identifiable and their condition / realizability are satisfactory.
- Internal control systems are adequate and effective.
- The system of compliance with statutory / regulatory requirements is satisfactory.

Generally, the Scores Allotted to Various Parameters are:

Credit Risk Management	- 500
Operational Risk Management	- 450
External Compliance	- <u>50</u>
Total	- <u>1,000</u>

Credit Risk Management	
a. Pre-Sanction Process	Score
a) Quality of Appraisal	70
b) Quality of Assessment	40
c) Sanction	10
Sub Total	120
b. Post Sanction Process.	
a) Documentation, Compliance with Terms and Conditions	120
b) Follow up, Monitoring and Control	175
Sub Total	295
c. Problem Loan Management	
1. Problem Loan Review and Reporting	10
2. Handling of Problem Loan Accounts.	10
3. Follow up of Suits	15
4. Suit Filed A/Cs and other Written-off Accounts	05
5. Quality of Assets	05



6. Reduction of NPAs	30
7. Suit Filed Accounts Recovery	10
Sub Total	85
Total for Credit Risk Management	500
Operational Risk Management	
1. Business Risks	
a) Clients, Deposit Products, & Business Practices	30
b) Remittance and Collection Business	15
c) Cash / Currency Chest / Small Coin Depot	10
d) Safe custody / Securities / Lockers	10
e) Government Business	10
f) Forex Business	30
Sub Total	105
2. Back Office Operations	
a) Protective Arrangements	05
b) Bank Branch Important Documents	05
c) Records Maintenance	05
Sub Total	15
3. Control Systems	
a) Information Systems (IS Audit) / Cloud Computing Audit (if any)	80
b) Frauds and Preventive Vigilance	15
c) Office Accounts (System Suspense A/cs in CBS) - Follow Up	15
d) Control Functions	10
e) Correspondence, Bank Branch Manager Monthly Certificate Inter-Office Accounts Reconciliation and Submission of Periodical Returns	10
f) Control of Errors in Income Calculation	15
g) Letters of Credits and Bank Guarantees	05
Sub Total	150
4. Customer Service	
Customer Service	25
Sub Total	25
5. General Management	
a) General Administration	10
b) Staff Profile	05
c) Control Environment	05
d) Premises and Furniture	05
e) Dealing with Audit Reports	30



f) High Risk Areas	50
g) Self-Audit (By the Branch Official to arrive the probable rating of RBIA before Commencement of Audit by the RBIA Auditor)	30
Sub Total	135
6. Budget and Performance	
Budgetary Control and Performance Review	20
Sub Total	20
Total for Operational Risk Management	450
External Compliances	
Compliance Risks	
RBI / GOI Guidelines	50
Sub Total	50
Aggregate Score Risk Parameters	1000

2. **Risk Rating System:** The different ratings are as under: **(These are Suggestive and it will vary from Bank to Bank)**

a. **Risk Rating Model:** Three Core Risk Parameters (Credit Risk, Operational Risk and External Compliance Risk) are evaluated for an aggregate score of 1,000 Marks and the Risk Rating are awarded based on the Marks secured as under:

Well Controlled	850 & above
Adequately Controlled	700 to 849
Moderately Controlled	500 to 699
Unsatisfactory	499 & below

Rating is based on a Risk Matrix, which is determined by the frequency as well as the magnitude of the deviations.

The scales to measure the deviations both in terms of frequency of occurrence as well as magnitude (impact) are as under:

b. **Quantification of Risks:**

Description	Frequency of Deviations
Very Few	0 to 4 %
Few	5 % and above to 9%
Some	10% and above to 20%
Many	Above 20%

**c. Assessment of the Risks:**

Risk Level	Score to be awarded
Very Low	90 % to 100 %
Low	70 %
Medium	60 %
High	0 to 50 %

- Bank Branches having no deviation in implementation of Systems and Procedures will get full marks.
- The risk level will be determined by the potential risk posed by the Bank Branch and not by the number of deviations.

d. Periodicity of Audit:

The periodicity of Next Audit based on the Risk Rating of the Bank Branch as under: (Within—— Months from the Date of last RBIA).

Risk Rating	Months
Well-Controlled Bank Branch	18
Adequately Controlled Bank Branch	15
Needs Improvement Bank Branch	12
Unsatisfactory Bank Branch	6 to 8

The date is calculated from the date of last Audit and not the date of report of last Audit.

All Newly opened Bank Branches will be subjected to Audit within 12 months from the date of opening of the Bank Branch.

e. Specimen of RBIA Format:

Sl. No.	Audit Area	High	Medium	Low	Very Low
1	Bank Branch Cash Balance.				
2	Currency Chest/ Small Coin Depot Balance.				
3	Security Forms (Bank Guarantees / Demand Drafts).				
4	Bank Branch keys (Original / Duplicate), Safe Custody Receipt for Keys, Bank Branch Key Register.				
5	Compliance with KYC Norms.				
6	Staff Advances.				
7	Advances to Public of ₹5 Lacs and below. (It will differ from Bank to Bank).				
8	Single Window Operators Delivery System.				



9	Income Leakage on account of Service Charges, appropriate Rate of Interest Not Recovered.				
10	Controller's Supervision.				
11	Customer Service.				
12	Outsourcing of ATM Cash Replenishment.				
13	Outsourcing of Various Services / Process of the Bank.				
14	Recovery Resolution Agents (to recover SARFAESI, 2002 Loans)				
15	Functioning of Business Correspondents (BCs)/ Customer Service Point (CSP).				
16	CMP – Cash Pick up and Cheque Pick Up etc.				

f. Details of High-Risk Areas:

- All Vouchers Verification / Bank Branch System Suspense A/cs and Parking Accounts are checked regularly and records kept.
- Checking of Verification / Bank Branch System Suspense A/cs and Parking Accounts is done by persons other than whom it relates to.
- False Certifications of earlier RBIA remarks pertaining to 'High Risk and Medium Risk' findings of previous report.
- False Certification in Bank Branch Manager Monthly Certificate.
- All formalities for opening and conduct of High-Risk accounts are complied with and extant instructions in respect of KYC norms are followed without exception. For this purpose, following accounts are treated as High-Risk Accounts.
 - Accounts of firms in Private Sector, Private limited companies, and individuals with Debit or Credit summations above ₹1 crore per annum.
 - Customers domiciled in certain countries. i.e., Myanmar, Nigeria etc. This list is updated and revised periodically.
 - Trusts, Charities, NGOs and organizations receiving donations from India and abroad.
 - Politically exposed persons of foreign origin.
 - Non-face-to-face customers.
 - Those with dubious reputation.
 - Borrowal accounts which are NPAs.
- Maintenance of pass word secrecy.



- Pass word secrecy for operating / cash replenishment in ATMs as well as change of pass word whenever there is change in incumbency / custodians / persons handling is evidenced.
- Proper custody and accounting of pre-printed INB kit (Internet Banking) containing the ID / Pass Word, ATM Pin mailers and welcome kits are observed.
- Prompt reporting of loss of password of INB (Internet Banking) customers to the Security Manager, Inter Net Banking is evidenced.
- No adverse remarks relating to Bank Branch Cash Balance or Currency Chest & Small Coin Balances as well as Security Forms and Gold Loans are made in Other Audit reports/ other currency chest verification reports etc.

g. High Risk Areas:

Sl. No.	Deviations
1	Insurance not Covered for Assets Hypothecated to Bank.
2	Insurance Policies not updated in CBS.
3	Inspection of Units (MSME / Company / Traders) Not Happened.
4	Opinion Reports Not Properly Compiled both on Borrower and Guarantors.
5	Invoice / Bills not obtained for the Assets Financed by the Bank.
6	Classification of Assets as per RBI-IRAC not Happened.
7	Monitoring of Standard Assets.
8	Identification of NPA Accounts.
9	Persisting Irregular Accounts / Probable NPA Accounts.
10	Suit Filing / Suit File Register / Recovery / Quarterly Reports.
11	KYC Norms for all Accounts (Deposit / Loan / Non-financial Products)
12	Account Opening Forms not submitted to Central Processing Centres (CPC).
13	Appropriate Rate of Interest Not Applied.
14	Fraud Related Areas.
15	Not Checking of Vouchers of Various Transactions by other Officers.
16	System Suspense Accounts / Parking Account Monitoring.
17	Maintenance of Documents (Loans & Advances) / Password Secrecy (Computer Systems).
18	High and Medium Risk areas of Previous Risk Based Internal Audit (RBIA).
19	TDS Recovered on Deposits / Vendors etc.

h. Medium Risk Areas:

Sl. No.	Deviations
1	CIBIL Reports of Individuals / Commercial Borrowers.
2	Submission of Irregularity Reports to Controllers.
3	Stock Statement Not submitted Units.



4	Review / Renewal of Accounts of Working Capital Accounts.
5	Advances Under Collection Accounts Review (Suit Filed Accounts)
6	Subsidy Back-up Register (State / Central Government Loans)
7	Dormant / Inoperative Accounts.
8	Safe Custody / Lockers.
9	'Security Officer of the Bank' Visit to the Bank Branch.
10	Insurance of Cash and Valuables of the Bank Branch.
11	Movement of Cash from One Bank Branch to another Bank Branch.
12	Office Accounts Reconciliation.
13	Records & Stationery Maintenance.
14	Disaster Recovery Management System at the Bank Branch.
15	Government Business and its Commission Received.
16	General Administration of the Bank Branch.
17	Premises and Fixed Assets Updation and Maintenance.
18	Rectification of Residual / Balance Irregularities in RBIA.
19	Recording of RBI / Govt. Instructions.
20	Re-occurrence of Irregularities from Previous Audit.

i. **Vital Areas in Credit Risk Management (CRM):**

Sl. No.	Common Deficiencies in CRM
1	Submission of Control Forms / Returning of Scrutinized Control forms of Advances.
2	Documents not produced for verification. (To the Auditors)
3	Completion of Equitable Mortgage, Mortgage of Document formalities not done.
4	Registration under CERSAI not done.
5	Obtaining of Revival letters.
6	Timely Review / Renewal of Accounts of Working Capital Loans.
7	Asset Classification as per IRAC Norms.
8	CRA Rating of LOANS AND ADVANCES not done.
9	Purity of Gold is not tested before disbursement of Gold Loans.
10	Conducting of Pre / Post sanction Inspections while sanction New Loans / Advances.
11	Advances > ₹1 Crore–Income Leakage–CRA Rating done but Rate of Interest not corrected, processing charges not recovered.
12	Insurance Policy for Primary and Collateral Securities of Loans and Advances not Taken / Inadequate.
13	Follow up of Irregular / SMA Accounts. (Special Mention Accounts)
14	CGTMSE cover for the eligible accounts.
15	Large number and amount of Time barred documents.

**j. Vital Areas in Operational Risk Management (ORM):**

Sl. No.	Common Deficiencies in ORM
1	All Voucher Verification are not checked & records kept.
2	Proper Custody & Accounting of Pre-printed INB Kit (Internet Banking) with ID / Password.
3	Signature Scanning not done.
4	KYC deficient since KYC documents not obtained.
5	Un-reconciled Government Accounts.
6	Un-authorised Parking Accounts / Current Accounts & Non-reconciliation thereof.
7	High Value undelivered Bankers Cheque (Pay Orders) - Many TDS, Government Departments, Difference in un-reconciled Accounts / Books.
8	Un-reconciled ATMs physical balance with Branch General Ledger balance.
9	False Compliance in Bank Branch Manager's Monthly Certificate.
10	Subsidy Register not maintained / un-reconciled (For important General Ledger A/cs).
11	Interest paid on Ineligible SB Accounts.
12	Balancing of Subsidy Accounts.

k. Critical Areas (High and Medium Risk) in Operational Risk Management:

Sl. No.	Deviations
1	KYC Documents not produced in respect of Newly Opened Accounts.
2	Security Officer (From Head Office during the Visit of the Branch) Observations / Compliance not confirmed.
3	Currency chest / Small coin Depot.
4	Fraud Prone areas and other critical areas not monitored.
5	Anti-Money Laundering: New Accounts opened are not monitored for High Value transactions in the initial period of 6 months.
6	All Vouchers Verification are not checked and records not available.
7	Undelivered cards and PINs (ATM) are not recorded in separate registers.
8	Passbooks / Welcome kits not handed over to the Account holder against acknowledgement / not maintained properly. (For Newly Opened A/cs)
9	Safe custody / Security / Lockers.
10	Monitoring of High Value Transaction not carried out.
11	False compliance in High Risk / Medium Risk Areas.
12	ATM Cash Replenishment register is not maintained and ATM Cash not verified by the Manager.
13	Access into Cash / SWOs cubicles is not permitted to unauthorized persons/ outsiders.



14	Drop Box is not visible, conveniently located and opening is not properly ensured.
15	Vouchers are not moved to Record Room on T+2 basis duly entered in Record Register.
16	In all inoperative accounts with balances over ₹.25,000, all extant guidelines for such cases are meticulously followed.
17	Courier / Postage Registers not maintained properly.
18	Scrutiny of Staff Accounts / Intraday cash verification of cash.
19	Non maintaining of Stationery / record register / requisition register.

I. Bank Branch Important Documents (Important Areas to be Covered under Bank Branch Documents):

1. Bank Branch License – In Case Currency Chest Bank Branches.
2. Gun License Renewed / History Book – In Case Currency Chest Bank Branches.
3. Cash Retention Limit / Review (For Non-Currency Chest Bank Branches - to be obtained from Controllers).
4. Loan Document Migration to CPCs (In case of Loan Documents are Centralized).
5. Password in sealed Cover of IT Systems.
6. ATM's Terminal Master Key.
7. Current Insurance Policies of:
 - i. All Risk Policy.
 - ii. Burglary Policy.
 - iii. Fire and Special Perils.
 - iv. Fire and Special Terrorism.
 - v. Third party Liability.
8. Systems and Procedures Booklets.
9. Audit Reports and Compliances of Previous Audits.
10. Documents relating to settlement of Deceased parties' assets.
11. Documents relating to issue of Duplicate Drafts / Pay Orders or Bankers Cheque etc.
12. Safe Deposit Receipt of Bank Branch Duplicate Keys kept in other Bank Branches.
13. GST Registration Number & TAN.
14. AMCs (Computer, AC, UPS, Generator, Alarm System, Smoke detectors, CCTV, Fax Machine, Note Counting Machine, Time Lock, Note Bundling Machine, Note sorting Machine, Premises Maintenance etc.,)
15. INB Password (Internet Banking - Maker, Checker).



16. ATM Combination Password (Joint Custodian's Separately sealed cover).
17. Weighing Machine Certificate
18. Strong Room Fitness Certificate (Currency Chest Bank Branch Only)
19. IP Address Chart (Computer Systems)
20. LAN / WAN Diagram for IT Systems of the Branch.
21. Lease deed of Bank Branch Premises, ATM & Other Premises.
22. Courier Agreement, KYC and Specimen Signature of Authorized Courier Persons.
23. Agreement in respect of White Ants, Pests and Rats if available i.e., Pest Control.
24. Current Signature of RBI Audit Official.
25. Guard Discharge Certificate (For Currency Chest Bank Branches).
26. Best Practices Code of BCSBI.
27. Arrangement from Local Police for Night Patrolling & Assistance in case of Emergency.
28. Documents Relating to Frauds / Law suits.
29. Bank Branch Dossier (Business Potential in the Area of Operation).
30. Receipts for Advances Paid by the Bank Branch for Utilities.
31. Forged Notes Detection / RBI Circular.
32. Booklet on Fair Practices Code.
33. Booklet on Lenders Liability.
34. Booklet on Banks Compensation Policy.
35. Locking Up Arrangement (Important Branch Keys).
36. Business Continuity Plan / Disaster Recovery Plan.
37. Emergency Relief Arrangements of Key Officials of the Bank Branch.

m. Registers to be Maintained by Bank Branch Manager:

Sl. No.	Name of the Register	Register	File
1	Complaint Register	Y	
2	Securities Register (NSCs, KVPs etc.)	Y	
3	Bank Branch Dossier Register (Business Potential)	Y	Y
4	Preventive Vigilance Committee Meeting Register	Y	
5	Fraud Register	Y	Y
6	Staff Accounts Scrutiny Register	Y	Y



7	Monthly Returns submitted & Controller's confirmation	Y	
8	Bank Branch Manager Monthly Certificate	Y	Y
9	Mail Register / Mail Undelivered Register	Y	Y
10	Bank Branch Visit Book (Official from Head Office etc.)	Y	Y
11	Self-Audit File (For RBIA Audit)	Y	
12	System Room Access Register	Y	
13	Hardware Access Register	Y	
14	Bank Branch Security Information Register	Y	
16	RBI / GOI Instructions Recording Register & Circulars	Y	Y
17	Official Language Returns	Y	
18	Complaint Book	Y	
19	Customer Call Register	Y	
20	Customer Service Committee Meeting Register	Y	
21	Customer Relation Programme Register	Y	
22	Community Services Banking	Y	Y
23	Ombudsman / COPRA/ Suits filed against the Bank	Y	
24	KYE – Service Sheet of Employees / Officials.	Y	
25	Increment Register of Employees / Officials.	Y	Y
26	Bonus Register (if Applicable)	Y	
27	Medical Expenses Reimbursement Register (Staff)	Y	
29	Loss of Pay Particulars Reported to Controllers (Staff)		Y
31	Fixed Assets Balancing & Physical Verification of Assets.		Y

n. **Registers to be Maintained by Manager (Operations):**

Sl. No.	Name of the Register	Register	File
1	Savings Bank Pass Book Issued Register / Duplicate Passbook issued Register	Y	
2	Savings Bank Passbook Retained Overnight Register	Y	
3	Welcome Kit (Savings Bank) Issued Register	Y	
4	Cheque Book Issued by Central Process Centre but Returned Undelivered Register & also Cheque Book Issued Register	Y	
5	Cheque Referred & Returned Register	Y	Y
6	Stop Payment of Cheques Register	Y	Y
7	Nomination Register	Y	Y
8	Concessions Register for Misc. Concessions to Customers.	Y	
9	Handling of Dormant / Inoperative accounts	Y	
10	Account transferred to / from other Bank Branches	Y	



11	Account opening forms sent to Central Processing Centre	Y	
12	Account opening forms returned from Central Processing Centre	Y	
13	Cheques Returned Unpaid Register	Y	
14	Local Trade Bills Collection Register	Y	
15	RTGS/ NEFT Register	Y	
16	Unclaimed Inter Officer Instruments / Pay Orders / Demand Drafts Register	Y	
17	Inter Office Instruments / Drafts / Pay Orders Cancelled and Destroyed Register	Y	
18	Hologram Register (For High Value Demand Drafts / Bank Guarantees)	Y	
19	Outward Clearing Returns Register (CTS)	Y	Y
20	Drop Box / Grahak Mitra (Reception Staff) Register	Y	
21	Pension Life Certificates	Y	
22	Government Commission Received / Receivable Register	Y	
23	Penalty Paid for delayed Reporting	Y	
24	Locker Applications Received Register	Y	
25	Locker Access Register	Y	
26	Locker Key Register	Y	
27	Locker Rent Monitoring Register	Y	
28	Lockers Nomination Register	Y	Y
29	Locker Agreement	Y	
31	Securities Register	Y	
32	Securities Ledger	Y	
33	Securities Ex- custody Register	Y	
34	Interest Realised on Securities		
35	Safe Custody Ledger	Y	
36	Safe Custody Register	Y	
37	Safe Custody Articles Register	Y	
38	Safe Custody Articles Nomination Register	Y	
39	Safe Deposit Register	Y	
40	Safe Deposit Articles Nomination Register	Y	
41	Postage / Courier Register	Y	
42	Registered Letter Despatch Register	Y	
43	PODs / Courier Bills / Speed post Receipts	Y	
44	Security Forms Received at Bank Branch Register/ Security Forms Invoice file	Y	Y



45	Police Beat Register	Y	
46	Pest Control	Y	
47	AMC Register	Y	Y
48	Bank Branch Key Register	Y	
49	Bank Branch Document Register	Y	Y
50	Stamp Register	Y	
51	Record Register	Y	
52	Record Requisition Register	Y	
53	Old Record Destruction Register	Y	
54	Voucher Verification Allotment	Y	Y
55	Missing Voucher Register	Y	
56	New Account Monitoring for High Value transactions/ High Value Transactions Register	Y	
57	Utility Services Maintenance Register	Y	
58	Charges (P&L A/c) Back up Register	Y	
59	User Creation / Allotment Register	Y	Y
60	User Logged out / Forced Closure / Capability change	Y	
61	ATM Card Applications Received Register	Y	Y
62	ATM Cards Received from LCPC (returned undelivered)	Y	
63	ATM Cards Destroyed Register	Y	
64	ATM Card Hot listing / De-Hot listing Register	Y	Y
65	ATM Card reported Lost Register	Y	Y
66	Green Remit Card Application (Without Withdrawals for Payment in Savings Bank Accounts at the Branch)	Y	
67	Green Remit Card Register	Y	
68	INB Kit Issued Register (Internet Banking)	Y	
69	INB Applications File Retail / CINB	Y	
70	INB User Creation	Y	
71	Mobile Banking Register	Y	Y
72	TDS Register	Y	Y
73	Handing over and Taking over Register (Whenever Branch Officials are Transferred / Retired / Resigned)	Y	
74	Attendance Register (Staff)	Y	
75	Late Attendance Register (Staff)	Y	
76	Absentee Register (Staff)	Y	
77	Leave Register (Staff)	Y	Y
78	Officiating Allowance Register (For Higher Assignments)	Y	
79	Overtime Register (If applicable)	Y	Y



80	Office Order Issued Register (For every 6 months – Movement of Staff from one Assignment to another)	Y	Y
81	Fixed Assets Register	Y	Y
82	Fixed Assets Ledger	Y	
83	Lease Deed (For Branch Premises / House Accommodation provided to Officials)	Y	
84	Last RBIA Report	Y	
85	Last RBI Audit Report	Y	
86	Last Statutory Audit report	Y	

o. Registers to be Maintained by Cash Officer:

Sl. No.	Name of the Register	Register	File
1	Intra Day Cash Verification Register	Y	Y
2	Cash Found Excess / Short Register	Y	
3	Remittance Received / Sent Register	Y	Y
4	Petty Charges Account Register (Petty Cash Register)	Y	
5	Mutilated Notes Exchange Register	Y	
6	Forged Notes Detection / Impounding Register	Y	Y
7	Cash Receipt & Delivery Register	Y	
8	Bank Branch Cash Balance Book	Y	
9	Vault Register	Y	
10	Strong Room access Register	Y	
11	Chest Verification Register	Y	
12	Deposit / Withdrawal from Currency Chest	Y	
13	Excess Cash Retained Control forms	Y	
14	Cash Box Receipt Delivery Register	Y	
15	Inter Bank Branch Cash Handling Register	Y	
16	Stationery Register (For various Stationery used as the Branch)	Y	
17	Stationery Ledger	Y	
18	Local Purchase / Printing of Stationery Register	Y	
19	Stationery Indent File	Y	
20	ATM Cash Replenishment Register	Y	
21	Excess / Short Cash in ATM Register	Y	
22	ATM Cash / Physical Cash Balance Register	Y	
23	Bank Branch ATM Cash Balance Verification Register	Y	
24	ATM Cash Back Up Register	Y	
25	ATM Debits-Claim Register	Y	Y



26	ATM Maintenance Register	Y	
27	ATM Pin Mailer Issued Register	Y	
28	High Value Transactions Register	Y	
29	ATM Related Complaints settled	Y	Y

p. Registers to be Maintained by Credit Officer:

Sl. No.	Name of the Register	Register	File
1	Loan Application Received & Disposal Register	Y	
2	Inspection Register	Y	
3	Document Execution Register (For Cash Credit & Term Loan)	Y	
4	Title Deed Register (Various Documents obtained for Loans sanctioned by the Branch)	Y	
5	Equitable Mortgage Register	Y	
6	Suit Filed Register	Y	Y
7	Demand Collection Balance Register (For Agriculture Advances)	Y	
8	Post Dated Cheque Register (PDCs obtained for various loans)	Y	
9	Compromise / OTS Register	Y	
10	Cash Credit Register (For Working Capital Loans)	Y	
11	Hypothecation Register	Y	
12	Loan Sanction / Disbursement Register	Y	
13	Non-Performing Asset Register	Y	
14	Irregularity reports	Y	
15	Tour Diary for Field Officers (In case of Unit Visits sanctioned by the Bank)		
16	Failed Standing Instructions Monitoring	Y	

3. Preparatory Work Plan Before RBIA Audit:

- a) Date of Audit is advised in advance by the Branch Controllers. On receipt of the advice or Six Months prior to the probable date Bank Branch Officials to undertake "SELF AUDIT". Self-audit is nothing but to verify all the areas of Credit Risk Management, Operational Risk Management and External compliance and mark deviations in these areas. Choose the appropriate form the Bank devised (Differ from Bank to Bank – If this System is in place). After marking the risks system automatically gives the score to the particular parameter. After arriving the marks, submit a copy of the same to the Branch Controllers for Validation and also submit plan of action for rectification in the areas of deficiencies.



- b) Self-Audit to be conducted every half yearly basis, so that Credit Risk and Operational Risk can be minimized.
- c) As Self-Audit and vetting of the same by the controllers carries 30 marks in Scoring in RBIA (Allotted by Some Banks), Branch Managers normally top priority in conducting the same. Secondly, if Bank Branch Self-Audit is up to date, filling up the RBIA formats given by Auditors does not take much time.
- d) Conduct a meeting of staff members and appraise them about the Self-Audit and allot the rectification work to each and every staff on time bound schedule and monitor on daily basis. Continue to conduct staff meeting on weekly basis to discuss improvements / rectifications. Involvement of each and every staff member is very much important.
- e) In respect of Deposit Accounts, Bank Branches ensure compliance of the following instructions:
 - Ensure all account opening forms are duly filled in correctly with all relevant data and duly authorized by Branch Manager for account opening.
 - KYC norms are duly followed and relevant documents were obtained and verified.
 - Acknowledgement of the depositor is obtained in the pass book issued register and cheque book issued register.
 - Nomination is obtained for all accounts and nomination is witnessed and entered in the system. Acknowledgement is also given to the depositor.
- f) As regards Cash Department ensure Clean Note Policy is followed in letter and spirit and following registers are maintained: (Differ from Bank to Bank – Books / Registers).
 - Cash officers cash Jotting book.
 - Bank Branch cash Balance book.
 - Cash received and Delivery book.
 - Cash Remittance Register with all relevant data as to Registration Number of the Vehicle, Name of the Potdar, Name of the Accompanying guard, Name of the driver etc. (In case of remittance sent / receive from the RBI / Other Currency Chest Branch).
 - Maintain Intraday Cash Verification Book and record the date of verification and remarks.
 - Ensure General Ledger Cash Balance tallies with cash balance and joint custodians certifies the same.
 - Cash verification register / currency chest verification register.
 - Petty cash book with Payments made.



- g) Ensure the following arrangements are renewed immediately and only Current Documents are held on Bank Branch record (Some of the Systems & Procedures differ from Bank to Bank).
 - Emergency Arrangement in case of sudden incapacitation of the Bank Branch Head.
 - Locking Up Arrangement (Important Keys of the Branch) including for system room.
 - Renew the Disaster Recovery Plan of the Branch and obtain controllers approval.
 - Review the Cash Retention Limit of the Branch and submit recommendations to the controllers if Branch need revision.
 - Renew the arrangement with local police for assistance in case of emergencies.
 - Ensure that Bank Branch Lease Agreement is current and in order.
 - Ensure certificate from the Weights and Measurement authorities are held and in order (For weighing Gold Ornaments for Gold Loans).
 - Strong Room fitness certificate is current and in order (Currency Chest).
 - Ensure Insurance of cash and valuables / cash in transit / are current and available in the Bank Branch.
- h) As regards premises ensure the following: (Some of the Systems & Procedures differ from Bank to Bank).
 - The lease deed of the premises is current.
 - Premises is kept neat and clean.
 - All mandatory boards / Telephone numbers of Banks Executives are displayed neatly.
 - Enough seating arrangement is made for customers.
 - All publicity posters of Bank products are displayed prominently.
 - Necessary vouchers are kept in the Banking Hall for use of customers.
 - Complaint Box is kept prominently.
- i) Ensure that all important registers are maintained properly and all Registers are duly authenticated properly.
- j) As regards security ensure the following: (Some of the Systems & Procedures differ from Bank to Bank).
 - All the Staff Wears ID Cards.
 - All SINGLE WINDOW OPERATORS at counters have been provided with self-locking facility.



- Alarm Bell in the Branch Premises is in working condition and it tested regularly and record is maintained for the same.
 - Cash is brought and kept in locked box from the strong room.
 - Key Registers is maintained properly.
 - All security measures observed while remitting cash to the link Bank Branch in case of Cash Remittance.
 - Arrangement with police is current and on record.
 - Loan documents and Bank Branch documents are kept in **Fire and Burglary-Resistant** -FBR (safes) Safe (Loan Documents and important Documents).
 - Security officers report (From Head Office) is attended and copy if kept on record.
 - Aid Memorie (All important Process / Activities) is kept on record.
- k) As regards all Types of Security Forms ensure the following:
- Ensure security forms (Demand Drafts, Pay Orders, Bank Guarantee Forms etc.) register maintained properly.
 - All packets containing security forms are opened and recorded in the register.
 - All security forms are duly counted and branded with Bank Branch stamp.
 - All security forms are verified by an officer other than Joint custodian at half yearly intervals and recorded.
 - Obsolete security forms are duly destroyed after obtaining permission from the Controllers.
 - All invoices (Security Forms) are filed neatly for verification by Auditors.
 - Number portion of the destroyed form is pasted in a register and authenticated.
- l) Ensure all previous Audit reports i.e., RBIA, Circle Audit, Statutory Audit, Govt Audit, RBI Currency chest verification report, are duly dealt with and closure letters are kept on record.
- m) Attend to all pending Inter Branches Reconciliation Memos. / Correction Memos. (Branch to Branch Transaction) etc.
- n) Monitor office accounts (System Suspense Accounts / Parking Accounts) on daily basis and reverse the entries as much as possible.
- o) Ensure that all relevant documents are held as Bank Branch Documents and neatly recorded in the Branch Important Documents Registers.
- p) Ensure record is maintained for Pest Control for all important places in the Branch, Testing of alarm system, time lock, smoke detector etc.



- q) Ensure that handing over / taking over certificates from joint custodians are duly obtained on every occasion of joint custodians (Cash Officer and Operations Manager) are going on leave and sent to the controllers / a copy is also filed in the Bank Branch file.
- r) Branch Manager Monthly Certificate (BMMC) register is duly maintained and BMMC is submitted to the controllers monthly. Any wrong certification in the BMMC will adversely affect Bank branch rating.
- s) Branch Stationery and Record registers maintained properly and records are kept neatly.
- t) Files relating to Customer Service Programme / Customer Relations Programme and Preventive Vigilance is maintained properly and minutes are submitted to the controllers.
- u) Ensure File / Register to record GOI / RBI instructions and TDS collection register is maintained properly.
- v) Ensure interest on delayed collection of Cheques / Bills etc. is paid and record maintained.
- w) Ensure Fixed Asset Register, Fixed Asset ledger, Depreciation Ledger is maintained properly and balance tallied with the Branch Fixed Assets. All Fixed Asset items are serially numbered.
- x) Safe Deposit Lockers: Please make sure that the below mentioned data are kept ready for verification by Auditor:

Sl. No	Particulars
I	Total No of Lockers (Size wise/ Unit wise & Total).
II	Total No of Vacant /surrendered Lockers (Size wise / Unit wise & Total).
III	Total No of Lockers rent is overdue (Break up with amount).
IV	Total No of Lockers Break open done and amount recovered if any.
V	Locker rent waived if any (details and amount).

- y) Notice Board to be Displayed in the Locker Room:

“Have You Effectively Locked Your Valuables in Prominently”

Nomination Facility for Lockers is well Published:

- Interchange of Locks and Keys should be done wherever lockers are re-allotted afresh.
- Locker Module should be maintained in CBS and updated regularly for the visits.



Day End Certificate by an official to be incorporated in the Locker Access Register.

“Verified the Lockers Operated during the Day Found them to be in Order”

- Account No, Locker No, Key No, Time of Access and Signature of the Locker access should be invariably obtained in the Locker Access Register.
- Key Register-Signature of All Hirers to be obtained in the Locker Key Register / Locker Card at the time of allotment.
- A 'Red Tape' is tied to the Locker, whose rental is arrears.
- No of Visits Allowed: 12 per Year, thereafter per visit to be recovered charges as per Bank Guidelines.
- Loss of Key-Actual Expenses incurred for Break open.

“In case the Lockers remains un-operated for more than Three Years, the Bank Branch would have right to cancel the allotment of the Locker and Open the Locker, even if the Rent is paid Regularly”.

z) In respect of Advances areas, please ensure that---

- All advances are sanctioned properly within their delegated financial powers.
- Control returns (Sanctioned Loans) have been submitted in respect of all loan accounts and scrutinized copy is held on record.
- Unit Inspection Registers (Working Capital and Term Loans) are maintained properly and are updated.
- All loan documents are held properly and are current. If any documents are time barred, arrange to obtain revival immediately.
- NPAs Suit filed register, Insurance register, Subsidy register, written off register, etc. are maintained properly and duly authenticated by the authorized official.

aa) An indicative list of important Registers / files which may be kept in readiness by the Bank Branch Officials so that they are scrutinized by the Auditors along with the relevant vouchers.

- Bank Branch Manager Monthly Certificate – Register / File.
- Branch Business Budget File.
- Bank Branch Dossier (Business Potential / Sources) File.
- Bank Branch Important Documents Register.
- Complaints Register / File.
- Frauds Register / File.



- Customer Service File.
- Customer Relation Programme File.
- Cheques Referred and Returned Register.
- Insurance Register.
- Term Loan Documents Executed Register.
- Cash Credit (Working Capital) Register.
- Stock Statement Register.
- Suits filed Register.
- Nomination Register.
- Branch Security Forms (Demand Drafts / Pay Orders etc.) Register.
- ATM related Register / File.
- Internet Banking Register / File.
- Cash Balance Register.
- Cash Vault Register.
- Loan Application Received and disposed Register.
- NPA Monitoring Register.
- Write-off of NPAs Register / Files.
- Recalled Assets (Suits Filed) Register.
- Unit Inspection (Loan Accounts) Register.
- Equitable Mortgage Register.
- Savings Bank Pass Book Issued and Retained Register.
- Cheque Book Issued and Retained Register.
- High Value Cash Monitoring Register.
- Key Register (Important Branch Keys).
- Previous RBIA File, Circle Audit File, Statutory Audit File (LFAR), Govt Audit File, Currency Chest verification File, etc.

ab) Destruction of Old Records:

Branch Officials may not aware of retention period of records, thereby this irregularity occurs in Bank Branch RBIA report, thereby Bank branches lose marks. Bank Branch Managers are going through it and arrange to destroy old records as on 1st January every year. However, we append retention period of some important registers / ledgers etc.

**Retention Period of Records (Illustrative and may vary from Bank to Bank)**

Sl. No.	Particulars	Period in Years
1	Branch Staff Attendance Register	5
2	Assets Hypothecation Register (Working Capital Loans)	8
3	Bank Branch Manager's Monthly Certificate Register	5
4	Bonus Register (For eligible Staff Members)	10
5	Bank Branch Important Document Register (Licences, Indemnities, Lease Agreements etc.	20
6	Cash Balance Book	8
7	Cash Credit Insurance Register (For Insure the Stocks)	5
8	Cash Credit Register (For Working Capital)	20
9	Cash Receipt and Payment Register	8
10	Charges Register (Expenditure – P&L)	5
11	Cheque Book Issued Register	5
12	Cheque Referred and Returned Register	8
13	Complaint Register	3
14	Currency Chest Books	8
15	Courier-cum-Cheques Realized Register	5
16	Voucher Verification / Allotment Register	8
17	Demand Collection Balance Register (For Agriculture Advances)	3
18	Demand Loan Register (Gold Loans, Against Bank FDs etc.)	10
19	Document Execution Register (Working Capital Loans)	20
20	Gold Loan Ledger (For Entering Gold Loans Details)	10
21	Cash Officers Jotting Book	8
22	Inspection Register	8
23	Insurance Register	8
24	Inward Mail Register	5
25	ATM Cash related Registers	8
26	Leave Application File (Staff Members)	3
27	Leave Register (Staff Members_	45
28	Local Mail Register (Courier / Postage)	5
29	Lost Document Register (Advances etc.)	10
30	Medical Aid Register (For payment of Staff Medical Bills)	5
31	Misc. Security Register	20
32	Overtime Register	5
33	Passbook Retained Overnight (Where customers are not taken back from the Counters)	5



34	Petty Cash Book	5
35	Postage / Courier Book (For Correspondence Purpose)	8
36	Power of Attorney Register	60
37	Record Register (For Stationery Purpose)	60
38	Registered Letters Despatched Register	8
39	RBI Remittances Drawn Register	8
40	RBI Remittances Encashed Register	8
41	Safe Custody Register/ Ledger	20
42	Safe Deposit Locker Register	45
43	Safe Deposit Locker Key Register	45
44	Locker Access Register	10
45	Passbook Issued Register (Savings Bank Accounts)	5
46	Security Register/ Ledger (Loans against FD/NSCs/KVP etc.)	20
47	Security Forms Issued Register	5
48	Security and Shares Ex-custody Register	5
49	Security and Shares Purchase and Sale Register	8
50	Cheques for Collection Despatched Register	8
51	Small Coin Depot Book	8
52	Stationery Ledger	10
53	Stationery Register	5
54	Stationery Requisition Book	5
55	Stock Register / Stock Insurance Register (Working Capital)	8
56	Stopped Cheque Register	5
57	Suspense Account Register (For Advance given to Staff etc.)	8
58	Title Deed Register (For Equitable Mortgage Documents)	30
59	Vault Register (Cash Safe Transactions)	5
60	Equitable Mortgage (CM) Register	8
61	Nomination Forms	8
62	Cheque Book Acknowledgements	1
63	Cheque Requisition Slips	1
64	Documents Relating to Closed Loan Accounts	10
65	Documents Relating to Closed Locker Accounts	5
66	Letter of Indemnity / Succession Certificate	60
67	Surrendered Safe Custody / Deposit Receipts	10
68	Stationery Indent / Invoices	5
69	Term Loan Documents Execution Register	20
70	Demand Loan Document Execution Register	10
71	User Identity Allocation Register	Permanent



72	Computer Hardware Access Register	5
73	System Room Access Register	5
74	Drafts Cancelled and Destroyed Register	8
75	Lease Deed (Branch / Staff Accommodation / ATM Room etc.)	Permanent
76	Routine Correspondence relating to Premises	20
77	Correspondence relating to Fixed Assets	5
78	Correspondence on Stationery	5
79	Cash Verification Report	5
80	Duplicate Keys Deposit / Withdrawal	5
81	INB Application Forms (Internet Banking)	8
82	ATM Card Application Received Register	2
83	Duplicate ATM Card Issued	3

Audit Reports

Sl. No.	Particulars	Period
1	Audit Reports	Previous three fully dealt with audit reports to be retained. All earlier reports may be destroyed.

4. What is to be Done on Commencement of Audit by the Branch Head / Manager (These are suggestive and it varies from Bank-to-Bank Systems and Procedures):

- Bank Branch Officials will advise the controllers about the commencement of the Audit and request the controllers to furnish position about Inter office Reconciliation pending entries and complaints / frauds to be furnished to the Audit official.
- Auditor will advise CBS Department, Head Office about commencement of the Audit and request for sending all relevant reports to the Bank Branch email.
- Branch Official will arrange for infrastructure support to the Auditor such as seating arrangement with PC / Printer, enquiry rights to the system and stationery items.
- As a Bank Branch Official should have full information about Bank Branch. Prepare a Bank Branch Profile containing Business figures, advances to various products, business potential of the area, NPA, Recovery efforts etc., and present the same to Bank Branch Auditor.
- Introduce Bank Branch staff to Auditor and arrange staff meeting to be addressed by Auditor.
- Branch Officials to arrange to withdraw duplicate keys (Branch Safe / Main Entrance / Cupboards etc.) deposited in a Nearby Bank Branch for the verification of Auditor. (Please ensure that the Branch Operations Head Keys / Cash Officers Keys are sealed separately with their personal Sealers-As these TWO Officials are Joint Custodians for the Cash Safe of the Branch).



- g) All Credit Officers to arrange their documents serially to enable the Auditor to verify these documents. Please ensure that all documents are produced to Auditor for his verification.
- h) Take Audit Notes from the Auditor daily and arrange to rectify these irregularities on day-to-day basis.
- i) Discuss with the Auditor on day-to-day basis and arrange to furnish all particulars required by him.
- j) Do not hide anything with Auditor by the Branch Staff.
- k) Branch Official will obtain list from Auditor and arrange for physical verifications of the Assets.
- l) During Audit all members of staff should work as a TEAM and do all work requested by Auditor. This team work will form the base for Audit in awarding score to the Bank Branch.
- m) Before Auditor makes up his mind about awarding of marks to the Bank Branch, discuss with him and present Bank Branch case. Explain Bank branch strength and weaknesses and Bank Branch effort in doing the best in the interest of the Bank Branch and Business growth.
- n) Other Points to be borne in the Mind as Bank Branch Head / Official.
 - Auditor is Bank Branch guest, take care of his possible comfort.
 - Put up Manager best during the Audit by the Auditor. Do not allow Manager or Bank Branch Staff to be harassed by the Auditor.

o) Bank Branch Profile to be Kept Ready for Audit (These are suggestive and it varies from Bank-to-Bank Systems and Procedures):

Sl. No.	Questionnaire Description	Response
1	Bank Branch has a Currency Chest	Yes / No
2	Whether Bank Branch is CTS enabled Bank Branch	Yes / No
3	Whether Bank Branch has CMP	Yes / No
4	Whether Bank Branch has Lockers	Yes / No
5	Whether Bank Branch Conducts State Government Transactions	Yes / No
6	Whether Bank Branch conducts Central Government Transactions	Yes / No
7	Whether Bank Branch conducts Public Provident Fund (PPF)	Yes / No
8	Whether Bank Branch conducts Senior Citizen Scheme	Yes / No
9	Whether Bank Branch conducts Sukanya Samriddhi Scheme	Yes / No
10	Whether, Bank Branch has onsite ATM and replenishment of cash being done by the Bank Branch	Yes / No



11	Whether, Bank Branch has Trade Bills Business	Yes / No
12	Whether, Bank Branch has Prepaid Card business	Yes / No
13	Whether Concurrent Auditor present in Bank Branch	Yes / No
14	Whether, Bank Branch has Pension Accounts	Yes / No
15	Whether, Bank Branch has Cheques Purchase Business	Yes / No
16	Whether, overdraft facilities are extended to clearing member Banks	Yes / No
17	Whether, the Bank Branch is authorised to carry out Forex Business under A or B Category	Yes / No
18	Whether, the Bank Branch is authorised to carry out Forex Business under C1 or C2 Category	Yes / No
19	Whether, Bank Branch has bill financing business	Yes / No
20	Whether, Bank Branch has financed Agricultural Loans under Contract Farming	Yes / No
21	Whether, Bank Branch has restructured the accounts	Yes / No
22	Whether Bank Branch has Letter of Credit Business	Yes / No
23	Whether Bank Branch has Bank Guarantee Business	Yes / No
24	Whether, Bank Branch has Warehouse Receipt Financing Business	Yes / No
25	whether, Bank Branch has Export Packing Credit Business	Yes / No
26	Whether, Bank Branch has Allocated Limits (Sub-Limits Corporate Advances)	Yes / No
Bank Branch Weekly Holiday		

p) CRM Areas-Check List for Officials during Bank Branch Visit - Registers to be Verified (These are suggestive and it varies from Bank-to-Bank Systems and Procedures):

List of Registers
Loan application Received & Disposed-off Register
Loan Units Inspection Register
Loan Documents Execution Register
Collateral Securities Title Deed Register
Equitable Mortgage Register
Suit filed with DRT / DRAT Register
Demand Collection and Balance (DCB) Register - Agriculture Advances
Post Dated Cheque Register – PDCs taken from Borrowers for Various Loans.

Compromise / OTS Loans Register
Cash Credit Register (For Working Capital Loans)
Hypothecation Register (Primary Security – Working Capital Loans)
Loan Sanction / Disbursement Register
Non-Performing Asset Register
Failed Standing Instructions (SI) / Equated Monthly Instalments (EMI) Monitoring
Write-off Register
NPAs Monitoring Register
Advanced Under Collection Account (Suits Filed Accounts) Register

q) High Risk (HR) / Medium Risk (MR) Areas for Verification:

HR/ MR AREAS
Inspection Details fed in CBS.
Insurance Details fed in CBS.
Opinion Reports fed in CBS.
End use of funds verification.
Monitoring of standard accounts.
Identification of NPA Accounts.
Suit filing / Recovery / Quarterly reports.
Appropriate Rate of Interest.
CIBIL.
Submission of irregularity reports.
Stock Statement.
Review / Renewal of accounts.
Advances Under Collection Account Review.
Subsidy Back up.
CERSAI Registration.
Equitable Mortgage /Memorandum of Deposit of Title Deeds / Latest Encumbrance Certificate after Memorandum of Deposit of Title Deeds.
Valuation Reports.
Title Deed Verification.
PDCs / SIs / Check off.
Noting of Bank Charge with ROC
Approval for transfer of accounts to DRT / DRAT
Sanction / Control forms
Revival letter
Follow up of Accounts/ Court cases.

**r) Others:**

Other Areas to Check
Loan Documents are kept in FBR safe - Fire and Burglary-Resistant
Balancing of loan balance file with physical documents
Data sheet Preparation (For Advances).
Obtention of quarterly reports from advocate for suit filed cases.

s) ORM Areas- Checklist for Officials during Bank Branch Visit:

Business Lines:
New Accounts Transactions Monitoring (Newly Opened Accounts Within 6 Months – Transaction of ₹10 Lakhs and above).
High Value Transactions Monitoring and Reporting.
Pass Book / Welcome Kit / ATM PIN Handed over against Proper Acknowledgement to SB A/c Holders.
Dormant / Inoperative Accounts Activation Register.
Customer Signatures Scanning Position.

Back Office Operations:
Time Lock in use (For Currency Chest Branches)
Alarm System is in working condition
Smoke detectors installed
Pest Control last done on date
Adequate Fire Extinguishers at Bank Branch
RBI License available in Branch Documents
Lease Deed of Bank Branch Premises / ATM premises renewed on time
Obsolete documents removed from Branch Documents.
Record Room properly maintained and vouchers are kept in proper place.
BCP/ DRP are current and approved
ATM PINs and cards are destroyed at periodical intervals
Physical cash / General Ledger Balance Certification
Branch Manager Monthly Certificate and charges control returns
Leave is properly debited in Leave Register
Drop Box installed at Bank Branch

Cash / Currency Chest:

Cash / Currency Chest
RBI Clean Note policy implemented
Cash retention limit properly maintained

**Safe Custody / Security / Lockers:**

Locker Module updated in CBS
Keys of vacant lockers are in joint custody
Break open of Lockers done if rent is overdue and Income Leakage recommended for waiver to controllers
All agreements duly filled in and adequately stamped

Government Business:

Reconciliation of Government Accounts
Life Certificate of Pensioners obtained in due time
Timely reporting / submission of reports pertaining to Government business to avoid penalty
Compliance on RBI Audit report on Government Business to be submitted by the Bank Branch

General Bank Branch Management:

General Bank Branch Management
KYE of Newly Recruited Employees
Preventive Vigilance Committee meeting and Back up Register
Conduct of Customer Relations Programme / Customer Service Committee Meetings and Back up Register
Dealing with Audit Reports
Compliance of Residual irregularities pointed out in various Audit reports
TDS Return filing
Self-Audit – Three Self-Audits to be done by the Bank Branch before the next RBIA

t) Information Systems Audit:

The RBIA Audit covers Various Systems / procedures followed in CBS Bank Branches and following is the checklist. **IS Audit Carries 80 Marks.**

Audit Check List for CBS – IS Audit

(This Checklist is only Indicative-It differs from Bank to Bank)

Checklist	Yes No
Software Development & Acquisition:	
All Software loaded in the Computer Systems at the Bank Branch are authorised.	
A record of all the licenses of the software used at the Bank Branch is available for scrutiny.	



Software Deployment:	
Migration Audit Report is kept as Bank Branch Document.	
IT Procurement & Service Level Agreement (SLA) Management:	
Procurements of Hardware (including Laptops / PCs / peripherals) and Software are duly approved by the Competent Authority.	
All new Hardware items purchased are entered in the Fixed Assets Register.	
Numbering and labelling of PCs and other peripherals / components are being done.	
Inventory of Hardware is maintained at the Bank Branch.	
Licenses of all Operating Systems / Application Systems /utilities being used at the Bank Branch are securely maintained.	
Original CDs / Media containing original Software are numbered and recorded.	
Hardware components / UPS / Air Conditioners / Power Generator are either covered by Warranty or Comprehensive AMC and the same is in force.	
Annual Maintenance Contracts (AMCs) are diarized.	
Preventive Maintenance is carried out by vendors and such acts are documented / recorded.	
Visits by Hardware Engineers and work done by them are properly recorded in Hardware Access Register.	
Insurance of all the hardware available at the Bank Branch is up to date and valid.	
Application Security:	
Only such Users have access rights to the Systems of the Bank Branch, who have been authorised at the Behest of the Bank Branch.	
Transferred / resigned / retired / absentee Users from the Bank Branch do not have access rights to the System.	
Whenever new User-IDs are created, User's fill-in an input form which is duly approved.	
User-IDs allotted by Central Data Centre to the Officials / staff at the Bank Branch are duly advised to the respective Users and acknowledgement obtained from them in the User-ID Allocation Register.	
Users created are allotted rights as per their roles / duties performed.	
User Administration functions relating to User-reset, changes in Capability / Group, Home- Bank Branch, Security level and User-Type are carried out after authorization by the Competent Officials of the Bank Branch and records thereof maintained.	
Capability Levels of the Users are being checked periodically.	
Users log on only onto the respective terminals allotted to them through an office order.	



Users are given access rights for restricted hours of the day.	
In case of Bank Branches functioning for extended timings, Users are given access to the Systems on a 'need to perform' basis and for limited hours which correspond to their working hours.	
In the event of temporary changes made by the Bank Branch in the Capability and Group for Users, proper records are maintained.	
User Logged-out Register for recording the changes to User rights, temporary disabling of the Users during leave / deputation are maintained and scrutinized.	
Details / Particulars of forced lock-out are maintained.	
Cash Officer and Vault Custodian / Custodian responsibilities / roles are assigned to suitable officials, through Office-Orders.	
Cash Officer and the Accountant perform their respective functions in the System as per their defined roles.	
When away from the terminals, even temporarily, User's log-off or lock the screen CBS.	
Administrator Password' of CBS server is kept in a sealed envelope as a Bank Branch Document.	
The password of Office-in-Charge, Cash Management Product is held in a sealed cover duly entered in Bank Branch Document.	
Input Control:	
All Financial and non-financial data input into the System (including Limit Changes, SI, Cheque Book issue, Stop Payment Instructions, Correction and Reversal Entries, Lost Documents and Lost Security Forms, Amendment to Customer's Name, etc.,) are based on relevant input forms / documents / instruments / vouchers.	
Reference number generated by the system are recorded on input documents and used while reversing Originating Entry.	
Journal / Trace numbers are incorporated in the vouchers.	
The Maker, Checker, as applicable, affix their initials on the vouchers. The Officer exercising Supervisory Override has also affixed his initials, wherever applicable.	
The name-stamp of the Maker or the last Checker or the Supervisor, as the case may be, is branded on all vouchers.	
The vouchers are retained by the Maker / Checker / Official who gave Supervisory override where the transactions terminate.	
All input forms (stitched along with the vouchers) are duly verified by the Appropriate Authority.	
Missing Voucher Register is maintained properly.	



'Undertaking' as per the appropriate Annexure of CBS Manual has been obtained from Customers in respect of data received for 'File Uploads'.	
CDs of input files are received in sealed cover with an identifying sticker / label thereon from authorised representatives of bona-fide customers.	
Hard copies in respect of data received for 'File Upload' are duly authenticated by the Authorised Signatory.	
Register is being maintained in respect of data received for 'File Uploads'.	
The printed list for all 'File Uploads' for Batch Jobs are being checked, authenticated and filed.	
Batch Jobs Status Reports are printed, verified, signed and kept on record.	
Reports containing 'Successful' / 'Unsuccessful' transactions sent by Computer Data Centre through FTP are verified and appropriate action taken for 'Unsuccessful' transactions parked in Suspense Account (Rejected Batch Processing Suspense Account).	
Signatures and Photographs of all the Customers are scanned and linked to Customer Accounts.	
Locker-wise date including all cabinet, locker and key numbers are captured in the system.	
The roles of system related functions and User Control functions are assigned to suitable officials through an Office Order.	
Process Control:	
EOD Signal is invariably given every day after ensuring that all mandatory validations /checking are complete and no item is pending in the queue for authorization.	
Screen print of EOD-Signal Screen is taken on a daily basis, time stamp affixed, duly signed by the Head of the Bank Branch and securely filed in the sequence of date for future verification.	
Calendar at the CBS server is checked at the time of creation and reviewed for, say, the next three months, on an on-going basis.	
Checking Roster has been introduced and all the EOD Reports are being generated, printed, sorted, distributed, checked on rotation, recollected and securely filed.	
All instances of postings made on account of Single Sided transactions are recorded in a Register with reasons thereof.	
Single sided entries are not passed for cash rectification.	
All System Suspense Accounts (including all intermediate Office Accounts like Pay Orders / Drafts to be issued Accounts, Technical Suspense a/c, etc., or any other office accounts) have only zero balances. (Please specify the exceptions viz. A/c No., Balance and Action Proposed to zeroize these balances).	



There are no balances in the Migration Suspense/ Misc. Migration Customer Account/any of the consolidated or Difference Accounts created on or before migration.	
Inward Clearing Suspense / Intermediate Accounts for Demand Drafts / Pay Orders etc., are being zeroized on a daily basis.	
Outstanding in Outward Clearing Suspense Account for more than two clearing dates does not exist.	
CBS Cash Balance is tallied with the Cash Officer Register's Balance / Cash on Hand on a daily basis. The balances are tallied with the General Ledger Cash Balance Account on a day-to-day basis.	
In Currency Chest Bank Branches, Currency Chest Reconciliation is being done before giving EOD Signal.	
All the Systems related discrepancies pointed out in the Bank Branch Implementation Report / earlier Audit Report have been rectified.	
Cheques realized are being posted through the appropriate menus.	
All schedules are generated before giving EOD signal.	
Customer centric facilities like printing of Pass Books / Fixed Deposits / Demand Drafts, Dr / Cr Advices, Pay Orders, Statement of Account, Welcome Letters, Letter of Thanks, Interest and Balance Certificate, Time Deposit Maturity Notices, etc., are functioning satisfactorily.	
The Officer-in-charge of Systems ensures that Bank Branch Server, Router & Switch functions 24x7x365 and normally never shut down.	
Date and Time setting on the Bank Branch Servers is correct.	
Reversal of erroneous transactions in government accounts are done only through appropriate menu on the same day as a correction entry.	
The following Control Registers are periodically verified and scrutinized by the concerned Officials in the manner laid down. i. Storage Media Record Register. ii. System Room Access Register. iii. Computer Hardware Access Record Register. iv. Computer Hardware Maintenance & Breakdown (including Network failure) Register. v. Roster for Checking of Reports Software Release Control Register etc.	
Process Controls relating to ATM:	
Admin Transaction Reports & Suspect Transaction Reports in respect of ATMs are scrutinized and suitable action taken by the concerned Official.	
ATM Cash Replenishment Register is maintained and being verified by the Bank Branch Manager.	
ATM Admin Balance enquiry slips are pasted in a register and are signed by both the Joint Custodians.	



Details of rectification entries put through in respect of the Cash replenishment in ATMs are reported to the concerned authorities.	
'Fanning' of the currency notes is being done either manually or through Note Counting Machine in all four directions before ATM Cash Replenishment.	
In case of closure of customer accounts / customer reporting loss of the ATM cards, the ATM Access Flag is being 'zeroised' on a timely basis.	
Hot-listing / De-hot listing of ATM Cards is being promptly informed to ASC by FAX / Letter / email.	
ATM's Terminal Master Keys (TMK) are entered in the Bank Branch Documents Register and is kept in the custody of two different Officials.	
Details of ATM 'Admin Card' and its PIN Mailers are entered in the Bank Branch Documents Register.	
Combination Keys (Passwords) of ATMs used by the Joint Custodians are kept in a sealed cover and maintained as Bank Branch Documents.	
In case where an Official is holding multiple Admin Cards (for multiple ATMs), these Cards are being kept separately to avoid damage to the magnetic stripes.	
ATM Cards "Hot Carding" is promptly done on receipt of requests from customer and the same is duly recorded in a Register maintained for this purpose.	
ATM PIN Mailers, Replacement / Undelivered Cards received by the Bank Branch are cross checked with the covering letters from Outsourcing Agency.	
ATM PIN Mailers and Cards are kept in the custody of two different Officials and the details of these items are properly recorded in the Cards Issued register.	
PIN Mailer / Cards held at the Bank Branch are verified with the register by the concerned Official periodically.	
ATM PINs, lying undelivered for more than 3 months (6 months, in respect of Prototype ATMs) are being effectively destroyed after recording in ATM cards/ PINs destroyed register (to be maintained on the lines of Security Forms Destroyed Register).	
Whenever Customer Calls on the Bank Branch for the delivery of either ATM PIN or ATM Card, as the case may be, it is ensured that a fresh requisition is made by the Bank Branch for reactivation of Card / Issue of PIN and duly recorded.	
All ATM Cards pertaining to destroyed PINs are blocked / deactivated as a measure of abundant precaution.	
Periodical visits are made by the Bank Branch Official to verify customer facilities, ambience and security at ATM Kiosks is satisfactorily functioning.	



Call Centre contact number and the ATM Officer's contact telephone numbers are displayed in the ATM Kiosk for the benefit of customers.	
The ATM Officer signs the Cleaning Chart on daily basis.	
Video Surveillance System (VSS) in the ATM Kiosk (wherever provided), is working satisfactorily.	
VSS cassettes are changed once a month, wherever used.	
The Bank Branch has adequate stock of VSS cassettes and proper custody of recorded cassettes are ensured.	
Insurance for Cash in the ATM is adequate and upto date.	
Unmatched transactions pertaining to ATM Switch advised by Computer Data Centre are promptly attended to.	
Journal Print log are perused and the transactions appearing in the Reports are reconciled.	
Bank Branch Official has ensured that ATM Manufacture Company has enabled / installed Electronic Journal in the ATMs and journal is preserved as soft copy instead of hard copy.	
Process Controls relating to SFMS (Structured Financial Message Solution):	
There are no Generic User-IDs in SFMS Application.	
Data Entry Operators initial the SFMS Message Input Forms for having entered the message into the system.	
SFMS Message Input Forms are authenticated by the Officials concerned for having verified / authorised the message after it has been updated in the system.	
NAK (For ECS) messages are retransmitted after making appropriate correction.	
Hard copies are generated at each stage of message entry, i.e., formatting, verification and authorization.	
All the SFMS related reports have been generated and scrutinized by the concerned official on a daily basis.	
The details of SWIFT messages sent and received are recorded in the SFMS Register and duly authenticated.	
Incoming and outgoing SFMS messages are reconciled with the report, on a daily basis.	
Archiving and stripping of SFMS transactions are done on a monthly basis.	
Process Controls relating to CASH MANAGEMENT PRODUCT (CMP)	
Control Registers are maintained as per CMP Manual (User Password Register, User Control Register, Record of corrupt files and Version Control Register).	
When a CMP account is closed, the Account / Channel Link for the account is deleted.	



Account Policy:	
Minimum Password length of 8 characters (alphanumeric) is being adhered to.	
Password changes are being made in the event of a user reset.	
Password secrecy is being maintained in general and at the time of exercise of supervisory over ride.	
'Screen Lock' System is being put to use.	
Status of Users are made 'Inactive' in the System as and when they proceed on leave.	
Records of Users created / deleted are being maintained.	
Where applicable, instructions for extended business hours from the Controllers are on record.	
Audit Logs:	
User Log-in / Log-out time reports are scrutinized.	
Unsuccessful Log-in Report is scrutinized.	
Journal Logs of ATM are duly checked and safely preserved.	
Network Security:	
The Bank Branch maintains detailed documentation of the LAN / Network of the Bank Branch.	
Branch IP Phone Number, contact Telephone Nos. of Net Work Service Provider, Service Desk & Hardware Vendors are displayed inside the cabin of Bank Branch Official as well as System Room.	
IP Addresses allotted to machines of the Bank Branch by the Corporate Centre are kept as Bank Branch Document.	
Changes made in respect of the following are done only after prior approval of the Appropriate Authority: • Connecting internal network to Bank Connect. • Changes in LAN architecture. • Changes in IP addressing scheme. • Modifications made to access control lists. • Changes in external connectivity.	
Third Party Access:	
Access to third parties viz., Service Providers / Hardware Vendors are permitted only after recording the same in System Room / Hardware Access Register.	
Third-Party personnel are always being accompanied by the Bank staff in case of access to System Room.	
Whenever an existing User-id, Password are to be shared with the Third-Party personnel for trouble shooting, these are changed by the respective Users soon after use. (A record of such access is maintained).	



All Media brought by Third Parties are scanned for Virus before being put to use.	
Configuration Management:	
Secure Configuration Document.	
Configuration Settings of CBS Sever conforms to the Secure Configuration Document (SCD) maintained at the Bank Branch.	
The Topology of the Bank Branch LAN is in accordance with the Network Diagram of LAN.	
Business Parameters:	
Bank Branch Parameter settings for CBDT transactions.	
Operating System Security:	
The Server memory, Hard Disk capacity, configurations of printers and other resources are reviewed by the Head of the Bank Branch from time to time.	
External Networks:	
External Connections in the Bank Branch are as per the Network Diagram approved by the Competent Authority.	
Anti-Virus & Firewall:	
Antivirus Software loaded on the CBS Server and local LAN is updated regularly.	
Antivirus Software is loaded on all the Systems which are not on the LAN and the virus definitions are updated regularly.	
External Users (including Consultants, Vendors, Customers and Service Providers) who bring Laptops / Desktops/ Servers into the Bank Branch premises are allowed to connect to the Bank's Network after prior approval and only after verifying that such System resources have Anti- Virus installed with the latest updates.	
Firewalls are placed to protect the important applications from both external and internal Users. (This statement is applicable for such of the Bank Branches where Firewalls are Configured).	
Monitoring & Incident Management:	
System Monitoring:	
Free disk space on the CBS Server's Hard Disk is being monitored at least weekly, to ensure that a minimum GB free disk space is available.	
Monthly Report on 'Connectivity Status' is being submitted to Core Banking Project of the Bank of the following month.	
Log Monitoring:	
Software Error Register is maintained at the Bank Branch and duly scrutinized.	



Error messages displayed by the System, the Error Codes, together with Transaction Details / Screen Numbers are documented in the Software Error Register.	
Logs pertaining to the following are generated on a daily basis and scrutinized. Authentication failure Account created Password change Privilege accounts System Error failures.	
System generated Errors Logs are reported to the Controllers and Computer Department in the prescribed format.	
Incident Management:	
"Service Desk of CBS Data" facility is being made use by all the staff members.	
Any instances of slow response, data corruption, change in user passwords, attempts to gain unauthorized access, disruption / denial of service is documented and escalated to Appropriate Authorities on observation.	
Back-Up & Disaster Recovery:	
The Officer-in-Charge of SOD/ EOD and report generation activities has been designated through an Office-Order.	
Instructions in respect of On-site and Off-site storage of periodic data back-ups are being followed as per approval of the Controllers.	
Regular Back-ups of CBS server (inclusive of all EOD reports) are taken and duly recorded in a register.	
Back-up Media is being properly labelled and stored securely to prevent damage and unauthorized access.	
Backup / Recovery Registers are reviewed periodically.	
Formatting of Hard Disks is performed and documented suitably before its transfer or sale.	
Disaster Recovery:	
Disaster Recovery Plan (DRP) for the Bank Branch has been prepared and the same has the approval of the Competent Authority.	
Disaster Recovery Plan (DRP) has been notified to all the persons concerned against their acknowledgement.	
Approved DRP is kept as Bank Branch Document.	
Bank Branch Recovery Team meeting is held periodically (quarterly).	
Head of the Bank Branch is furnishing a Certificate in Branch Manager Monthly Certificate indicating periodical testing of DRP.	
Important telephone numbers of Support Team are held on record and also with DRP Team members.	
'Off-line' functionality is being put to use by the Bank Branch whenever required.	
Transactions processed Offline are authorised and monitored by a designated Official.	



Physical Security:	
Physical Access Control:	
Access to the System Room is restricted and entry into the System Room is permitted only after entering in the 'System Room Access' Register.	
'System Room Access' Register is scrutinized by the designated Official regularly and authenticated in token thereof.	
Locking up arrangement for System Room is on record and approved. Key register is maintained.	
Locking up arrangement for ATM is on record and approved. Key register is maintained.	
Custody of duplicate keys for the System Room is documented in the key register, notified to the persons concerned against their acknowledgments.	
Secrecy of ATM combination lock is ensured by Joint Custodian and changes are made in combination whenever there is change in incumbency of joint custodians.	
Hardware Control:	
Instances of Hardware break down, response time / downtime is recorded in the Hardware maintenance register and verified by the Head of the Bank Branch at periodic intervals and suitable action taken.	
Adequate security is provided for ODUs (Outdoor Units of VSATs) and other Communication / Electrical equipment installed outside the building.	
Router / Switches of Bank-Connect are securely installed in a box having locking arrangement.	
Old servers, including Bank master Server and IBS-Net server left unused in the Bank Branch are properly secured.	
Computer Systems / UPS / Generator(s) / Air Conditioners are comprehensively insured.	
Environmental Control:	
Environmental protection against heat, humidity, water and dust is generally ensured in places where Systems are installed.	
System Room is free from stacked computer stationery / old print out or other extraneous / hazardous materials.	
System Room is free from dampness and moisture and the required temperature is maintained.	
Pest Control treatment for the System Room is done periodically.	
Power Control:	
The UPS is kept separate from the System room, preferably under lock and key, with restricted access.	
The UPS is functioning satisfactorily.	
The Bank Branch has been provided with generator of suitable capacity to ensure continuity of operations.	



Fire Control:	
System Room is provided with adequate number of smoke detectors and fire alarms.	
Smoke Detectors are tested at periodic intervals.	
The Bank Branch is provided with adequate number of fire extinguishers and are refilled periodically.	
Appropriate Fire Extinguishers (like Halon Extinguisher / CO2 Extinguisher) are placed in close proximity to the Servers.	
Output Control:	
Customer account vouchers are stitched Maker/ last Checker - Supervisor-wise and BGL vouchers are stitched Product-wise in ascending order of amount with debits first and credits later.	
All Security Forms are accounted for and duly returned to VPIS Custodian, before EOD.	
All the necessary reports sent through FTP by Computer Department are printed and verified.	
Bank Branch Cash Reports are saved and generated.	
Voucher Verification checking / Allotment Register is maintained.	
Checking Officials sign the Reports in token of having checked them.	
Branch Officials ensure proper checking of Voucher Verification under their authentication.	
Voucher Verification are checked in rotation by Officials other than the person to whom they relate to. (Any deviations / defects observed in the process of checking of verification of vouchers to be commented).	
Exception Reports, Control Reports and other Operational Reports are checked by designated staff with respective input forms for authorization.	
'Back Value Dated' transactions are being checked by the Officials concerned.	
'Non-home' transactions, where applicable, are authorized and reported to Controllers.	
A record of all Reports generated by the System is maintained on a daily basis in a Register maintained for this purpose and these are handed over to the Officials concerned for checking, against acknowledgement.	
Personnel Security:	
Adequate Institutional training on CBS has been imparted to all the staff members.	
Updated Operating Manuals, User Manuals and Supplement to Bank's Book of instructions are available at the Bank Branch.	
Operational Manuals, Service Desk announcements etc., on the relevant areas of operations are made available to staff members.	

**Rectification of Irregularities and Submission of Remarks (These are suggestive and it varies from Bank-to-Bank Systems and Procedures):**

- a. Normally, the Bank Branch is given 8 weeks' time for rectification and submission of remarks to controllers. All Bank branches find it very difficult to adhere to time norm. But it is not difficult, if Branch plan Bank Branch work with time frame.
- b. Immediately after report is received hold a meeting of all the officers, employees and appraise the marks / rating the Bank Branch has received. Allot each and every staff particular are as to be rectified and also fix the date before which it should be done.
- c. Irregularities can be broadly classified into two groups. First group is "irregularities which are in the control of the Bank Branch and can be rectified." i.e., Signature for issuance of cheque book, pass book not obtained, A/C opening forms are not authorized, Office use column left blank etc. Second group is " Irregularities which are beyond the control of the Bank Branch". i.e., Long outstanding Cheques Purchased, Pay Orders not reversed, Accounts running irregular, Audited Balance sheets not obtained, etc. All irregularities which can be rectified must be rectified. And all efforts should be made to rectify all irregularities which are beyond the control of the Bank Branch. Head Office of the Bank normally expects rectification to 95%.
- d. For obtaining broken period Encumbrance Certificate (From Sub-Registration Office for the Collateral Security Property offered by the Borrowers) for Loan Accounts, do not go to customers, list the account numbers and submit application directly to Sub-Registrar and obtain the same without loss of time.
- e. For obtaining copy of Registration Copy Book (For Vehicles), Branch may apply directly to Road Transport Office (RTO) giving particulars of the vehicle and can obtain the same within a week. If any borrowers have not registered their vehicle, impress upon the borrower to register the same immediately.
- f. For accounts where sanctions are not there, sanction the same immediately. If it pertains to Bank Branch Manager / Official predecessor, the present official may sanction the advance, if it is in order. If official is not satisfied with the conduct of the account, official may refer it to their Branch Controllers for future course of action.
- g. For accounts where scrutinized control forms / copies are not there, official may control if it is sanctioned by Bank Branch Credit Officer within his discretionary power. If these accounts are sanctioned by the Branch Official, prepare a copy of control form take personally to controlling office, and get it done.
- h. If revival letter (Acknowledgements of Debt) is to be obtained, visit the Borrower Units / Villages concerned frequently and obtain revivals.
- i. If, insurance is to be obtained, do it immediately so that Branch can confirm in Bank Branch Audit Report remarks.



- j. All irregularities pertaining to staff accounts should be rectified with more attention / accuracy.
- k. If, suits, EP are pending for filing, do it immediately so that Branch can confirm having filed suit, EP in Bank Branch Audit Report remarks.
- l. Correct all deviations in Account opening forms of SB and Current Accounts. Attestations for Photos, Specimen Signatures, Blanks in 'Office Use columns', Account opening authorizations etc. be done without lapse.
- m. If, locking up arrangement, Disaster Recovery Plan, Cash Retention Limit is not Current, submit the same to controllers for approval. If, approval is required for destroy of obsolete security forms, submit the same immediately for approval. Bank Branch Officials Remarks on these areas should be affirmative only.
- n. If, Inter-Office / Branch entries are to be attended / in arrears, attend to it immediately and report NIL position in Bank Branch Audit Report remarks.
- o. Auditor reports position of Cheques for Collection, Cheques Purchased, and Pay Orders/ Bankers Cheques in his report. Branch Officials have to mark-off as many entries as possible and report the present position of these entries.
- p. If, any Registers are to be introduced, place indent to Head Office Stationery Department and arrange to get the same immediately. If Bank Branch Neighbouring Bank branches can spare a copy for Branch, Branch may take it. If Branch do not get standard registers before submitting remarks, Branch may use "Kutchra registers" on the similar lines and confirm the same. Here maintenance of records is very much important.
- q. Obtain suit filed position from panel advocates and report present position of the suit filed. Update Suit Filed Registers.
- r. Deviations in obtaining acknowledgements in Pass book issued Registers, Cheque Book issued register be taken and confirmed.
- s. Submission of Irregular Accounts reports, submission of Excess Drawings of Loans, Submission of Excess drawings be submitted immediately and control copy be placed on branch record.

5. **Submission of Remarks and its Language (These are suggestive and it varies from Bank-to-Bank Systems and Procedures):**

- a) As per the instructions compliance remarks be submitted in four columns as shown under:

Irregularity No.	Irregularity	Branch Remarks	Controllers Remarks
1	2	3	4

On completion of Audit, the Auditor give a soft copy of the High / Medium / Low deviations in the above said format keeping the last two columns blank. Please use



the same soft copy and record Bank Branch remarks in column No 3 against each deviation, keeping the fourth column blank to enable controllers to record their comments. Also ensure that a hard copy of Bank Branch remarks duly signed Bank Branch Official as well as a soft copy is sent to controllers for onward transmission to Head Office.

- b) The language of Branch Official / Manager remarks be simple, specific, and meaningful. Explain how Branch have rectified the deviation. Do not write only 'Since Rectified'. Ensure that Branch Official / Manager remarks convey clear and unambiguous meaning. Remarks like Being done now, being attended, are not acceptable as Head Office of the Bank take it as non-compliance. Few examples are given here under as to how Branch Manager / Official remarks should be.

Sl. No.	Irregularity	Branch Remark	Expected Remark (After rectifying the Irregularity)
01	Opinion reports on Borrower/ Guarantor not compiled in respect of 12 Loan accounts list of which has been given to Branch Head.	Since obtained.	Opinion reports have Since been compiled in respect of these accounts.
02.	Balance confirmation not obtained as on 31.03.2021.	Balance confirmation is being obtained invariably.	Balance confirmation Since obtained as on 31.03.2021.
03.	Insurance not done in respect of 22 Loan Accounts.	Efforts are on to insure these assets.	Insurance since obtained (After taken the Insurance Policies).
04.	Signature of the depositor not attested by the Branch Official. E.g., A/c No: 00001, 00002, 00004, 00007, 00008.	Now all the Signatures of the depositor are attested.	Signatures of the depositors since attested.
05.	'Office Use' column not filled in for account numbers (20)	Now office use column is duly filled in.	Office use column is duly filled in. (Using the word now gives the impression that Branch have not rectified in the cited account numbers.)
06.	Documents not produced for verification in respect of 15 Loan accounts.	Efforts are on to trace the documents.	Documents since traced and kept on record (After traced).



07.	25 Cheques amounting to ₹1,22,020.00 are outstanding as on the date of Audit.	Most of the Cheques have since been paid.	19 Cheques amounting to ₹98,252.00 have since been paid and follow up is continued in respect of remaining Cheques.
08.	Following 20 Loan accounts are irregular, if care is not taken, may slip into NPAs.	All these accounts are being closely followed up.	These accounts are followed up closely and following recoveries have been made. (Give account wise recoveries made and present outstanding.)
09.	52 Accounts are time barred list of which has been given to Branch Official.	Revivals being obtained.	35 Accounts have since been revived and efforts are on to revive remaining accounts.
10.	Pre-sanction / Post-Sanction inspections have not been done; No record maintained.	Now being done.	Though inspections have been conducted, due to work pressure it was not evidenced. Inspection registers have since been updated.
11.	For XYZ account limit sanctioned is ₹5 lacs but account opened is for ₹10 lacs and documents obtained is for ₹10 lacs.	Since rectified.	The Sanction was erroneously recorded as ₹5 lacs, now Sanction obtained for ₹10 lacs.
12.	Joint Custodians have not verified the duplicate keys after they have taken over.	Noted for future guidance.	Since verified on 02.02.2021.
13.	Obsolete records not destroyed during review period.	Identification of old records is in process and would be destroyed on receipt of the approval from the controllers.	Old records since destroyed and recordings are made in the register.



14.	Fixed Assets items have not been serially numbered.	It is in the process / Will be done shortly.	All Fixed Assets items have since been serially numbered.
15.	Locking up arrangement for system room not on record.	System room entry restricted.	Locking up arrangement for system room since submitted to the controllers. We note to keep it as Branch Documents on receipt of the approval from the controllers.
16.	Standard Nomination register not maintained.	Register since maintained.	Standard Nomination register since introduced and updated.

- c) Remarks should be on behalf of the branch and all should own it up. Remarks like Credit Analyst / Officer has been advised to obtain revivals, Personal Banking Manager has been advised to rectify the position are not acceptable.
- d) Remarks like will be obtained before due date for compliance of the RBIA Report, noted for future guidance are not at all acceptable.
- e) Remarks like "Will be rectified in the next renewal" is not acceptable from RBIA point of view. Mistakes / Irregularities are to be rectified.
- f) Do not give false certification. If Branch give false certification, Branch will lose marks in Bank Branch next Audit. In certain cases, it has attracted Disciplinary Action in the matter by the Bank (In some Banks). Hence, please do not do that.
- g) If any irregularities complied by Branch as rectified in the previous Audit, continues to persist in the present Audit also it is taken as "Persisting Irregularity". Branch Officials should give personal attention on these matters and ensure these deviations are rectified in full and compliance remarks are given accordingly. Such deviations affect the Bank branch rating adversely.

6. Common Registers to be Maintained (These are suggestive and it varies from Bank-to-Bank Systems and Procedures):

Some of the registers that are required for verification by the Auditors but are not normally maintained are listed below. The list, however, is not exhaustive and does not contain several other registers, such as, Branch Manager's Monthly Certificate Register, Cash Officer's Cash Jotting Register, Cash Balance Book, Attendance Register, Leave Register, Charges (Expenditure) Account etc., which the Bank branches are supposed to maintain. Needless to add, all the registers should be verified by the Bank Branch / Division Head at periodical intervals to create evidence of effective supervision and control.



Sl. No.	Name of the Register
Credit Risk Management	
01	Loan Applications Received and Disposal Register
02	TL Documents Execution Register
03	Cash Credit Register
04	Assets Hypothecation Register
05	Subsidy Accounts Register
06	Pre-sanction Inspection Register
07	Title Deeds Register (Loan Collateral Securities)
08	DCB Register (Demand Collection Balance – Agriculture Loans)
09	Written off Accounts Register (Both for Suit Filed and Non-Suit Filed)
10	Suits Filed Register
11	Post Dated Cheques Register
12	Insurance Register
13	Inspection register (Loan Units)
14	Daily list for obtaining revival letters, renewal of insurance policies and review / renewal of accounts
15	Security / Safe Custody Register (For NSCs, KVPs etc.)
16	Security / Safe Custody Ledger
17	Fixed Deposit Joint Custody Register (Loans against FDs)
18	Miscellaneous Security Register

Sl. No.	Operational Risk Management
01	Passbook Retained Overnight Register
02	Nomination Register
03	Cash Transactions Monitoring Register
04	Inter-branch Transfer of Accounts Register
05	Dak-cum-Cheques Received for Realization Register
06	Cheque Received for Realization Register
07	Register for Cheques Collection outstanding for more than 3 months
08	Stopped Cheques Register
09	Register for Testing of Alarm System in the Branch Premises



10	Register for Frauds / Law Suits against the Bank
11	Record of Various Records of the Branch Register
12	Records Requisition Register
13	Obsolete Security Forms Destroyed Register
14	Undelivered Demand Drafts / Pay Orders Register
15	Security Forms Register
16	Inter Branch Transactions Register
17	Register for Reversing Entries in Branch General Accounts
18	Preventive Vigilance Committee Meeting Register
19	System Suspense Account Follow-up Register
20	Register for Pay Orders transferred to Charges A/c (More than 3 Years)
21	Register for Acting/Officiating/incentives paid to employees / officials.
22	Inward Mail Register
23	Controlling Office Dak Received / Sent Register
24	Absentee Register
25	Complaints Register
26	Drop Box Clearance Register
27	ATM Cash Balance Register
28	Claim Settlement Register for Deceased Constituents' A/cs.
29	Sundry Documents Register
30	Register for Customer Relations programmes and Customer Service Committee Meetings
31	Register for Branch Management Committee Meetings and Staff Meetings
32	Missing Vouchers Register
33	Branch Visit Book (By Officials of the Head Office)
34	Fixed Assets Register and Fixed Assets Ledger
35	Register for Fixed Assets provided at residence of the Officials
36	Reports Distribution Register to the Branch Officials
37	Cheques Returned unpaid Register (Clearing / Cheques)
38	ATM Cards Undelivered Register
39	ATM PIN Mailers Register
40	Welcome Kit / INB kit Register (Internet Banking)
41	Cash Box Delivery Register



42	Intra-day Cash Verification Register
43	Gold ornament packets / weight in / out / balance register
44	Excess / short found in cash counters register
45	Cash Account rectification Register
46	Locker Allotment Priority Register
47	Register for Surrendered Lockers and Keys
48	Penalty paid o/a Government Business Register
49	Commissions Received o/a Govt. Business Register
50	User Control Register (CBS – Allotment of IDs)
51	System Room Access Register
52	Computer Hardware / Software Inventory Register
53	Computer Hardware Access Register
54	Hardware Maintenance and Breakdown Register
55	Software Release Control Register
56	Storage Media Record Register

Sl. No.	External Compliance
1	RBI/Govt. Instructions Register
2	Interest Paid o/a Delayed Collections Register
3	TDS Register

Annexure - I

Model-Risk Based Internal Audit Report

Note: Readers are to be Noted that this a '**Specimen / Model** RBIA Report' – So far, no 'Standard Report' defined by Regulator in this regard.

Based on the Type of Bank Products / Business / Transactions etc. and its Risks. Banks are developed on their own Formats. Hence, it will differ from Bank to Bank.

The Format is normally drawn from the Policies, Manuals and Standard Operating Procedures of the individual Banks/Financial Institutions and as such reference has to be made to those documents while drawing the Format.

Following Specimen of RBIA Covers Broadly the Common Areas of Risks in Banks' Business/ Transactions / Products etc.

Summary of Audit Report

(All Amounts - ₹ In Lakhs)

Name of the Branch:			
Name of the Region / Zone:			
Grade of the Branch:			
Category of the Branch (Rural/Semi-Urban/Urban/Metro):			
Business Levels (As on date of RBIA):		₹ In Lakhs.	
Deposits	Advances	Profit /Loss	NPA's
Date of Start / End of the Present Audit:		Start Date:	End Date:
Name of the Auditor and ID No.			
Name of Branch Manager and ID No.			
How many ATMs (Off-site / On-site):		Off-Site:	On-Site:
Whether it is Currency Chest Branch?		Yes / No	
Whether the Branch is Authorised Dealer for Foreign Exchange Transactions		A Category	B Category C Category



1. Summary of Risk Rating:

Sub-Risks (Marks in %)	Previous RBIA-Rating As on --/--/----		Current RBIA-Rating As on --/--/----	
Credit Risk				
Legal Risk				
Earnings Risk				
Operational Risk				
Business Risk				
Internal Control Risk				
Compliance Risk				
Control Risk				
Overall Rating				

Applicability of Additional Riders (Based on NPA & Frauds at the Branch the Final Rating to be arrived):

Non-performing Assets	Number of Frauds & Amount	Final Rating

Risk Trend:

Movement in Risk of the Branch (Increased / Decreased)	
Reasons for Up Gradation / Down Gradation:	1. 2. 3.
Features of Risk Perception of Branch:	1. 2. 3.
Positive Features (Explain Briefly):	1. 2. 3.
Negative Features (Explain Briefly):	1. 2. 3.



Comments on High-Risk Areas (if any) and Suggestions to Mitigate the Risk.	High Risk Areas: 1. 2. 3. Suggestions to Mitigate the Risk: 1. 2. 3.

(Based on Risk Rating (For High-Risk Areas-Controllers are to be Closely Monitor the Branch))

2. Number of Irregularities Reported in RBIA:

Part-1: -----

Part-2: -----

Total: -----

2.1 Previous RBIA Details:

Date of Previous RBIA	Date of Closure	No. of Irregularities Reported in Part - 1	No. of Irregularities Reported in Part - 2	Rectification Approved by RBIA Department of the Bank (Part - 1 & its %)	Rectification Approved by RBIA Department of the Bank (Part - 2 & its %)
1	2	3	4	5	6

Balance of irregularities to be approved by RBIA Department? (Column No: 5 & 6 mentioned in the above Table)	Yes / No	
If yes, summary of un-rectified irregularities of previous RBIA:	Type of Irregularity	Number of Irregularities
Certificate of Closure of Previous Audit Report is kept on Record:	Yes / No	

**2.2 Present RBIA Details:**

Sl. No.	RBIA Report Part I / Part II	Reported in Previous RBIA	Reported in Current RBIA	Increase / Decrease Since Last RBIA	Spot Rectification of Irregularities in Current RBIA	% Of Spot Rectification in Current RBIA (6/4%)
1	2	3	4	5 (4-3)	6	7
1						
2						
3						

- 3. Special Report:** Whether any Irregularities requiring **Special Report** (Serious Irregularities in Credit and Operational Risks) are observed by Auditor and any 'Special Report' is made separately:
Yes / No

If Yes, the details there of:

A. Special Report for Non-Credit Portfolio:

Sl. No.	Short Description	Amount Involved	Report Submission Date

B. Special Report for Credit Portfolio:

Sl. No.	Name of A/c	A/c No.	Amount Involved	Report Submission Date

4. Branch Business Performance:

(₹ in Lakhs)

Particulars	Deposit*	Advances*	NPA's	Profit / Loss
Current Financial Year				
Last Financial Year				

Particulars	Budget				Actual			
	D	A	N	P/L	D	A	N	P/L
Previous Financial Year 31 st March ----								
Previous Half Year 30 th Sep ----								
Position as on Date of RBIA --/--/----.								

Note: D-Deposits: A-Advances: N-NPAs: P/L-Profit/Loss.

5. NPA Portfolio:**5.1 NPA Position:**

Particulars	Previous Year 31 Mar ----	Current Year 31 Mar ----
NPA's		
% In total Advances		

Comments of the Auditor (If NPAs raised – Segment, Number of A/cs, Amount):

5.2 NPA & Write-Off Recovery:

Particulars	NPA A/c		Write-Off A/c	
	Previous Year 31 st Mar ----	Current Year 31 st Mar ----	Previous Year 31 st Mar ----	Current Year 31 st Mar ----
Budget				
Achievement				

6. Position of Time Barred Documents:

Sl. No.	Segment (Retail / Agriculture / MSME / C&I etc.)	No. of A/cs	Amount (₹. In Lakhs)
1			
2			
3			

6.1 List of Major Time Barred Documents (Above ₹.10.00 Lacs.):

Sl. No.	Name / Account Number	Outstanding Amount (In Lakhs)
1		
2		

6.2 Renewal Accounts (Working Capital A/cs) is updated in CBS: Yes / No.

The Position of A/cs pending for Renewal / Up-dation in CBS:

Sl. No.	Description	No. of A/cs	₹ In Lakhs
1	MSME Segment – Working Capital Loans.		
2	C&I / Mid-Corporate Segment – Working Capital Loans.		

**7. Position of Suits Filled / Decreed Cases in Civil Courts / DRT / DRAT / NCLT / NCLAT:**

Sl. No.	Description	No. of A/cs	₹ In Lakhs
1	No. of Cases of Civil Suits / DRT / NCLT.		
2	Out Sl. No. 1 How many are Decreed / Final Order.		
3	Out of Sl. No. 2 Time Barred Decreed		

8. Position of Claim with Credit Guarantee Fund (CGTSME):

Sl. No.	Particulars	Eligible Cases for Revocation of Claim	Actual Cases where Claim is revoked
1			

8.1 Status of Reconciliation of A/c with other Banks:

A. If Branch is maintaining A/cs with State Bank of India / other Banks: Yes / No.

B. If Yes, then whether it is Reconciled & Latest details of outstanding entries is kept on record: Yes / No.

C. Details of pending entries in reconciliation for more than 1 month with balance > ₹5,000/-

Sl. No.	Description	Pending for Reconciliation Since	Amount	Remarks for Follow-Up (In Short)
01				
02				

8.2 Administrative Accounts opened for parking funds to be remitted etc.:

A. Branch is maintaining A/cs for Parking of Funds / Parking Accounts for onward Remittance / Administrative Account: Yes / No

B. Details of pending entries in Reconciliation for more than 1 month:

Sl. No.	Description	Pending for Reconciliation Since	Amount	Remarks for Follow up (in Short)
01				

9. Pending entries in Office Accounts (System Suspense A/cs) - Summary of Pending entries involving sizable amounts and pending beyond 1 Months.



Sl. No.	Office Accounts	No. of Entries	Amount (In Lakhs.)	Remarks for Follow up (In Short) **
1	Clearing House-Credits			
2	Clearing House-Debits			
3	Inland Remittance			
4	Bills Purchased			
5	Interest Subvention Claims			
6	Subsidy to be Received from State / Central Government for Government Sponsored Accounts			
7	Pending Entries Originated from Branch not responded by other Branches.			
8	PPF / Government Commission Receivable – Central / State Governments.			
10	Suspense A/c (Amount Debit Fraud Case)-Not reversed.			
11	No. of ATMs System Suspense Account Entries.			

** Remarks such as No Follow up / Follow up Not Adequate / Follow-Up Adequate / Recommended for Write-off to Head Office etc. may be incorporated.

10. Outstanding Debit balances in Savings and Current Accounts:

Sl. No.	Description	No. of A/cs	Amount (In Lakhs)
1	Debit Balance in Current A/c		
2	Debit Balance in Saving A/c (Excluding sanctioned limit of Salary A/cs / Jan Dhan A/cs)		

10.1 Details of Temporary Over Draft sanctioned on Individual Basis in A/cs having Debit Balance > ₹25,000/- (Excluding Debit Balance exclusively due to Non-recovery of Minimum Balance / Cheque Return Charges and Interest thereof, Temporary Overdraft within Sanctioned Limit of Salary Loans Scheme / Jan-Dhan Yojana etc.)



Sl. No.	Name of A/c Holder	A/c No.	Amount (In Lakhs)	Documents for Temporary Overdraft on Record Yes / No	Remarks for Follow up (In Short) **

** Remarks such as No Follow up / Follow up not adequate / Follow up adequate / Recommended for Write-off to Head Office etc. may be incorporated.

11. Income Leakage:

Income Leakage detected during Audit	₹
Of which: Recovered during Audit	₹
Un-recovered Income leakage	₹

Major Area of Income Leakage:

1. Less Interest Charged on Advances:
2. Processing Charges Not Recovered:
3. Cheque Return Charges:
4. Locker Rent Not Recovered/ Short Recovered:

(Please mention only Name of areas and incorporate A/c wise details)

12. Comments on Abnormal Debits in Interest (In connection with Payment of Interest on Deposits):

13. Pending Compliance (Rectifications) of Credit Audit / Legal Audit, if any?

Sl. No.	Nature of Audit Credit / Legal	Name of A/c	A/c No.	Amount (In Lakhs)	Status of Compliance and details of Un-rectified / Unattended Observations.

**14. Submission / Periodicity of various Control Returns:**

Particulars	Whether Submitted Regularly	Date of Last Submission
Excess / Temporary Drawing Statement		
Advances Sanctioned by Branch Manager.		
Any Other Report (Like Branch Managers Monthly Certificate etc.)		

15. Laxity, if any observed during the course of Audit in "Non-Credit Portfolio" and "General Branch Administration":

- a.
- b.
- c.

16. Observation on Compliance of KYC Norms:

- A.** Deposit Portfolio:
- B.** Credit Portfolio:

17. Any other irregularity, which needs to be brought to the Notice of Head Office (Other than A/cs where 'Special Report' is submitted):

(Here mention only those cases which Needs immediate attention of Controlling Office)

A. Major Irregularities / Serious Lapses for Non-Credit Portfolio:

Sl. No.	Short Description	Amount (In Lakhs)	Major Irregularities / Serious Lapses observed by Auditor
1			
2			

B. Major irregularities / Serious Lapses for Credit Portfolio:

Sl. No.	Name of A/c	A/c Number	Amount (In Lakhs)	Major Irregularities / Serious Lapses observed by Auditor
1				
2				

**18. Consolidated Irregularities of Advances Portfolio (For all Advances):**

Note: Wherever the Branch **Not Implemented** / **Followed-up** the Bank Systems & Procedures (In respect of Advances and Non-fund-based business etc., those irregularities Number of Accounts and Amount to be mentioned in below Statement).

Sl. No.	Irregularity Description	No. of A/Cs	Amount (In. Lakhs)
	Pre-Sanction: Value Statements		
1	Applications are Completely filled in.		
2	All Primary Security and Collateral Securities are Inspected Periodically and Visit Reports Placed on Record.		
3	Analysis of Latest Financial Statements and Verification of Genuineness of Financial Statements of Applicant and its Group Concerns are on record.		
4	Assessment of Entry Level Risk Rating / Internal Risk Rating, its Compliance with Hurdle Rate and Details of External Rating obtained (₹5.00 lacs. & Above) are on record.		
5	Audited Financial Statements for Past 3 years obtained.		
6	Confidential Opinion / Regularity Certificate / No Objection Certificate from existing Bankers are obtained in the case of a New Borrower and Associate / Sister concerns dealing with other Banks / Branches.		
7	Credentials and Antecedents of the borrower(s) / Promoter(s) / guarantor (s) are ensured.		
8	Due Diligence carried out in Identification of the Borrower and KYC documents duly verified.		
9	Financial Statements of Borrower / Associate / Sister concern are obtained Regularly and Analysed to Verify and Interlocking of Funds etc.		
10	Limit sought Commensurate with Needs of the Unit, Assumptions made are Correlated with Trend / Profits wherever Applicable and Veracity of Assumptions is ensured through Proper Documents.		
11	Management Due Diligence, Business Due Diligence, Financial Due Diligence Carried out in respect of Units finance by the Bank.		



12	Monitoring of Performance of Borrower vis-à-vis with Projections as mentioned in the Appraisal at the Time of Sanction / Renewal.		
13	Inherent Risk in the Business of the Borrower is Identified and its Mitigations are Discussed in the Appraisal Note / Unit Inspection Register etc.		
14	'No Objection Certificate' for Creation of Charge obtained from Concerned Authorities in Applicable Cases (Builder / Housing Societies etc.).		
15	Personal Information Forms of All Borrowers along with Necessary Documents are on Record / Complete / Net worth ascertained.		
16	Personal Information Forms of All Guarantors along with Necessary Documents are on Record / Complete / Net worth ascertained.		
17	Prescribed / Standard Applications as designed by the Bank are obtained.		
18	Prescribed Documents are Obtained & Kept on Record (For Regular Sanctions + Temporary Overdraft / Excess Drawings).		
19	Prescribed Processing Charges, Documentation Charges, Inspection Charges and other Service Charges / Commission are Collected for fund based and Non-Fund-Based Limits.		
20	Projected Balance Sheets are on record for New Sanctions / Enhancements.		
21	Quotations from Vendors are obtained.		
22	Releases are made against Original Invoice / Delivery Challans / Inspection Notes in case of Supply Bills.		
23	Renewal Application Submitted by the Borrower in Time and processed by the Bank.		
24	Reviewing Internal Credit Rating and Obtaining Fresh External Rating as per Guidelines.		
25	Scrutiny of Documents obtained like Memorandum & Articles of Association, Certification of Registration and Commencement, Partnership Deed, Board Resolution to Borrow from Bank, Annual Report etc. are carried out.		



26	Search / Verification for Existing Charge conducted with ROC.		
27	Search / Verification of Existing Mortgage / Charge wherever required CERSAI etc.		
28	Sensitivity Analysis, Internal Rate of Return is Worked out as per Guidelines and are Satisfactory.		
29	Statutory Dues / Liability including Contingent Liability outstanding against the Applicant / Prospective Borrower were Examined.		
30	Technical Feasibility, Economic Viability, Location etc., have been Assessed and Ensured.		
31	Valuation of Securities giving Full Descriptions of the Assets is obtained as per Guidelines from Approved Valuers.		
32	Valuation of Securities is obtained as per Guidelines Periodically from Approved Valuers.		
33	Vetting of Documents by Panel Advocate / Law Officer as per extant Guidelines. Deficiency observed by Panel Advocates if any, are Rectified.		
34	Whether book debt statements are duly certified by Chartered Accountant on Quarterly Basis.		
	Sanction: Value Statements		
1	All Sanctions within the Delegation Powers given by the Bank.		
2	Any Stipulations made in the Sanctions / Completed before disbursement of the Loan.		
	Post Sanction: Value Statements		
1	All formalities regarding Creation of Mortgage / Charge, including Pari Pasu / Second Charge is Completed.		
2	All Pre and Post release Terms and Conditions of Sanction are separately specified. The same are conveyed to the Borrower and Acknowledgement obtained.		
3	Annual Review, Mid-year Review and other Periodical Reviews are carried out in respect of Term Loans etc.		
4	Acceptance of Terms and Conditions of sanction by Borrower/s and Guarantor/s are on Record.		



5	Balance / Security Confirmation are obtained and Signature of the Borrowers / Guarantors thereon verified.		
6	Contribution of Borrower i.e., Margin is ensured while making Disbursement.		
7	Copy to Sanction Letter on record / Signed by the Sanctioning Authority.		
8	Disbursements are made as per terms of Sanction / prescribed Norms, Margin is ensured, and proper Rate of Interest is applied.		
9	Diversion of Funds, is Monitored and Steps taken to safeguard Interest of the Bank.		
10	Documents obtained are Signed by all the Parties concerned.		
11	Drawing Power is Fixed & Updated into System in Regular Accounts as per Guidelines. The same updated in CBS.		
12	End use of Funds is Physically Verified after Disbursement / continuous basis as per requirement and Proof of Purchase of Securities are held.		
13	Facilities are released only after Compliance of Sanction terms and the same Certified by Appropriate Authority in case such Certification is prescribed.		
14	In case of Loan against Deposits, Fixed Deposit Receipts are Obtained, Duly Discharged & Charge of Lien is Registered in CBS.		
15	In case of Vehicles - Banks Hypothecation Charge is Registered with RTO and Blank Transfer Form 29 and 30 with Borrower's Signed (Owner of Vehicle) are obtained.		
16	In Cash Credit Accounts, Sales Proceeds are Routed through the Account & Monitored Regularly.		
17	In respect of Equitable Mortgage, Bank's Charge is Notified to Central Registry / Revenue Authority (CERSAI).		
18	In respect of Equitable Mortgage, Form-A (Confirmation of EM) is on Record.		
19	In respect of Equitable Mortgage, Original Title Deeds are held on record.		



20	In respect of loans sanctioned for Purchase of Vehicles / Articles / Machineries etc., Loan proceeds are released by Direct Payment to the Suppliers / Dealer and Documentary Evidence is held by the Bank.		
21	Negative features like Adverse Audit Remarks, Non-Routing of Sale Proceeds, Devolvement of LCs, Invocation of Guarantees, Adverse Features in the Accounts of Associates / Group Concerns etc. have been commented upon and informed to the Controlling Authority.		
22	Notice of Intimation of Equitable Mortgage is given to Sub-Registrar within 30 days wherever applicable.		
23	Operations are not allowed in Expired Limits.		
24	Penal Interest / Additional Interest is charged for Overdue Loans / Delay in Submission of Renewal Proposal, Stock Statements, QIS, Financial Statements, Non-creation of Mortgage, Adhoc Limit, Excess Drawings etc.		
25	Projects are Completed in Time and Commercial Production Commenced, Completion of Project in Time and Commencement of Commercial Operation are Monitored.		
26	Property Extracts with Bank's Charge Obtained & Kept on Record.		
27	Renewal Premium is Remitted Well in Advance to ensure Timely Renewal of Insurance Policies and Recovered from respective Borrower (For Both Primary and Collateral Security Properties given to the Bank for the Loans & Advances).		
28	Repayment Period, Moratorium Period, Margin, Surety, Security etc. is Stipulated / Obtained as per Bank Guidelines. Deviation if any Approved / Permitted by the Competent Authority. This Information feed in CBS.		
29	Required Margins is brought in and necessary Certificates for Infusion of Margins are Obtained.		
30	Review Note Prepared & Kept on Record (including Agriculture Cash Credit Accounts).		



31	Sanctioned Limits are Opened in the CBS Properly. Information of all Fields Especially Repayment Schedule and Security Values are filled in System Correctly.		
32	Securities have been Insured for Full Value Covering all Stipulated Risks with Bank Clause.		
33	Specific / Stage wise releases are made wherever required / Applicable after proper verification of End utilization of Previous Release.		
34	Stock Statements and Book Debt Statements / List of Sundry Creditors are obtained Periodically from the Borrower as per Prescribed Schedule, Verified and Analysed. Provide List of Accounts where Stock statement is more than 2 Months Old.		
35	Temporary Over-Drawings / Adhoc Limits / Additional Limits permitted are as per Guidelines and are reported to Higher Authorities.		
36	The Documents Obtained are Complete – Valid, Enforceable, Adequately Stamped and all Covenants duly Incorporated.		
37	Timely Review / Renewal / Enhancement of the Accounts Done as Stipulated.		
38	Unit Visits are Done Periodically and Report kept on Record.		

(**Note:** The Auditors may add points as per his / her observation. The details of Accounts along with Account Number and other particulars in respect of 'Irregular Accounts' Statement is to **attached to the Audit Report** based on the each '**Value Statement**' mentioned above for rectification by the Branches 'Post Audit Report' submitted by the RBIA Auditor to the Branch).

19. Implementation of Various Modules:

A. Use of Loan Documents Software : YES / NO / Not Applicable.

B. Locker Module etc. : YES / NO / Not Applicable.

**20. Observation of Auditor on various Branch Aspects / Functioning:**

Sl. No.	Area / Parameter	Observation of Auditor
20.1	Upkeep of Credit portfolio and General Health of Advances.	
20.2	Observation of Auditor on: a) Arresting Fresh slippages. b) NPA Recovery. c) Timely Action for Legal Recourse.	
20.3	Staff Punctuality / Staff Discipline.	
20.4	Customer Service Quality.	
20.5	Branch Ambiance.	

21. Extent of Computerization:

A. Secrecy of Pass Word Maintained.	Yes / No
B. Exceptional Reports Generated & Checked Regularly.	Yes / No
C. Regular Checking of Vouchers list generated by CBS.	Yes / No
D. Proper Control is exercised on Modification in Parameter Files in CBS.	Yes / No
E. Disaster Recovery Plan is in Place.	Yes / No
F. Business Continuity Plan is in Place.	Yes / No
G. 'Biometric Access' System is followed for every CBS User.	Yes / No

**22. Compliance of Various Audit:**

Sl. No.	Audit	Date of Audit	Date of 1 st Rectification Report Submitted	Date of Last Rectification Report Submitted	Date of Closure of Report.
1	Internal Audit.				
2	Surprise Audit.				
3	Statutory Audit (Annual).				
4	Concurrent Audit (Immediate Last 3 Months).				
5	Revenue Audit / Income – Expenditure Audit.				
6	Government Business Audit.				
7	Electrical Audit.				
8	Any Other Audit (Please Specify).				

23. Observation on KYC / AML Compliance on the Basis of Test Checking:

1	Opening of Account by requisite documents.	Yes / No
2	The Turnover in the Account does not exceed Allowable Limits in case, Account is opened with Introduction of the Existing Account Holder.	Yes / No
3	Exercise on Classification of Account into High Medium & Low Risk.	Yes / No
4	KYC Compliance on Renewal of Deposit.	Yes / No
5	Observation on any Abnormal Transactions.	Yes / No
6	Cash Deposited / Withdrawals of ₹.10 lakhs & above is promptly reported to Controlling Office.	Yes / No
7	Submission of Monthly KYC Compliance Report to Controlling Office.	Yes / No
8	Obtaining of Photographs / Address Proof / PAN Card.	Yes / No



Discrepancies / Irregularities in the Account opened:

Abnormal Transaction observed:

[If during the course of Audit, the Auditor comes across any Information / Records which he Suspects as Fraudulent Activity the same should be reported to Controlling Office under Copy to Audit Department, Head Office and Fraud Monitoring Cell, Head Office].

Any other information to be Reported to Head Office:

Signature of the RBIA Auditor

Name of the Auditor:

Date:

Observations of Audit Cell-in-Charge on Contents of Summary Report:

Scrutinized the Audit Summary submitted by the RBIA Auditor and Confirm / Not Confirm the Contents of the Report. (In case Contents are Not Confirmed the Details are Furnished Below):

Name of the Branch	
Date of Audit	
Name of the Auditor & ID No.	
No. of Days Allotted and Consumed	

Annexure - II

Regulatory Guidelines

Banks in the process of financial intermediation are confronted with various kinds of financial and non-financial risks viz., credit, interest rate, foreign exchange rate, liquidity, equity price, commodity price, legal, regulatory, reputational, operational, etc. These risks are highly interdependent and events that affect one area of risk can have ramifications for a range of other risk categories. Thus, top management of banks should attach considerable importance to improve the ability to identify, measure, monitor and control the overall level of risks undertaken.

The broad parameters of risk management function should encompass:

1. Organisational structure.
2. Comprehensive risk measurement approach.
3. Risk management policies approved by the Board which should be consistent with the broader business strategies, capital strength, management expertise and overall willingness to assume risk.
4. Guidelines and other parameters used to govern risk taking including detailed structure of prudential limits.
5. Strong MIS for reporting, monitoring and controlling risks.
6. Well, laid out procedures, effective control and comprehensive risk reporting framework.
7. Separate risk management framework independent of operational Departments and with clear delineation of levels of responsibility for management of risk; and
8. Periodical review and evaluation.

A. Risk Management Structure

A major issue in establishing an appropriate risk management organisation structure is choosing between a centralised and decentralised structure. The global trend is towards centralising risk management with integrated treasury management function to benefit from information on aggregate exposure, natural netting of exposures, economies of scale and easier reporting to top management. The primary responsibility of understanding the risks run by the bank and ensuring that the risks are appropriately managed should clearly



be vested with the Board of Directors. The Board should set risk limits by assessing the bank's risk and risk bearing capacity. At organisational level, overall risk management should be assigned to an independent Risk Management Committee or Executive Committee of the top Executives that reports directly to the Board of Directors. The purpose of this Top-level committee is to empower one group with full responsibility of evaluating overall risks faced by the bank and determining the level of risks which will be in the best interest of the bank. At the same time, the Committee should hold the line management more accountable for the risks under their control, and the performance of the bank in that area. The functions of Risk Management Committee should essentially be to identify, monitor and measure the risk profile of the bank. The Committee should also develop policies and procedures, verify the models that are used for pricing complex products, review the risk models as development takes place in the markets and also identify new risks. The risk policies should clearly spell out the quantitative prudential limits on various segments of banks' operations. Internationally, the trend is towards assigning risk limits in terms of portfolio standards or Credit at Risk (Credit Risk) and Earnings at Risk and Value at Risk (Market Risk). The Committee should design stress scenarios to measure the impact of unusual market conditions and monitor variance between the actual volatility of portfolio value and that predicted by the risk measures. The Committee should also monitor compliance of various risk parameters by operating Departments.

A prerequisite for establishment of an effective risk management system is the existence of a robust MIS, consistent in quality. The existing MIS, however, requires substantial upgradation and strengthening of the data collection machinery to ensure the integrity and reliability of data.

The risk management is a complex function and it requires specialised skills and expertise. Banks have been moving towards the use of sophisticated models for measuring and managing risks. Large banks and those operating in international markets should develop internal risk management models to be able to compete effectively with their competitors. As the domestic market integrates with the international markets, the banks should have necessary expertise and skill in managing various types of risks in a scientific manner. At a more sophisticated level, the core staff at Head Offices should be trained in risk modelling and analytical tools. It should, therefore, be the endeavour of all banks to upgrade the skills of staff.

Given the diversity of balance sheet profile, it is difficult to adopt a uniform framework for management of risks in India. The design of risk management functions should be bank specific, dictated by the size, complexity of functions, the level of technical expertise and the quality of MIS. The proposed guidelines only provide broad parameters and each bank may evolve their own systems compatible to their risk management architecture and expertise.

Internationally, a committee approach to risk management is being adopted. While the Asset - Liability Management Committee (ALCO) deal with different types of market risk, the Credit Policy Committee (CPC) oversees the credit / counterparty risk and country risk. Thus, market and credit risks are managed in a parallel two-track approach in banks. Banks



could also set-up a single Committee for integrated management of credit and market risks. Generally, the policies and procedures for market risk are articulated in the ALM policies and credit risk is addressed in Loan Policies and Procedures.

Currently, while market variables are held constant for quantifying credit risk, credit variables are held constant in estimating market risk. The economic crises in some of the countries have revealed a strong correlation between unhedged market risk and credit risk. Forex exposures, assumed by corporates who have no natural hedges, will increase the credit risk which banks run vis-à-vis their counterparties. The volatility in the prices of collateral also significantly affects the quality of the loan book. Thus, there is a need for integration of the activities of both the ALCO and the CPC and consultation process should be established to evaluate the impact of market and credit risks on the financial strength of banks. Banks may also consider integrating market risk elements into their credit risk assessment process.

i) Credit Risk

a) General

Lending involves a number of risks. In addition to the risks related to creditworthiness of the counterparty, the banks are also exposed to interest rate, forex and country risks.

Credit risk or default risk involves inability or unwillingness of a customer or counterparty to meet commitments in relation to lending, trading, hedging, settlement and other financial transactions. The Credit Risk is generally made up of transaction risk or default risk and portfolio risk. The portfolio risk in turn comprises intrinsic and concentration risk. The credit risk of a bank's portfolio depends on both external and internal factors. The external factors are the state of the economy, wide swings in commodity/equity prices, foreign exchange rates and interest rates, trade restrictions, economic sanctions, Government policies, etc. The internal factors are deficiencies in loan policies/administration, absence of prudential credit concentration limits, inadequately defined lending limits for Loan Officers / Credit Committees, deficiencies in appraisal of borrowers' financial position, excessive dependence on collaterals and inadequate risk pricing, absence of loan review mechanism and post sanction surveillance, etc.

Another variant of credit risk is counterparty risk. The counterparty risk arises from non-performance of the trading partners. The non-performance may arise from counterparty's refusal / inability to perform due to adverse price movements or from external constraints that were not anticipated by the principal. The counterparty risk is generally viewed as a transient financial risk associated with trading rather than standard credit risk.

The management of credit risk should receive the top management's attention and the process should encompass:

- a) Measurement of risk through credit rating / scoring.
- b) Quantifying the risk through estimating expected loan losses i.e., the amount of loan losses that bank would experience over a chosen time horizon (through tracking

portfolio behaviour over 5 or more years) and unexpected loan losses i.e., the amount by which actual losses exceed the expected loss (through standard deviation of losses or the difference between expected loan losses and some selected target credit loss quantile).

- c) Risk pricing on a scientific basis; and
- d) Controlling the risk through effective Loan Review Mechanism and portfolio management.

The credit risk management process should be articulated in the bank's Loan Policy, duly approved by the Board. Each bank should constitute a high-level Credit Policy Committee, also called Credit Risk Management Committee or Credit Control Committee etc. to deal with issues relating to credit policy and procedures and to analyse, manage and control credit risk on a bank wide basis. The Committee should be headed by the Chairman / CEO / ED, and should comprise heads of Credit Department, Treasury, Credit Risk Management Department (CRMD) and the Chief Economist. The Committee should, *inter alia*, formulate clear policies on standards for presentation of credit proposals, financial covenants, rating standards and benchmarks, delegation of credit approving powers, prudential limits on large credit exposures, asset concentrations, standards for loan collateral, portfolio management, loan review mechanism, risk concentrations, risk monitoring and evaluation, pricing of loans, provisioning, regulatory / legal compliance, etc. Concurrently, each bank should also set up Credit Risk Management Department (CRMD), independent of the Credit Administration Department. The CRMD should enforce and monitor compliance of the risk parameters and prudential limits set by the CPC. The CRMD should also lay down risk assessment systems, monitor quality of loan portfolio, identify problems and correct deficiencies, develop MIS and undertake loan review / audit. Large banks may consider separate set up for loan review / audit. The CRMD should also be made accountable for protecting the quality of the entire loan portfolio. The Department should undertake portfolio evaluations and conduct comprehensive studies on the environment to test the resilience of the loan portfolio.

b) Instruments of Credit Risk Management

Credit Risk Management encompasses a host of management techniques, which help the banks in mitigating the adverse impacts of credit risk.

c) Credit Approving Authority

Each bank should have a carefully formulated scheme of delegation of powers. The banks should also evolve multi-tier credit approving system where the loan proposals are approved by an 'Approval Grid' or a 'Committee'. The credit facilities above a specified limit may be approved by the 'Grid' or 'Committee', comprising at least 3 or 4 officers and invariably one officer should represent the CRMD, who has no volume and profit targets. Banks can also consider credit approving committees at various operating levels i.e., large Bank branches (where considered necessary), Regional Offices, Zonal Offices, Head Offices, etc. Banks could consider delegating powers for sanction of higher limits to the 'Approval Grid' or



the 'Committee' for better rated / quality customers. The spirit of the credit approving system may be that no credit proposals should be approved or recommended to higher authorities, if majority members of the 'Approval Grid' or 'Committee' do not agree on the creditworthiness of the borrower. In case of disagreement, the specific views of the dissenting member/s should be recorded.

The banks should also evolve suitable framework for reporting and evaluating the quality of credit decisions taken by various functional groups. The quality of credit decisions should be evaluated within a reasonable time, say 3 – 6 months, through a well-defined Loan Review Mechanism.

d) Prudential Limits

In order to limit the magnitude of credit risk, prudential limits should be laid down on various aspects of credit:

- a) Stipulate benchmark current / debt equity and profitability ratios, debt service coverage ratio or other ratios, with flexibility for deviations. The conditions subject to which deviations are permitted and the authority therefor should also be clearly spelt out in the Loan Policy.
- b) Single/group borrower limits, which may be lower than the limits prescribed by Reserve Bank to provide a filtering mechanism.
- c) Substantial exposure limit i.e., sum total of exposures assumed in respect of those single borrowers enjoying credit facilities in excess of a threshold limit, say 10% or 15% of capital funds. The substantial exposure limit may be fixed at 600% or 800% of capital funds, depending upon the degree of concentration risk the bank is exposed.
- d) Maximum exposure limits to industry, sector, etc. should be set up. There must also be systems in place to evaluate the exposures at reasonable intervals and the limits should be adjusted especially when a particular sector or industry faces slowdown or other sector / industry specific problems. The exposure limits to sensitive sectors, such as, advances against equity shares, real estate, etc., which are subject to a high degree of asset price volatility and to specific industries, which are subject to frequent business cycles, may necessarily be restricted. Similarly, high-risk industries, as perceived by the bank, should also be placed under lower portfolio limit. Any excess exposure should be fully backed by adequate collaterals or strategic considerations; and
- e) Banks may consider maturity profile of the loan book, keeping in view the market risks inherent in the balance sheet, risk evaluation capability, liquidity, etc.

f) Risk Rating

Banks should have a comprehensive risk scoring / rating system that serves as a single point indicator of diverse risk factors of a counterparty and for taking credit decisions in a consistent manner. To facilitate this, a substantial degree of standardisation is required in ratings across borrowers. The risk rating system should be designed to reveal the overall



risk of lending, critical input for setting pricing and non-price terms of loans as also present meaningful information for review and management of loan portfolio. The risk rating, in short, should reflect the underlying credit risk of the loan book. The rating exercise should also facilitate the credit granting authorities some comfort in its knowledge of loan quality at any moment of time.

The risk rating system should be drawn up in a structured manner, incorporating, *inter alia*, financial analysis, projections and sensitivity, industrial and management risks. The banks may use any number of financial ratios and operational parameters and collaterals as also qualitative aspects of management and industry characteristics that have bearings on the creditworthiness of borrowers. Banks can also weigh the ratios on the basis of the years to which they represent for giving importance to near term developments. Within the rating framework, banks can also prescribe certain level of standards or critical parameters, beyond which no proposals should be entertained. Banks may also consider separate rating framework for large corporate / small borrowers, traders, etc. that exhibit varying nature and degree of risk. Forex exposures assumed by corporates who have no natural hedges have significantly altered the risk profile of banks. Banks should, therefore, factor the unhedged market risk exposures of borrowers also in the rating framework. The overall score for risk is to be placed on a numerical scale ranging between 1-6, 1-8, etc. on the basis of credit quality. For each numerical category, a quantitative definition of the borrower, the loan's underlying quality, and an analytic representation of the underlying financials of the borrower should be presented. Further, as a prudent risk management policy, each bank should prescribe the minimum rating below which no exposures would be undertaken. Any flexibility in the minimum standards and conditions for relaxation and authority therefor should be clearly articulated in the Loan Policy.

The credit risk assessment exercise should be repeated biannually (or even at shorter intervals for low quality customers) and should be delinked invariably from the regular renewal exercise. The updating of the credit ratings should be undertaken normally at quarterly intervals or at least at half-yearly intervals, in order to gauge the quality of the portfolio at periodic intervals. Variations in the ratings of borrowers over time indicate changes in credit quality and expected loan losses from the credit portfolio. Thus, if the rating system is to be meaningful, the credit quality reports should signal changes in expected loan losses. In order to ensure the consistency and accuracy of internal ratings, the responsibility for setting or confirming such ratings should vest with the Loan Review function and examined by an independent Loan Review Group. The banks should undertake comprehensive study on migration (upward-lower to higher and downward-higher to lower) of borrowers in the ratings to add accuracy in expected loan loss calculations.

g) Risk Pricing

Risk-return pricing is a fundamental tenet of risk management. In a risk-return setting, borrowers with weak financial position and hence placed in high credit risk category should be priced high. Thus, banks should evolve scientific systems to price the credit risk,



which should have a bearing on the expected probability of default. The pricing of loans normally should be linked to risk rating or credit quality. The probability of default could be derived from the past behaviour of the loan portfolio, which is the function of loan loss provision/charge offs for the last five years or so. Banks should build historical database on the portfolio quality and provisioning / charge off to equip themselves to price the risk. But value of collateral, market forces, perceived value of accounts, future business potential, portfolio/industry exposure and strategic reasons may also play important role in pricing. Flexibility should also be made for revising the price (risk premia) due to changes in rating / value of collaterals over time. Large sized banks across the world have already put in place Risk Adjusted Return on Capital (RAROC) framework for pricing of loans, which calls for data on portfolio behaviour and allocation of capital commensurate with credit risk inherent in loan proposals. Under RAROC framework, lender begins by charging an interest mark-up to cover the expected loss – expected default rate of the rating category of the borrower. The lender then allocates enough capital to the prospective loan to cover some amount of unexpected loss- variability of default rates. Generally, international banks allocate enough capital so that the expected loan loss reserve or provision plus allocated capital covers 99% of the loan loss outcomes.

There is, however, a need for comparing the prices quoted by competitors for borrowers perched on the same rating / quality. Thus, any attempt at price-cutting for market share would result in mispricing of risk and 'Adverse Selection'.

h) Portfolio Management

The existing framework of tracking the Non-Performing Loans around the balance sheet date does not signal the quality of the entire Loan Book. Banks should evolve proper systems for identification of credit weaknesses well in advance. Most of international banks have adopted various portfolio management techniques for gauging asset quality. The CRMD, set up at Head Office should be assigned the responsibility of periodic monitoring of the portfolio. The portfolio quality could be evaluated by tracking the migration (upward or downward) of borrowers from one rating scale to another. This process would be meaningful only if the borrower-wise ratings are updated at quarterly / half-yearly intervals. Data on movements within grading categories provide a useful insight into the nature and composition of loan book.

The banks could also consider the following measures to maintain the portfolio quality:

- 1) Stipulate quantitative ceiling on aggregate exposure in specified rating categories, i.e., certain percentage of total advances should be in the rating category of 1 to 2 or 1 to 3, 2 to 4 or 4 to 5, etc.
- 2) Evaluate the rating-wise distribution of borrowers in various industry, business segments, etc.
- 3) Exposure to one industry / sector should be evaluated on the basis of overall rating distribution of borrowers in the sector / group. In this context, banks should weigh the

pros and cons of specialisation and concentration by industry group. In cases where portfolio exposure to a single industry is badly performing, the banks may increase the quality standards for that specific industry.

- 4) Target rating-wise volume of loans, probable defaults and provisioning requirements as a prudent planning exercise. For any deviation/s from the expected parameters, an exercise for restructuring of the portfolio should immediately be undertaken and if necessary, the entry level criteria could be enhanced to insulate the portfolio from further deterioration.
- 5) Undertake rapid portfolio reviews, stress tests and scenario analysis when external environment undergoes rapid changes (e.g., volatility in the forex market, economic sanctions, changes in the fiscal / monetary policies, general slowdown of the economy, market risk events, extreme liquidity conditions, etc.). The stress tests would reveal undetected areas of potential credit risk exposure and linkages between different categories of risk. In adverse circumstances, there may be substantial correlation of various risks, especially credit and market risks. Stress testing can range from relatively simple alterations in assumptions about one or more financial, structural or economic variables to the use of highly sophisticated models. The output of such portfolio-wide stress tests should be reviewed by the Board and suitable changes may be made in prudential risk limits for protecting the quality. Stress tests could also include contingency plans, detailing management responses to stressful situations.
- 6) Introduce discriminatory time schedules for renewal of borrower limits. Lower rated borrowers whose financials show signs of problems should be subjected to renewal control twice / thrice a year.

Banks should evolve suitable framework for monitoring the market risks especially forex risk exposure of corporates who have no natural hedges on a regular basis. Banks should also appoint Portfolio Managers to watch the loan portfolio's degree of concentrations and exposure to counterparties. For comprehensive evaluation of customer exposure, banks may consider appointing Relationship Managers to ensure that overall exposure to a single borrower is monitored, captured and controlled. The Relationship Managers have to work in co-ordination with the Treasury and Forex Departments. The Relationship Managers may service mainly high value loans so that a substantial share of the loan portfolio, which can alter the risk profile, would be under constant surveillance. Further, transactions with affiliated companies/groups need to be aggregated and maintained close to real time. The banks should also put in place formalised systems for identification of accounts showing pronounced credit weaknesses well in advance and also prepare internal guidelines for such an exercise and set time frame for deciding courses of action.

Many of the international banks have adopted credit risk models for evaluation of credit portfolio. The credit risk models offer banks framework for examining credit risk exposures, across geographical locations and product lines in a timely manner, centralising data and analysing marginal and absolute contributions to risk. The models also provide estimates of



credit risk (unexpected loss) which reflect individual portfolio composition. The Altman's Z Score forecasts the probability of a company entering bankruptcy within a 12-month period. The model combines five financial ratios using reported accounting information and equity values to produce an objective measure of borrower's financial health. J. P. Morgan has developed a portfolio model 'Credit Metrics' for evaluating credit risk. The model basically focuses on estimating the volatility in the value of assets caused by variations in the quality of assets. The volatility is computed by tracking the probability that the borrower might migrate from one rating category to another (downgrade or upgrade). Thus, the value of loans can change over time, reflecting migration of the borrowers to a different risk-rating grade. The model can be used for promoting transparency in credit risk, establishing benchmark for credit risk measurement and estimating economic capital for credit risk under RAROC framework. Credit Suisse developed a statistical method for measuring and accounting for credit risk which is known as Credit Risk+. The model is based on actuarial calculation of expected default rates and unexpected losses from default.

The banks may evaluate the utility of these models with suitable modifications to Indian environment for fine-tuning the credit risk management. The success of credit risk models impinges on time series data on historical loan loss rates and other model variables, spanning multiple credit cycles. Banks may, therefore, endeavour building adequate database for switching over to credit risk modelling after a specified period of time.

i) Loan Review Mechanism (LRM)

LRM is an effective tool for constantly evaluating the quality of loan book and to bring about qualitative improvements in credit administration. Banks should, therefore, put in place proper Loan Review Mechanism for large value accounts with responsibilities assigned in various areas such as, evaluating the effectiveness of loan administration, maintaining the integrity of credit grading process, assessing the loan loss provision, portfolio quality, etc. The complexity and scope of LRM normally vary based on banks' size, type of operations and management practices. It may be independent of the CRMD or even separate Department in large banks.

j) The main objectives of LRM could be:

- To identify promptly loans which develop credit weaknesses and initiate timely corrective action.
- To evaluate portfolio quality and isolate potential problem areas.
- To provide information for determining adequacy of loan loss provision.
- To assess the adequacy of and adherence to, loan policies and procedures, and to monitor compliance with relevant laws and regulations; and
- To provide top management with information on credit administration, including credit sanction process, risk evaluation and post-sanction follow-up.



Accurate and timely credit grading is one of the basic components of an effective LRM. Credit grading involves assessment of credit quality, identification of problem loans, and assignment of risk ratings. A proper Credit Grading System should support evaluating the portfolio quality and establishing loan loss provisions. Given the importance and subjective nature of credit rating, the credit ratings awarded by Credit Administration Department should be subjected to review by Loan Review Officers who are independent of loan administration.

Banks should formulate Loan Review Policy and it should be reviewed annually by the Board. The Policy should, *inter alia*, address:

i. Qualification and Independence

The Loan Review Officers should have sound knowledge in credit appraisal, lending practices and loan policies of the bank. They should also be well versed in the relevant laws/regulations that affect lending activities. The independence of Loan Review Officers should be ensured and the findings of the reviews should also be reported directly to the Board or Committee of the Board.

ii. Frequency and Scope of Reviews

The Loan Reviews are designed to provide feedback on effectiveness of credit sanction and to identify incipient deterioration in portfolio quality. Reviews of high value loans should be undertaken usually within three months of sanction / renewal or more frequently when factors indicate a potential for deterioration in the credit quality. The scope of the review should cover all loans above a cut-off limit. In addition, banks should also target other accounts that present elevated risk characteristics. At least 30-40% of the portfolio should be subjected to LRM in a year to provide reasonable assurance that all the major credit risks embedded in the balance sheet have been tracked.

iii. Depth of Reviews

The loan reviews should focus on:

- Approval process.
- Accuracy and timeliness of credit ratings assigned by loan officers.
- Adherence to internal policies and procedures, and applicable laws / regulations.
- Compliance with loan covenants.
- Post-sanction follow-up.
- Sufficiency of loan documentation.
- Portfolio quality; and
- Recommendations for improving portfolio quality.



The findings of Reviews should be discussed with line Managers and the corrective actions should be elicited for all deficiencies. Deficiencies that remain unresolved should be reported to top management.

k) Credit Risk and Investment Banking

Significant magnitude of credit risk, in addition to market risk, is inherent in investment banking. The proposals for investments should also be subjected to the same degree of credit risk analysis, as any loan proposals. The proposals should be subjected to detailed appraisal and rating framework that factors in financial and non-financial parameters of issuers, sensitivity to external developments, etc. The maximum exposure to a customer should be bank-wide and include all exposures assumed by the Credit and Treasury Departments. The coupon on non-sovereign papers should be commensurate with their risk profile. The banks should exercise due caution, particularly in investment proposals, which are not rated and should ensure comprehensive risk evaluation. There should be greater interaction between Credit and Treasury Departments and the portfolio analysis should also cover the total exposures, including investments. The rating migration of the issuers and the consequent diminution in the portfolio quality should also be tracked at periodic intervals.

As a matter of prudence, banks should stipulate entry level minimum ratings / quality standards, industry, maturity, duration, issuer-wise, etc. limits in investment proposals as well to mitigate the adverse impacts of concentration and the risk of illiquidity.

l) Credit Risk in Off-balance Sheet Exposure

Banks should evolve adequate framework for managing their exposure in off-balance sheet products like forex forward contracts, swaps, options, etc. as a part of overall credit to individual customer relationship and subject to the same credit appraisal, limits and monitoring procedures.

Banks should classify their off-balance sheet exposures into three broad categories - full risk (credit substitutes) - standby letters of credit, money guarantees, etc, medium risk (not direct credit substitutes, which do not support existing financial obligations) - bid bonds, letters of credit, indemnities and warranties and low risk - reverse repos, currency swaps, options, futures, etc.

The trading credit exposure to counterparties can be measured on static (constant percentage of the notional principal over the life of the transaction) and on a dynamic basis. The total exposures to the counterparties on a dynamic basis should be the sum total of:

1. The current replacement cost (unrealised loss to the counterparty); and
2. The potential increase in replacement cost (estimated with the help of VaR or other methods to capture future volatilities in the value of the outstanding contracts/ obligations).

The current and potential credit exposures may be measured on a daily basis to evaluate the impact of potential changes in market conditions on the value of counterparty positions. The potential exposures also may be quantified by subjecting the position to market movements involving normal and abnormal movements in interest rates, foreign exchange rates, equity prices, liquidity conditions, etc.

m) Inter-bank Exposure and Country Risk

A suitable framework should be evolved to provide a centralised overview on the aggregate exposure on other banks. Bank-wise exposure limits could be set on the basis of assessment of financial performance, operating efficiency, management quality, past experience, etc. Like corporate clients, banks should also be rated and placed in range of 1-5, 1-8, as the case may be, on the basis of their credit quality. The limits so arrived at should be allocated to various operating centres and followed up and half-yearly / annual reviews undertaken at a single point. Regarding exposure on overseas banks, banks can use the country ratings of international rating agencies and classify the countries into low risk, moderate risk and high risk. Banks should endeavour for developing an internal matrix that reckons the counterparty and country risks. The maximum exposure should be subjected to adherence of country and bank exposure limits already in place. While the exposure should at least be monitored on a weekly basis till the banks are equipped to monitor exposures on a real time basis, all exposures to problem countries should be evaluated on a real time basis.

n) Market Risk

Traditionally, credit risk management was the primary challenge for banks. With progressive deregulation, market risk arising from adverse changes in market variables, such as interest rate, foreign exchange rate, equity price and commodity price has become relatively more important. Even a small change in market variables causes substantial changes in income and economic value of banks. Market risk takes the form of:

- 1) Liquidity Risk.
- 2) Interest Rate Risk.
- 3) Foreign Exchange Rate (Forex) Risk.
- 4) Commodity Price Risk and
- 5) Equity Price Risk.

o) Market Risk Management

Management of market risk should be the major concern of top management of banks. The Boards should clearly articulate market risk management policies, procedures, prudential risk limits, review mechanisms and reporting and auditing systems. The policies should address the bank's exposure on a consolidated basis and clearly articulate the risk measurement systems that capture all material sources of market risk and assess the effects on the bank. The operating prudential limits and the accountability of the line management should also



be clearly defined. The Asset-Liability Management Committee (ALCO) should function as the top operational unit for managing the balance sheet within the performance/risk parameters laid down by the Board. The banks should also set up an independent Middle Office to track the magnitude of market risk on a real time basis. The Middle Office should comprise of experts in market risk management, economists, statisticians and general bankers and may be functionally placed directly under the ALCO. The Middle Office should also be separated from Treasury Department and should not be involved in the day-to-day management of Treasury. The Middle Office should apprise the top management / ALCO/ Treasury about adherence to prudential / risk parameters and also aggregate the total market risk exposures assumed by the bank at any point of time.

p) Liquidity Risk

Liquidity Planning is an important facet of risk management framework in banks. Liquidity is the ability to efficiently accommodate deposit and other liability decreases, as well as, fund loan portfolio growth and the possible funding of off-balance sheet claims. A bank has adequate liquidity when sufficient funds can be raised, either by increasing liabilities or converting assets, promptly and at a reasonable cost. It encompasses the potential sale of liquid assets and borrowings from money, capital and forex markets. Thus, liquidity should be considered as a defence mechanism from losses on fire sale of assets.

The liquidity risk of banks arises from funding of long-term assets by short-term liabilities, thereby making the liabilities subject to rollover or refinancing risk.

The liquidity risk in banks manifest in different dimensions:

- i. **Funding Risk**-Need to replace net outflows due to unanticipated withdrawal / nonrenewal of deposits (wholesale and retail).
- ii. **Time Risk**-Need to compensate for non-receipt of expected inflows of funds, i.e., performing assets turning into non-performing assets; and
- iii. **Call Risk**-Due to crystallisation of contingent liabilities and unable to undertake profitable business opportunities when desirable.

The first step towards liquidity management is to put in place an effective liquidity management policy, which, *inter alia*, should spell out the funding strategies, liquidity planning under alternative scenarios, prudential limits, liquidity reporting / reviewing, etc.

Liquidity measurement is quite a difficult task and can be measured through stock or cash flow approaches. The key ratios, adopted across the banking system are:

- i) **Loans to Total Assets.**
- ii) **Loans to Core Deposits.**
- iii) **Large Liabilities (minus) Temporary Investments to Earning Assets (minus) Temporary Investments**, where large liabilities represent wholesale deposits which are market sensitive and temporary Investments are those maturing within one year and those investments which are held in the trading book and are readily sold in the market;



iv) Purchased Funds to Total Assets, where purchased funds include the entire inter-bank and other money market borrowings, including Certificate of Deposits and institutional deposits; and

v) Loan Losses / Net Loans.

While the liquidity ratios are the ideal indicator of liquidity of banks operating in developed financial markets, the ratios do not reveal the intrinsic liquidity profile of Indian banks which are operating generally in an illiquid market. Experiences show that assets commonly considered as liquid like Government securities, other money market instruments, etc. have limited liquidity as the market and players are unidirectional. Thus, analysis of liquidity involves tracking of cash flow mismatches. For measuring and managing net funding requirements, the use of maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates is recommended as a standard tool. The format prescribed by RBI in this regard under ALM System should be adopted for measuring cash flow mismatches at different time bands. The cash flows should be placed in different time bands based on future behaviour of assets, liabilities and off-balance sheet items. In other words, banks should have to analyse the behavioural maturity profile of various components of on / off-balance sheet items on the basis of assumptions and trend analysis supported by time series analysis. Banks should also undertake variance analysis, at least, once in six months to validate the assumptions. The assumptions should be fine-tuned over a period which facilitate near reality predictions about future behaviour of on / off-balance sheet items. Apart from the above cash flows, banks should also track the impact of prepayments of loans, premature closure of deposits and exercise of options built in certain instruments which offer put / call options after specified times. Thus, cash outflows can be ranked by the date on which liabilities fall due, the earliest date a liability holder could exercise an early repayment option or the earliest date contingencies could be crystallised.

The difference between cash inflows and outflows in each time period, the excess or deficit of funds, becomes a starting point for a measure of a bank's future liquidity surplus or deficit, at a series of points of time. The banks should also consider putting in place certain prudential limits to avoid liquidity crisis:

1. Cap on inter-bank borrowings, especially call borrowings.
2. Purchased funds vis-à-vis liquid assets.
3. Core deposits vis-à-vis Core Assets i.e. Cash Reserve Ratio, Liquidity Reserve Ratio and Loans.
4. Duration of liabilities and investment portfolio.
5. Maximum Cumulative Outflows. Banks should fix cumulative mismatches across all time bands.
6. Commitment Ratio-Track the total commitments given to corporates/banks and other financial institutions to limit the off-balance sheet exposure.
7. Swapped Funds Ratio, i.e., extent of Indian Rupees raised out of foreign currency sources.



Banks should also evolve a system for monitoring high value deposits (other than interbank deposits) say ₹1 crore or more to track the volatile liabilities. Further the cash flows arising out of contingent liabilities in normal situation and the scope for an increase in cash flows during periods of stress should also be estimated. It is quite possible that market crisis can trigger substantial increase in the amount of drawdowns from cash credit/overdraft accounts, contingent liabilities like letters of credit, etc.

The liquidity profile of the banks could be analysed on a static basis, wherein the assets and liabilities and off-balance sheet items are pegged on a particular day and the behavioural pattern and the sensitivity of these items to changes in market interest rates and environment are duly accounted for. The banks can also estimate the liquidity profile on a dynamic way by giving due importance to:

- 1) Seasonal pattern of deposits/loans;
- 2) Potential liquidity needs for meeting new loan demands, un-availed credit limits, loan policy, potential deposit losses, investment obligations, statutory obligations, etc.

q) Alternative Scenarios

The liquidity profile of banks depends on the market conditions, which influence the cash flow behaviour. Thus, banks should evaluate liquidity profile under different conditions, viz. normal situation, bank specific crisis and market crisis scenario. The banks should establish benchmark for normal situation, cash flow profile of on / off balance sheet items and manages net funding requirements.

Estimating liquidity under bank specific crisis should provide a worst-case benchmark. It should be assumed that the purchased funds could not be easily rolled over; some of the core deposits could be prematurely closed; a substantial share of assets have turned into non-performing and thus become totally illiquid. These developments would lead to rating downgrades and high cost of liquidity. The banks should evolve contingency plans to overcome such situations.

The market crisis scenario analyses cases of extreme tightening of liquidity conditions arising out of monetary policy stance of Reserve Bank, general perception about risk profile of the banking system, severe market disruptions, failure of one or more of major players in the market, financial crisis, contagion, etc. Under this scenario, the rollover of high value customer deposits and purchased funds could extremely be difficult besides flight of volatile deposits / liabilities. The banks could also sell their investment with huge discounts, entailing severe capital loss.

r) Contingency Plan

Banks should prepare Contingency Plans to measure their ability to withstand bank-specific or market crisis scenario. The blue-print for asset sales, market access, capacity to restructure the maturity and composition of assets and liabilities should be clearly documented and alternative options of funding in the event of bank's failure to raise liquidity from existing



source/s could be clearly articulated. Liquidity from the Reserve Bank, arising out of its refinance window and interim liquidity adjustment facility or as lender of last resort should not be reckoned for contingency plans. Availability of back-up liquidity support in the form of committed lines of credit, reciprocal arrangements, liquidity support from other external sources, liquidity of assets, etc. should also be clearly established.

s) Interest Rate Risk (IRR)

The management of Interest Rate Risk should be one of the critical components of market risk management in banks. The regulatory restrictions in the past had greatly reduced many of the risks in the banking system. Deregulation of interest rates has, however, exposed them too the adverse impacts of interest rate risk. The Net Interest Income (NII) or Net Interest Margin (NIM) of banks is dependent on the movements of interest rates. Any mismatches in the cash flows (fixed assets or liabilities) or repricing dates (floating assets or liabilities), expose banks' NII or NIM to variations. The earning of assets and the cost of liabilities are now closely related to market interest rate volatility.

Interest Rate Risk (IRR) refers to potential impact on NII or NIM or Market Value of Equity (MVE), caused by unexpected changes in market interest rates. Interest Rate Risk can take different forms:

t) Types of Interest Rate Risk

i. Gap or Mismatch Risk:

A gap or mismatch risk arises from holding assets and liabilities and off-balance sheet items with different principal amounts, maturity dates or repricing dates, thereby creating exposure to unexpected changes in the level of market interest rates.

ii. Basis Risk

Market interest rates of various instruments seldom change by the same degree during a given period of time. The risk that the interest rate of different assets, liabilities and off-balance sheet items may change in different magnitude is termed as basis risk. The degree of basis risk is fairly high in respect of banks that create composite assets out of composite liabilities. The Loan book in India is funded out of a composite liability portfolio and is exposed to a considerable degree of basis risk. The basis risk is quite visible in volatile interest rate scenarios. When the variation in market interest rate causes the NII to expand, the banks have experienced favourable basis shifts and if the interest rate movement causes the NII to contract, the basis has moved against the banks.

iii. Embedded Option Risk

Significant changes in market interest rates create another source of risk to banks' profitability by encouraging prepayment of cash credit / demand loans / term



loans and exercise of call / put options on bonds / debentures and / or premature withdrawal of term deposits before their stated maturities. The embedded option risk is becoming a reality in India and is experienced in volatile situations. The faster and higher the magnitude of changes in interest rate, the greater will be the embedded option risk to the banks' NII. Thus, banks should evolve scientific techniques to estimate the probable embedded options and adjust the Gap Statements (Liquidity and Interest Rate Sensitivity) to realistically estimate the risk profiles in their balance sheet. Banks should also endeavour for stipulating appropriate penalties based on opportunity costs to stem the exercise of options, which is always to the disadvantage of banks.

iv. Yield Curve Risk

In a floating interest rate scenario, banks may price their assets and liabilities based on different benchmarks, i.e., TBs yields, fixed deposit rates, call money rates, MIBOR, etc. In case the banks use two different instruments maturing at different time horizon for pricing their assets and liabilities, any non-parallel movements in yield curves would affect the NII. The movements in yield curve are rather frequent when the economy moves through business cycles. Thus, banks should evaluate the movement in yield curves and the impact of that on the portfolio values and income.

v. Price Risk

Price risk occurs when assets are sold before their stated maturities. In the financial market, bond prices and yields are inversely related. The price risk is closely associated with the trading book, which is created for making profit out of short-term movements in interest rates. Banks which have an active trading book should, therefore, formulate policies to limit the portfolio size, holding period, duration, defeasance period, stop loss limits, marking to market, etc.

vi. Reinvestment Risk

Uncertainty with regard to interest rate at which the future cash flows could be reinvested is called reinvestment risk. Any mismatches in cash flows would expose the banks to variations in NII as the market interest rates move in different directions.

vii. Net Interest Position Risk

The size of non-paying liabilities is one of the significant factors contributing towards profitability of banks. When banks have more earning assets than paying liabilities, interest rate risk arises when the market interest rates adjust downwards. Thus, banks with positive net interest positions will experience a reduction in NII as the market interest rate declines and increases when interest rate rises. Thus, large float is a natural hedge against the variations in interest rates.

viii. Measuring Interest Rate Risk

Before interest rate risk could be managed, they should be identified and quantified. Unless the quantum of IRR inherent in the balance sheet is identified, it is impossible to measure the degree of risks to which banks are exposed. It is also equally impossible to develop effective risk management strategies / hedging techniques without being able to understand the correct risk position of banks. The IRR measurement system should address all material sources of interest rate risk including gap or mismatch, basis, embedded option, yield curve, price, reinvestment and net interest position risks exposures. The IRR measurement system should also take into account the specific characteristics of each individual interest rate sensitive position and should capture in detail the full range of potential movements in interest rates.

There are different techniques for measurement of interest rate risk, ranging from the traditional Maturity Gap Analysis (to measure the interest rate sensitivity of earnings), Duration (to measure interest rate sensitivity of capital), Simulation and Value at Risk. While these methods highlight different facets of interest rate risk, many banks use them in combination, or use hybrid methods that combine features of all the techniques.

Generally, the approach towards measurement and hedging of IRR varies with the segmentation of the balance sheet. In a well-functioning risk management system, banks broadly position their balance sheet into Trading and Investment or Banking Books. While the assets in the trading book are held primarily for generating profit on short-term differences in prices / yields, the banking book comprises assets and liabilities, which are contracted basically on account of relationship or for steady income and statutory obligations and are generally held till maturity. Thus, while the price risk is the prime concern of banks in trading book, the earnings or economic value changes are the main focus of banking book.

u) Trading Book

The top management of banks should lay down policies with regard to volume, maximum maturity, holding period, duration, stop loss, defeasance period, rating standards, etc. for classifying securities in the trading book. While the securities held in the trading book should ideally be marked to market on a daily basis, the potential price risk to changes in market risk factors should be estimated through internally developed Value at Risk (VaR) models. The VaR method is employed to assess potential loss that could crystallise on trading position or portfolio due to variations in market interest rates and prices, using a given confidence level, usually 95% to 99%, within a defined period of time. The VaR method should incorporate the market factors against which the market value of the trading position is exposed. The top management should put in place bank-wide VaR exposure limits to the trading portfolio (including forex and gold positions, derivative products, etc.) which is then disaggregated across different desks and departments. The loss-making tolerance level should also be stipulated to ensure that potential impact on earnings is managed within acceptable limits.



The potential loss in Present Value Basis Points should be matched by the Middle Office on a daily basis vis-à-vis the prudential limits set by the Board. The advantage of using VaR is that it is comparable across products, desks and Departments and it can be validated through 'back testing'. However, VaR models require the use of extensive historical data to estimate future volatility. VaR model also may not give good results in extreme volatile conditions or outlier events and stress test has to be employed to complement VaR. The stress tests provide management a view on the potential impact of large size market movements and also attempt to estimate the size of potential losses due to stress events, which occur in the 'tails' of the loss distribution. Banks may also undertake scenario analysis with specific possible stress situations (recently experienced in some countries) by linking hypothetical, simultaneous and related changes in multiple risk factors present in the trading portfolio to determine the impact of moves on the rest of the portfolio. VaR models could also be modified to reflect liquidity risk differences observed across assets over time. International banks are now estimating Liquidity adjusted Value at Risk (La VaR) by assuming variable time horizons based on position size and relative turnover. In an environment where VaR is difficult to estimate for lack of data, non-statistical concepts such as stop loss and gross/net positions can be used.

v) Banking Book

The changes in market interest rates have earnings and economic value impacts on the banks' banking book. Thus, given the complexity and range of balance sheet products, banks should have IRR measurement systems that assess the effects of the rate changes on both earnings and economic value. The variety of techniques ranges from simple maturity (fixed rate) and repricing (floating rate) to static simulation, based on current on-and-off-balance sheet positions, to highly sophisticated dynamic modelling techniques that incorporate assumptions on behavioural pattern of assets, liabilities and off-balance sheet items and can easily capture the full range of exposures against basis risk, embedded option risk, yield curve risk, etc.

w) Maturity Gap Analysis

The simplest analytical techniques for calculation of IRR exposure begins with maturity Gap analysis that distributes interest rate sensitive assets, liabilities and off-balance sheet positions into a certain number of pre-defined time-bands according to their maturity (fixed rate) or time remaining for their next repricing (floating rate). Those assets and liabilities lacking definite repricing intervals (Savings Bank, Cash Credit, Overdraft, Loans, Export Finance, Re-finance from RBI etc.) or actual maturities vary from contractual maturities (embedded option in bonds with put / call options, loans, cash credit / overdraft, time deposits, etc.) are assigned time-bands according to the judgement, empirical studies and past experiences of banks.

A number of time bands can be used while constructing a gap report. Generally, most of the banks focus their attention on near-term periods, viz. monthly, quarterly, half-yearly or



one year. It is very difficult to take a view on interest rate movements beyond a year. Banks with large exposures in the short-term should test the sensitivity of their assets and liabilities even at shorter intervals like overnight, 1-7 days, 8-14 days, etc.

In order to evaluate the earnings exposure, interest Rate Sensitive Assets (RSAs) in each time band are netted with the interest Rate Sensitive Liabilities (RSLs) to produce a repricing 'Gap' for that time band. The positive Gap indicates that banks have more RSAs than RSLs. A positive or asset sensitive Gap means that an increase in market interest rates could cause an increase in NII. Conversely, a negative or liability sensitive Gap implies that the banks' NII could decline as a result of increase in market interest rates. The negative gap indicates that banks have more RSLs than RSAs. The Gap is used as a measure of interest rate sensitivity. The Positive or Negative Gap is multiplied by the assumed interest rate changes to derive the Earnings at Risk (EaR). The EaR method facilitates to estimate how much the earnings might be impacted by an adverse movement in interest rates. The changes in interest rate could be estimated on the basis of past trends, forecasting of interest rates, etc. The banks should fix EaR which could be based on last/current year's income and a trigger point at which the line management should adopt on-or off-balance sheet hedging strategies may be clearly defined.

The Gap calculations can be augmented by information on the average coupon on assets and liabilities in each time band and the same could be used to calculate estimates of the level of NII from positions maturing or due for repricing within a given time-band, which would then provide a scale to assess the changes in income implied by the gap analysis.

The periodic gap analysis indicates the interest rate risk exposure of banks over distinct maturities and suggests magnitude of portfolio changes necessary to alter the risk profile. However, the Gap report quantifies only the time difference between repricing dates of assets and liabilities but fails to measure the impact of basis and embedded option risks. The Gap report also fails to measure the entire impact of a change in interest rate (Gap report assumes that all assets and liabilities are matured or repriced simultaneously) within a given time-band and effect of changes in interest rates on the economic or market value of assets, liabilities and off-balance sheet position. It also does not take into account any differences in the timing of payments that might occur as a result of changes in interest rate environment. Further, the assumption of parallel shift in yield curves seldom happen in the financial market. The Gap report also fails to capture variability in non-interest revenue and expenses, a potentially important source of risk to current income.

In case banks could realistically estimate the magnitude of changes in market interest rates of various assets and liabilities (basis risk) and their past behavioural pattern (embedded option risk), they could standardise the gap by multiplying the individual assets and liabilities by how much they will change for a given change in interest rate. Thus, one or several assumptions of standardised gap seem more consistent with real world than the simple gap method. With the Adjusted Gap, banks could realistically estimate the EaR.

x) Duration Gap Analysis

Matching the duration of assets and liabilities, instead of matching the maturity or repricing dates is the most effective way to protect the economic values of banks from exposure to IRR than the simple gap model. Duration gap model focuses on managing economic value of banks by recognising the change in the market value of assets, liabilities and off-balance sheet (OBS) items. When weighted assets and liabilities and OBS duration are matched, market interest rate movements would have almost same impact on assets, liabilities and OBS, thereby protecting the bank's total equity or net worth. Duration is a measure of the percentage change in the economic value of a position that will occur given a small change in the level of interest rates.

Measuring the duration gap is more complex than the simple gap model. For approximation of duration of assets and liabilities, the simple gap schedule can be used by applying weights to each time-band. The weights are based on estimates of the duration of assets and liabilities and OBS that fall into each time band. The weighted duration of assets and liabilities and OBS provide a rough estimation of the changes in banks' economic value to a given change in market interest rates. It is also possible to give different weights and interest rates to assets, liabilities and OBS in different time buckets to capture differences in coupons and maturities and volatilities in interest rates along the yield curve.

In a more scientific way, banks can precisely estimate the economic value changes to market interest rates by calculating the duration of each asset, liability and OBS position and weigh each of them to arrive at the weighted duration of assets, liabilities and OBS. Once the weighted duration of assets and liabilities are estimated, the duration gap can be worked out with the help of standard mathematical formulae. The Duration Gap measure can be used to estimate the expected change in Market Value of Equity (MVE) for a given change in market interest rate.

The difference between duration of assets (DA) and liabilities (DL) is bank's net duration. If the net duration is positive ($DA > DL$), a decrease in market interest rates will increase the market value of equity of the bank. When the duration gap is negative ($DL > DA$), the MVE increases when the interest rate increases but decreases when the rate declines. Thus, the Duration Gap shows the impact of the movements in market interest rates on the MVE through influencing the market value of assets, liabilities and OBS.

The attraction of duration analysis is that it provides a comprehensive measure of IRR for the total portfolio. The duration analysis also recognises the time value of money. Duration measure is additive so that banks can match total assets and liabilities rather than matching individual accounts. However, Duration Gap analysis assumes parallel shifts in yield curve. For this reason, it fails to recognise basis risk.

y) Simulation

Many of the international banks are now using balance sheet simulation models to gauge the effect of market interest rate variations on reported earnings/economic values over

different time zones. Simulation technique attempts to overcome the limitations of Gap and Duration approaches by computer modelling the bank's interest rate sensitivity. Such modelling involves making assumptions about future path of interest rates, shape of yield curve, changes in business activity, pricing and hedging strategies, etc. The simulation involves detailed assessment of the potential effects of changes in interest rate on earnings and economic value. The simulation techniques involve detailed analysis of various components of on-and off-balance sheet positions. Simulations can also incorporate more varied and refined changes in the interest rate environment, ranging from changes in the slope and shape of the yield curve and interest rate scenario derived from Monte Carlo simulations.

The output of simulation can take a variety of forms, depending on users' need. Simulation can provide current and expected periodic gaps, duration gaps, balance sheet and income statements, performance measures, budget and financial reports. The simulation model provides an effective tool for understanding the risk exposure under variety of interest rate/balance sheet scenarios. This technique also plays an integral-planning role in evaluating the effect of alternative business strategies on risk exposures.

The simulation can be carried out under static and dynamic environment. While the current on and off-balance sheet positions are evaluated under static environment, the dynamic simulation builds in more detailed assumptions about the future course of interest rates and the unexpected changes in bank's business activity.

The usefulness of the simulation technique depends on the structure of the model, validity of assumption, technology support and technical expertise of banks.

The application of various techniques depends to a large extent on the quality of data and the degree of automated system of operations. Thus, banks may start with the gap or duration gap or simulation techniques on the basis of availability of data, information technology and technical expertise. In any case, as suggested by RBI in the guidelines on ALM System, banks should start estimating the interest rate risk exposure with the help of Maturity Gap approach. Once banks are comfortable with the Gap model, they can progressively graduate into the sophisticated approaches.

z) Funds Transfer Pricing

The Transfer Pricing mechanism being followed by many banks does not support good ALM Systems. Many international banks which have different products and operate in various geographic markets have been using internal Funds Transfer Pricing (FTP). FTP is an internal measurement designed to assess the financial impact of uses and sources of funds and can be used to evaluate the profitability. It can also be used to isolate returns for various risks assumed in the intermediation process. FTP also helps correctly identify the cost of opportunity value of funds. Although banks have adopted various FTP frameworks and techniques, Matched Funds Pricing (MFP) is the most efficient technique. Most of the international banks use MFP. The FTP envisages assignment of specific assets and liabilities to various functional units (profit centres) – lending, investment, deposit taking and funds management. Each unit attracts sources and uses of funds. The lending, investment and



deposit taking profit centres sell their liabilities to and buys funds for financing their assets from the funds management profit centre at appropriate transfer prices. The transfer prices are fixed on the basis of a single curve (MIBOR or derived cash curve, etc) so that asset-liability transactions of identical attributes are assigned identical transfer prices. Transfer prices could, however, vary according to maturity, purpose, terms and other attributes.

The FTP provides for allocation of margin (franchise and credit spreads) to profit centres on original transfer rates and any residual spread (mismatch spread) is credited to the funds management profit centre. This spread is the result of accumulated mismatches. The margins of various profit centres are:

aa) Deposit Profit Centre:

Transfer Price (TP) on deposits-cost of deposits-deposit insurance- overheads.

ab) Lending Profit Centre:

Loan yields + TP on deposits-TP on loan financing-Cost of Deposits-Deposit Insurance-overheads-loan loss provisions.

ac) Investment Profit Centre:

Security yields + TP on deposits-TP on security financing-Cost of Deposits-Deposit Insurance -Overheads-Provisions for depreciation in investments and loan loss.

ad) Funds Management Profit Centre:

TP on funds lent-TP on funds borrowed-Statutory Reserves cost – overheads.

For illustration, let us assume that a bank's Deposit profit centre has raised a 3-month deposit @ 6.5% p.a. and that the alternative funding cost i.e., MIBOR for 3 months and one year @ 8% and 10.5% p.a., respectively. Let us also assume that the bank's Loan profit centre created a one-year loan @ 13.5% p.a. The franchise (liability), credit and mismatch spreads of bank is as under:

	Profit Centres			Total
	Deposit	Funds	Loan	
Interest Income	8.0	10.5	13.5	13.5
Interest Expenditure	6.5	8.0	10.5	6.5
Margin	1.5	2.5	3.0	7.0
Loan Loss Provision (expected)	-	-	1.0	1.0
Deposit Insurance	0.1	-	-	0.1
Reserve Cost (CRR/ SLR)	-	1.0	-	1.0
Overheads	0.6	0.5	0.6	1.7
NII	0.8	1.0	1.4	3.2

Under the FTP mechanism, the profit centres (other than funds management) are precluded from assuming any funding mismatches and thereby exposing them to market risk. The credit or counterparty and price risks are, however, managed by these profit centres. The entire market risks, i.e., interest rate, liquidity and forex are assumed by the funds management profit centre.

The FTP allows lending and deposit raising profit centres determine their expenses and price their products competitively. Lending profit centre which knows the carrying cost of the loans needs to focus on to price only the spread necessary to compensate the perceived credit risk and operating expenses. Thus, FTP system could effectively be used as a way to centralise the bank's overall market risk at one place and would support an effective ALM modelling system. FTP also could be used to enhance corporate communication; greater line management control and solid base for rewarding line management.

ee) Foreign Exchange (Forex) Risk

The risk inherent in running open foreign exchange positions have been heightened in recent years by the pronounced volatility in forex rates, thereby adding a new dimension to the risk profile of banks' balance sheets.

Forex risk is the risk that a bank may suffer losses as a result of adverse exchange rate movements during a period in which it has an open position, either spot or forward, or a combination of the two, in an individual foreign currency. The banks are also exposed to interest rate risk, which arises from the maturity mismatching of foreign currency positions.

Even in cases where spot and forward positions in individual currencies are balanced, the maturity pattern of forward transactions may produce mismatches. As a result, banks may suffer losses as a result of changes in premia/discounts of the currencies concerned.

In the forex business, banks also face the risk of default of the counterparties or settlement risk. While such type of risk crystallisation does not cause principal loss, banks may have to undertake fresh transactions in the cash/spot market for replacing the failed transactions. Thus, banks may incur replacement cost, which depends upon the currency rate movements. Banks also face another risk called time-zone risk or Herstatt risk which arises out of time-lags in settlement of one currency in one centre and the settlement of another currency in another time zone. The forex transactions with counterparties from another country also trigger sovereign or country risk.

i. Forex Risk Management Measures

1. Set appropriate limits-open positions and gaps.
2. Clear-cut and well-defined division of responsibility between front, middle and back offices.

The top management should also adopt the VaR approach to measure the risk associated



with exposures. Reserve Bank of India has recently introduced two statements viz. Maturity and Position (MAP) and Interest Rate Sensitivity (SIR) for measurement of forex risk exposures. Banks should use these statements for periodical monitoring of forex risk exposures.

ff) Capital for Market Risk

The Basle Committee on Banking Supervision (BCBS) had issued comprehensive guidelines to provide an explicit capital cushion for the price risks to which banks are exposed, particularly those arising from their trading activities. The banks have been given flexibility to use in-house models based on VaR for measuring market risk as an alternative to a standardised measurement framework suggested by Basle Committee. The internal models should, however, comply with quantitative and qualitative criteria prescribed by Basle Committee.

Reserve Bank of India has accepted the general framework suggested by the Basle Committee. RBI has also initiated various steps in moving towards prescribing capital for market risk. As an initial step, a risk weight of 2.5% has been prescribed for investments in Government and other approved securities, besides a risk weight each of 100% on the open position limits in forex and gold. RBI has also prescribed detailed operating guidelines for Asset-Liability Management System in banks. As the ability of banks to identify and measure market risk improves, it would be necessary to assign explicit capital charge for market risk. In the meanwhile, banks are advised to study the Basle Committee's paper on 'Overview of the Amendment to the Capital Accord to Incorporate Market Risks'. While the small banks operating predominantly in India could adopt the standardised methodology, large banks and those banks operating in international markets should develop expertise in evolving internal models for measurement of market risk.

The Basle Committee on Banking Supervision proposes to develop capital charge for interest rate risk in the banking book as well for banks where the interest rate risks are significantly above average ('outliers'). The Committee is now exploring various methodologies for identifying 'outliers' and how best to apply and calibrate a capital charge for interest rate risk for banks. Once the Committee finalises the modalities, it may be necessary, at least for banks operating in the international markets to comply with the explicit capital charge requirements for interest rate risk in the banking book.

gg) Operational Risk

Managing operational risk is becoming an important feature of sound risk management practices in modern financial markets in the wake of phenomenal increase in the volume of transactions, high degree of structural changes and complex support systems. The most important type of operational risk involves breakdowns in internal controls and corporate governance. Such breakdowns can lead to financial loss through error, fraud, or failure to perform in a timely manner or cause the interest of the bank to be compromised.

Generally, operational risk is defined as any risk, which is not categorised as market or credit risk, or the risk of loss arising from various types of human or technical error. It is also synonymous with settlement or payments risk and business interruption, administrative and legal risks. Operational risk has some form of link between credit and market risks. An operational problem with a business transaction could trigger a credit or market risk.

i. Measurement

There is no uniformity of approach in measurement of operational risk in the banking system. Besides, the existing methods are relatively simple and experimental, although some of the international banks have made considerable progress in developing more advanced techniques for allocating capital with regard to operational risk.

Measuring operational risk requires both estimating the probability of an operational loss event and the potential size of the loss. It relies on risk factor that provides some indication of the likelihood of an operational loss event occurring. The process of operational risk assessment needs to address the likelihood (or frequency) of a particular operational risk occurring, the magnitude (or severity) of the effect of the operational risk on business objectives and the options available to manage and initiate actions to reduce/ mitigate operational risk. The set of risk factors that measure risk in each business unit such as audit ratings, operational data such as volume, turnover and complexity and data on quality of operations such as error rate or measure of business risks such as revenue volatility, could be related to historical loss experience. Banks can also use different analytical or judgmental techniques to arrive at an overall operational risk level. Some of the international banks have already developed operational risk rating matrix, similar to bond credit rating. The operational risk assessment should be bank-wide basis and it should be reviewed at regular intervals. Banks, over a period, should develop internal systems to evaluate the risk profile and assign economic capital within the RAROC framework.

In the absence any sophisticated models, banks could evolve simple benchmark based on an aggregate measure of business activity such as gross revenue, fee income, operating costs, managed assets or total assets adjusted for off-balance sheet exposures or a combination of these variables.

ii. Risk Monitoring

The operational risk monitoring system focuses, *inter alia*, on operational performance measures such as volume, turnover, settlement facts, delays and errors. It could also be incumbent to monitor operational loss directly with an analysis of each occurrence and description of the nature and causes of the loss.



iii. Control of Operational Risk

Internal controls and the internal audit are used as the primary means to mitigate operational risk. Banks could also explore setting up operational risk limits, based on the measures of operational risk. The contingent processing capabilities could also be used as a means to limit the adverse impacts of operational risk. Insurance is also an important mitigator of some forms of operational risk. Risk education for familiarising the complex operations at all levels of staff can also reduce operational risk.

iv. Policies and Procedures

Banks should have well defined policies on operational risk management. The policies and procedures should be based on common elements across business lines or risks. The policy should address product review process, involving business, risk management and internal control functions.

v. Internal Control

One of the major tools for managing operational risk is the well-established internal control system, which includes segregation of duties, clear management reporting lines and adequate operating procedures. Most of the operational risk events are associated with weak links in internal control systems or laxity in complying with the existing internal control procedures.

The ideal method of identifying problem spots is the technique of self-assessment of internal control environment. The self-assessment could be used to evaluate operational risk along with internal / external audit reports / ratings or RBI inspection findings. Banks should endeavour for detection of operational problem spots rather than their being pointed out by supervisors/internal or external auditors.

Along with activating internal audit systems, the Audit Committees should play greater role to ensure independent financial and internal control functions.

The Basle Committee on Banking Supervision proposes to develop an explicit capital charge for operational risk.

hh) Risk Aggregation and Capital Allocation

Most of internally active banks have developed internal processes and techniques to assess and evaluate their own capital needs in the light of their risk profiles and business plans. Such banks take into account both qualitative and quantitative factors to assess economic capital. The Basle Committee now recognises that capital adequacy in relation to economic risk is a necessary condition for the long-term soundness of banks. Thus, in

addition to complying with the established minimum regulatory capital requirements, banks should critically assess their internal capital adequacy and future capital needs on the basis of risks assumed by individual lines of business, product, etc. As a part of the process for evaluating internal capital adequacy, a bank should be able to identify and evaluate its risks across all its activities to determine whether its capital levels are appropriate.

Thus, at the bank's Head Office level, aggregate risk exposure should receive increased scrutiny. To do so, however, it requires the summation of the different types of risks. Banks, across the world, use different ways to estimate the aggregate risk exposures. The most commonly used approach is the Risk Adjusted Return on Capital (RAROC). The RAROC is designed to allow all the business streams of a financial institution to be evaluated on an equal footing. Each type of risks is measured to determine both the expected and unexpected losses using VaR or worst-case type analytical model. Key to RAROC is the matching of revenues, costs and risks on transaction or portfolio basis over a defined time period. This begins with a clear differentiation between expected and unexpected losses. Expected losses are covered by reserves and provisions and unexpected losses require capital allocation which is determined on the principles of confidence levels, time horizon, diversification and correlation. In this approach, risk is measured in terms of variability of income. Under this framework, the frequency distribution of return, wherever possible is estimated and the Standard Deviation (SD) of this distribution is also estimated. Capital is thereafter allocated to activities as a function of this risk or volatility measure. Then, the risky position is required to carry an expected rate of return on allocated capital, which compensates the bank for the associated incremental risk. By dimensioning all risks in terms of loss distribution and allocating capital by the volatility of the new activity, risk is aggregated and priced.

The Second approach is similar to the RAROC, but depends less on capital allocation and more on cash flows or variability in earnings. This is referred to as EaR, when employed to analyse interest rate risk. Under this analytical framework also frequency distribution of returns for any one type of risk can be estimated from historical data. Extreme outcome can be estimated from the tail of the distribution. Either a worst-case scenario could be used or Standard Deviation $1 / 2 / 2.69$ could also be considered. Accordingly, each bank can restrict the maximum potential loss to certain percentage of past / current income or market value. Thereafter, rather than moving from volatility of value through capital, this approach goes directly to current earnings implications from a risky position. This approach, however, is based on cash flows and ignores the value changes in assets and liabilities due to changes in market interest rates. It also depends upon a subjectively specified range of the risky environments to drive the worst-case scenario.

Given the level of extant risk management practices, most of Indian banks may not be in a position to adopt RAROC framework and allocate capital to various businesses units on the basis of risk.



Summary

Due to the large size of some banks, overexposure to risk can cause bank failure and impact millions of people. By understanding the risks posed to banks, governments can set better regulations to encourage prudent management and decision-making. The ability of a bank to manage risk also affects investors' decisions. Even if a bank can generate large revenues, lack of risk management can lower profits due to losses on loans. Value investors are more likely to invest in a bank that is able to provide profits and is not at an excessive risk of losing money.

The Basel III rule introduced several measures to strengthen the capital requirement of banks across the globe and presented more capital buffers to supplement the risk-based minimum capital requirements. This is to ensure that adequate funding is maintained in case there are other severe banking crises. The Reserve Bank of India introduced Basel III norms in India in 2003 and aims to bring in all commercial banks by March 2019. In India, lenders have to adhere to these regulations by March 2019.

Compared to Basel II frame work, the Basel III framework prescribes more of common equity, creation of capital buffer, introduction of Leverage Ratio, Introduction of Liquidity coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The Basel III rule introduced the following measures to strengthen the capital requirement and introduced more capital buffers. The capital norms recommend Capital Adequacy ratio (CAR) be increased to 8 per cent internationally, while in India it is 9 per cent. CAR is a ratio of a bank's capital to its risk. Out of the 9 per cent of CAR, 7 per cent has to be met by Tier 1 capital while the remaining 2 per cent by Tier 2 capital. So, if the bank has risky assets worth Rs.100, it needs to have Tier 1 capital worth ₹7/-. This capital can be easily used to raise funds in times of troubles.

- i. **Creation of capital buffer:** In addition, banks also have to hold an additional buffer of 2.5 per cent of risky assets known as Capital Conservation Buffer which is designed to absorb losses during periods of financial and economic stress. The capital conservation buffer must be met exclusively with common equity. Financial institutions that do not maintain the capital conservation buffer faces restrictions on pay-outs of dividends, share buybacks, and bonuses. In addition to the above,
- ii. **Countercyclical buffers:** Counter cyclical buffer is another support system for Capital Conservation Buffer recommended by BASLE- III on the basis of weighted average of capital conservation buffer built up in earlier years. The Countercyclical Capital Buffer is within a range of 0% and 2.5% of common equity or other fully loss absorbing capital which may be implemented according to national circumstances. This buffer serves as an extension to the capital conservation buffer.



- iii. **Leverage ratio:** The leverage ratio is calculated by dividing Tier 1 capital by the bank's average total consolidated assets; the banks were expected to maintain a leverage ratio in excess of 3% under Basel III. The new leverage ratio is a non-risk-based measure to supplement the risk-based minimum capital requirements. This is to ensure that adequate funding is maintained in case there are other severe banking crises.
- iv. **Liquidity Coverage Ratio:** The liquidity coverage ratio (LCR) signifies to highly liquid assets held by financial institutions to meet short-term obligations. The ratio is a generic stress test that aims to anticipate market-wide shocks. The LCR is a requirement under Basel III for a bank to hold high-quality liquid assets (HQLAs) sufficient to cover 100% of its stressed net cash requirements over 30 days. The LCR is calculated as: $LCR = \frac{HQLAs}{Net\ cash\ outflows}$. **Net stable funding (NSF):** The net stable funding is to ensure that banks maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.

Annexure - III

Entities Regulated by Reserve Bank of India and Applicable Regulations:

There is no common 'Risk Based Internal Audit Specimen' due to variety of 'Business Models' Registered as NBFC with Reserve Bank of India.

RBIA Templet to be developed by NBFCs based on Products Selling to their Customers, its Processes and Nature of Risk involved in Business Process etc.

However, we have enclosed a Specimen of RBIA of both Commercial Banks / UCBs as Annexures.

Different "Business Models" of Non-banking Finance Companies-NBFCs:

- ❖ Asset Finance Company (AFC).
- ❖ Infrastructure Finance Company (IFC).
- ❖ Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI).
- ❖ Non-Banking Financial Company-Factors (NBFC-Factors).
- ❖ Leasing and Hire Purchase Companies.
- ❖ Investment Company (IC).
- ❖ Loan Company (LC).
- ❖ Systemically Important Core Investment Company (CIC-ND-SI).
- ❖ Infrastructure Debt Fund.
- ❖ Mortgage Guarantee Companies (MGC).
- ❖ NBFC-Non-Operative Financial Holding Company (NOFHC).

Different Types of Co-operative Banks:

- ❖ Central Cooperative Banks (CCBs) at the District Level.
- ❖ State Cooperative Banks (StCBs) at the State Level.
- ❖ Primary Co-operative Banks (PCBs), also referred to as Urban Co-operative Banks (UCBs), cater to the financial needs of Customers in Urban and Semi-urban Areas.



Different Types / Categories of NBFCs Registered with RBI as:

- (a) In terms of the type of liabilities into Deposit and Non-Deposit accepting NBFCs.
- (b) Non-deposit taking NBFCs by their size into systemically important and other non-deposit holding companies (NBFC-NDSI and NBFC-ND) and
- (c) By the kind of activity, they conduct. Within this broad categorization the different types of NBFCs are as follows:
 - I. **Asset Finance Company (AFC):** An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/ economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipment, moving on own power and general-purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real / physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.
 - II. **Investment Company (IC):** IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.
 - III. **Loan Company (LC):** LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.
 - IV. **Infrastructure Finance Company (IFC):** IFC is a non-banking finance company
 - (a) Which deploys at least 75 per cent of its total assets in infrastructure loans.
 - (b) Has a minimum Net Owned Funds of ₹300 crore.
 - (c) Has a minimum credit rating of 'A 'or equivalent.
 - (d) And a CRAR of 15%.
 - V. **Systemically Important Core Investment Company (CIC-ND-SI):** CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:
 - (a) It holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies.
 - (b) Its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets.
 - (c) It does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment.



- (d) It does not carry on any other financial activity referred to in Section 45l(c) and 45l(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
- (e) Its asset size is $\geq$ 100 Crores or above and
- (f) It accepts public funds.

VI. Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC): IDF-NBFC is a company registered as NBFC to facilitate the flow of long-term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5-year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.

VII. Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI): NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:

- (a) Loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding ₹1,00,000 or urban and semi-urban household income not exceeding ₹1,60,000.
- (b) Loan amount does not exceed ₹50,000 in the first cycle and ₹1,00,000 in subsequent cycles.
- (c) Total indebtedness of the borrower does not exceed ₹1,00,000.
- (d) Tenure of the loan not to be less than 24 months for loan amount in excess of ₹15,000 with prepayment without penalty.
- (e) Loan to be extended without collateral.
- (f) Aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs.
- (g) Loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower.

VIII. Non-Banking Financial Company-Factors (NBFC-Factors): NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

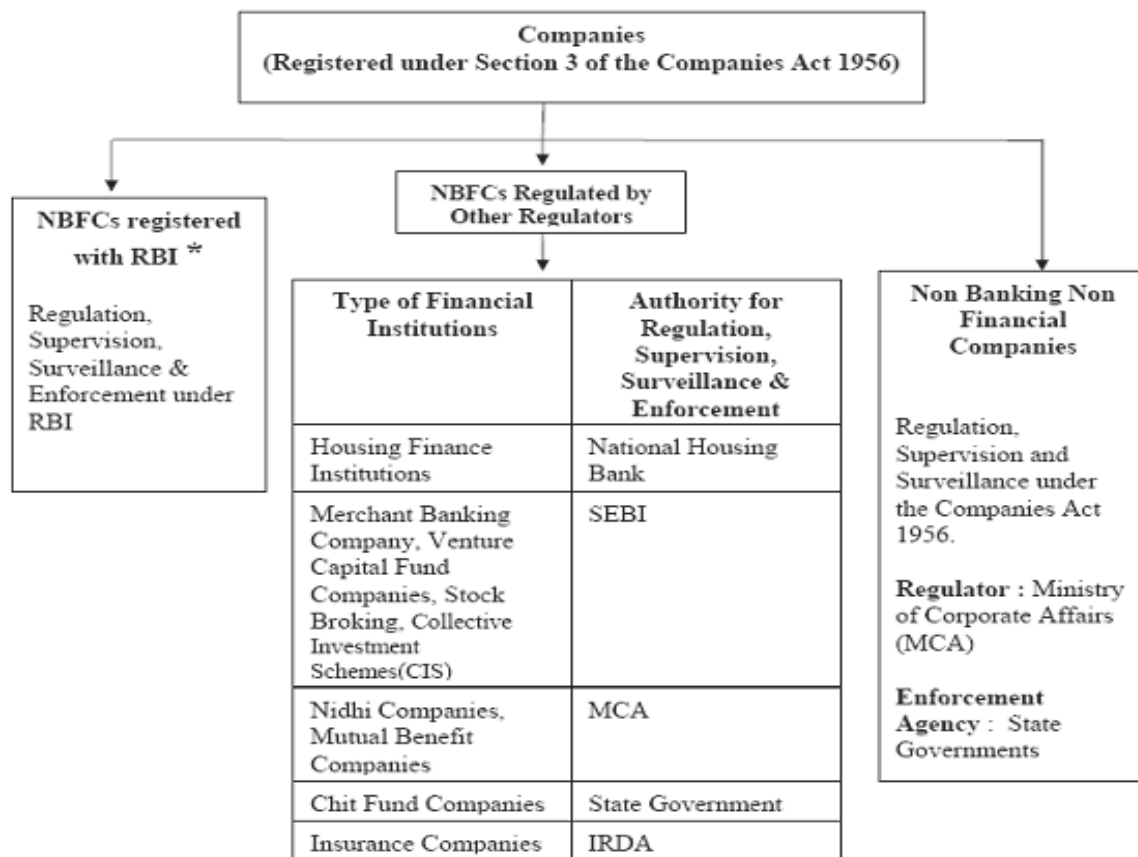
IX. Mortgage Guarantee Companies (MGC): MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is ₹100 crore.

X. NBFC-Non-Operative Financial Holding Company (NOFHC): NOFHC is financial institution through which promoter / promoter groups will be permitted to set up a

new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

CHART - I

Overview of Regulators of Non-Banking Companies

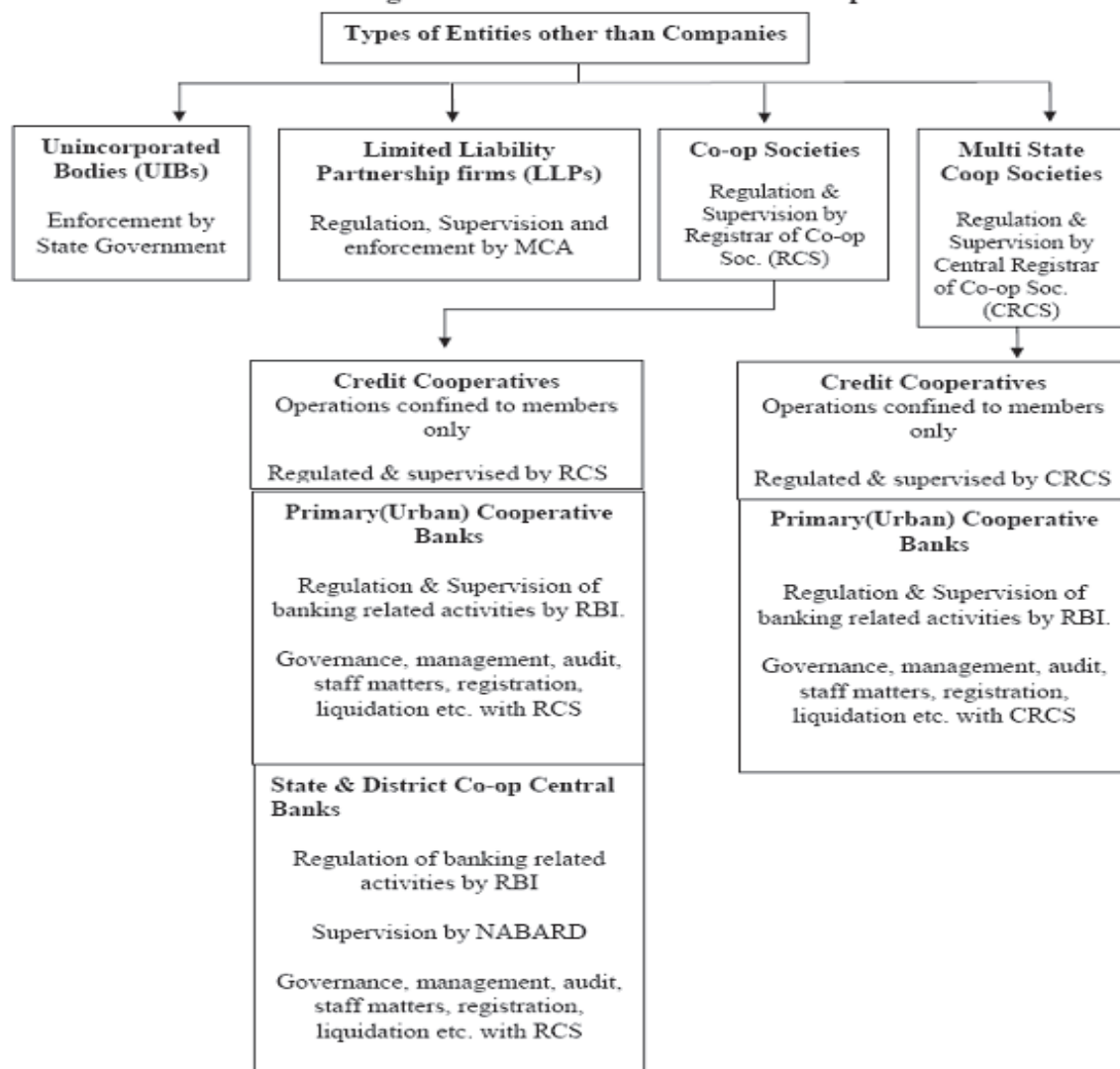


* NBFC is a financial Institution that is into Lending or Investment or collecting monies under any scheme or arrangement but does not include any institutions which carry on its principal business as agriculture activity, industrial activity, trading and purchase or sale of immovable properties. A company that carries on the business of accepting deposits as its principal business is also a NBFC.



CHART II

Overview of Regulators of Entities other than Companies



Reserve Bank Regulate Financial Companies – NBFCs / HFCs:

Housing Finance Companies, Merchant Banking Companies, Stock Exchanges, Companies engaged in the business of stock-broking / sub-broking, Venture Capital Fund Companies, Nidhi Companies, Insurance Companies and Chit Fund Companies are NBFCs but they have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions.

Housing Finance Companies are regulated by National Housing Bank, Merchant Banker / Venture Capital Fund Company/stock-exchanges/stock brokers/sub-brokers are regulated by Securities and Exchange Board of India, and Insurance companies are regulated by



Insurance Regulatory and Development Authority. Similarly, Chit Fund Companies are regulated by the respective State Governments and Nidhi Companies are regulated by Ministry of Corporate Affairs, Government of India. Companies that do financial business but are regulated by other regulators are given specific exemption by the Reserve Bank from its regulatory requirements for avoiding duality of regulation.

Mortgage Guarantee Companies have been notified as Non-Banking Financial Companies under Section 45 I(f)(iii) of the RBI Act, 1934. Core Investment Companies with asset size of less than ₹100 crore, and those with asset size of ₹100 Crores and above but not accessing public funds are exempted from registration with the RBI.

Systemically important NBFCs:

NBFCs whose Asset Size is of ₹500 Crores or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability of the overall economy.

Regulating Co-operative Banking – Reserve Bank of India:

The Rural Co-operative Credit System in India is Primarily mandated to ensure flow of Credit to the Agriculture Sector. It comprises Short-term and Long-term Co-operative Credit Structures. The Short-term Co-operative Credit structure operates with a Three-tier system –

- Primary Agricultural Credit Societies (PACS) at the Village Level.
- Central Cooperative Banks (CCBs) at the District Level and
- State Cooperative Banks (StCBs) at the State Level.

PACS are outside the purview of the Banking Regulation Act, 1949 and hence not regulated by the Reserve Bank of India.

StCBs / DCCBs are registered under the provisions of State Cooperative Societies Act of the State concerned and are regulated by the Reserve Bank. Powers have been delegated to National Bank for Agricultural and Rural Development (NABARD) under Sec 35 (6) of the Banking Regulation Act (As Applicable to Co-operative Societies) to conduct inspection of State and Central Cooperative Banks.

Primary Co-operative Banks (PCBs), also referred to as Urban Co-operative Banks (UCBs), cater to the financial needs of customers in Urban and Semi-urban Areas. UCBs are Primarily Registered as Co-operative Societies under the provisions of either the State Co-operative Societies Act of the State concerned or the Multi State Co-operative Societies Act, 2002 if the area of operation of the Bank extends beyond the boundaries of One State. The Sector is heterogeneous in character with uneven geographic spread of the Banks. While many of them are unit Banks without any Branch Network, some of them are Large in Size and operate in more than One State.

**Dual Control:**

Though the Banking Regulation Act came in to force in 1949, the Banking Laws were made applicable to Co-operative Societies only in 1966 through an amendment to the Banking Regulation Act, 1949. Since then, there is duality of control over these banks with Banking related functions being regulated by the Reserve Bank and Management related functions regulated by respective State Governments / Central Government.

The Reserve Bank regulates the Banking functions of StCBs/DCCBs/UCBs under the provisions of Sections 22 and 23 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies (AACs)).

Convergence between Regulation & Supervision:

As part of the arrangements under MoU, the Reserve Bank constitutes a State-level Task Force for Co-operative Urban Banks (TAFUCB) for UCBs which operate only in one State. A Central TAFUCB is constituted for the Multi-State UCBs. TAFUCBs bring all the Decision-makers with regard to UCBs on one table, thus facilitating quick decision-making. TAFUCBs identify potentially Viable and Non-viable UCBs in the states and suggest revival path for the viable and Non-disruptive exit route for the Non-viable ones. The exit of Non-viable Banks could be through Merger / Amalgamation with Stronger Banks, conversion into Societies or Liquidation as the last option.

The State Governments / Central Governments may, for instance, through the MoU, agree to take immediate action on requisitions of the Reserve Bank for supersession of the Board of Directors, Appointment of Liquidators, initiating action for removal of CEO / Chairman of a Bank, enhancing quality of HR and IT resources in the Banks on the lines required by the Reserve Bank, work to raise the Standards of Corporate Governance by putting in place certain minimum fit and proper criteria for members to be eligible for seeking election for the post of Director, Institute Special Audit by Chartered Accountants and furnish reports of the findings within a given time frame, introduce Long Form Audit Reports for conducting Statutory Audit, modify its Audit Rating Models to bring it on par with the Rating System of the Reserve Bank and Conduct Statutory Audit only through External Chartered Accountants in respect of Banks with Deposits over a Specified Minimum Level.

The Department of Co-operative Bank Regulation (DCBR) regulates State Co-operative Banks (StCBs), District Central Co-operative Banks (DCCBs) and Urban Cooperative Banks (UCBs).



Risk Based Internal Audit – NBFCs / UCBs / HFCs:

The Internal Auditing Structures, Procedures, and Practices followed by various types of Banks, such as Public Sector Banks, Private Sector Banks, International Banks, and Urban Co-operative Banks, are Substantially Different in India.

As a result of Non-standardized Internal Auditing Systems in the Banking Sector, the Quality of Internal Audit Supervision and Board Reporting has been affected.

RBI released guidelines on **3 February 2021** vide Circular Ref. No. DoS.CO.PPG./SEC.05/11.01.005/2020-21 to introduce uniformity in the methodology taken by the Banks, as well as to match the expectations on internal audit function with the worldwide best practices to all Non-deposit receiving **Non-Banking Financial Companies (NBFCs) with asset size of ₹5,000 Crores and above**, to all NBFCs taking Deposit regardless of their Asset Size and to all main **Urban Cooperative Banks (UCBs) with Asset Size of ₹500 Crores and above** on the subject of Internal Risk-Based Audit (RBIA).

RBI asked NBFCs and UCBs to create a committee of senior executives responsible for formulating an appropriate action plan to ensure a seamless transition from the Current Method of Internal Audit to RBIA and requested that the committee discuss transitional aspects of change management and report directly to the Board and Senior Management on a regular basis.

According to RBI the last date for implementing this framework is 31, MARCH 2022.

Risk Based Internal Audit (RBIA) – NBFCs / UCBs / HFCs:

RBIA: Risk Based Internal Audit (RBIA) is an Audit Methodology that incorporates an overall Risk Management structure for an Organisation, providing assurance on the Consistency and Efficiency of the Internal Controls, Management of Risks, and Systems and Processes related to Governance to the Board of Directors and the Senior Management.

In addition to transaction testing which can enable organisations to Avoid and Reduce Risks, the Internal Audit System will also Review Risk Management Processes and Control Protocols for **NBFC and UCB**.

Including Core elements of RBIA as proposed by RBI:

- ❖ For the purposes of formulating a Risk-based Audit Strategy, the Internal Audit shall conduct an Independent Risk Assessment. This Risk Assessment, as well as similar procedures, will cover Risks at Multiple Levels / Areas (Corporate and Branch, Portfolio and Individual Transactions, etc.). The Internal Audit Department's Risk Assessment should be used to concentrate on the areas of Material Risk and to prioritise Audit Work.
- ❖ The Risk Assessment process should include, among other aspects, the detection of inherent business risks in the different operations performed, the assessment of the efficacy of the control mechanisms for controlling the inherent Risks of Business activities and the creation of a Risk Index for both Variables, i.e., Inherent Business Risks and Control Risks.



- ❖ Both Quantitative and Qualitative Methods can be used for Risk Assessment. Although Quantitative Evaluation may primarily evaluate the Quantity of Credit, Competition and Operating Risks, a Qualitative Approach may be followed to measure the Consistency of overall Governance and Controls in different Business Operations.
- ❖ The Risk Assessment Methodology should include, inter alia, factors such as:
 - Past Internal Audit findings and Compliance.
 - Potential Improvements in Business Lines or Shifts of Focus.
 - Major Changes in Management / Key Staff.
 - Regulatory Audit Report Results.
 - External Audit Reporting.
 - Market Dynamics and other Environmental Factors.
 - Time Elapsed since Last Audit Reporting.
 - The Scale of Business and the Complexity of Activities.
 - Significant differences in Budget Performance; and
 - The Entity's Business Plan with respect to Risk Appetite and Adequacy of Regulation.
- ❖ It would be necessary to provide adequate MIS and Data Integrity arrangements for the Risk Assessment to be reliable. All Trends, such as the launch of New Products, improvements in reporting lines, changes in Accounting Practices / Policies, etc, should be kept aware of the Internal Audit feature. Invariably, the Risk Assessment should be performed on an Annual Basis. In order to consider improvements in the Market Environment, operations and work practices, etc., the Evaluation should also be regularly revised.
- ❖ To meet the Goals of the Audit Task, the Complexity of the audit and the Distribution of Resources should be Appropriate. Every SE must decide the precise Scope of the RBIA for Low, Medium, High, Very High and Extremely High-risk Areas. System and Process Assessments for all Essential Operations should also be included in the framework of the Internal Audit. It is therefore important to put the results of such Audits before the IT Committee of the Board.
- ❖ It is essential to develop the Internal Audit Report on accurate Analysis and Evaluation. It should bring out Adequate, Reliable, Relevant and useful information to support the observations and Conclusions. It should cover the Audit Assignment's Priorities, Scope, and Findings and make relevant recommendations and / or Action Plans.
- ❖ Both ongoing High-and Medium-Risk paras and significant anomalies should be submitted to the ACB / Board in order to identify main areas where, despite Risk Detection, Risk Reduction has not been carried out.



- ❖ The Internal Audit Function should have a System for monitoring compliance with Internal Audit observations. An important part of Reporting to the ACB / Board should be Compliance Status.
- ❖ There will be **NO** Outsourcing of the Internal Audit Function. However, where possible, Consultants, including former Personnel, can be employed on a contractual basis, subject to the Guarantee of the ACB / Board that such experience does not exist beyond the SE's Audit Function. Any Conflict of interest in such matters is recognized and dealt with effectively. In such cases, the ownership of Audit results lies with Standard Internal Audit Functionaries.

Annexure - IV

A Brief on Risk Based Internal Audit

Financial crisis that emerged in the international markets and accounting abuses as Enron, WorldCom in the U.S.A. that brought out the need of detection of the risks that organisations will encounter in the future and the management of these risks.

Organisations to use Risk Management as an auxiliary tool in order to reach the stated targets raised management's expectation about adding value of **Internal Auditing**. Risk Based Internal Auditing which is the present latest stage of internal auditing and which brings to create achievement that having expected from Internal Auditing place the retrospective point of view the conventional control mentality on one side and had focused on Risks that Organisations will encounter.

Risk findings obtained as a result of Risk Assessment Studies constitute an important support to Internal Auditors at the stage designing of planning.

Risk Based Internal Audit Mechanics:

1. To drive the risk management processes in an objective manner a metric for measuring risk significance and a statement of risk appetite delineating the risk to be considered significant and therefore to be managed would be essential.
2. Under RBIA framework inherent risks facing the entity are measured before application of internal control in place and then it would be compared with the residual risks after application of the control. The controls would be considered effective if the residual risk is found to be lower than the risk appetite as set by the Board.
3. Thus, the most significant outcome of the RBIA function is an independent and objective opinion to an organization's Board and management as to whether its internal controls are effective and adequate in managing its risks to acceptable levels (risk tolerance). Risk Based Internal Audit Mechanics is shown in diagram 1.

Diagram-1

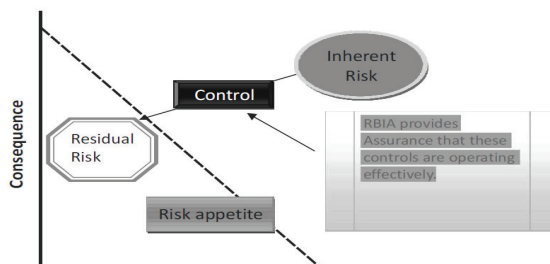
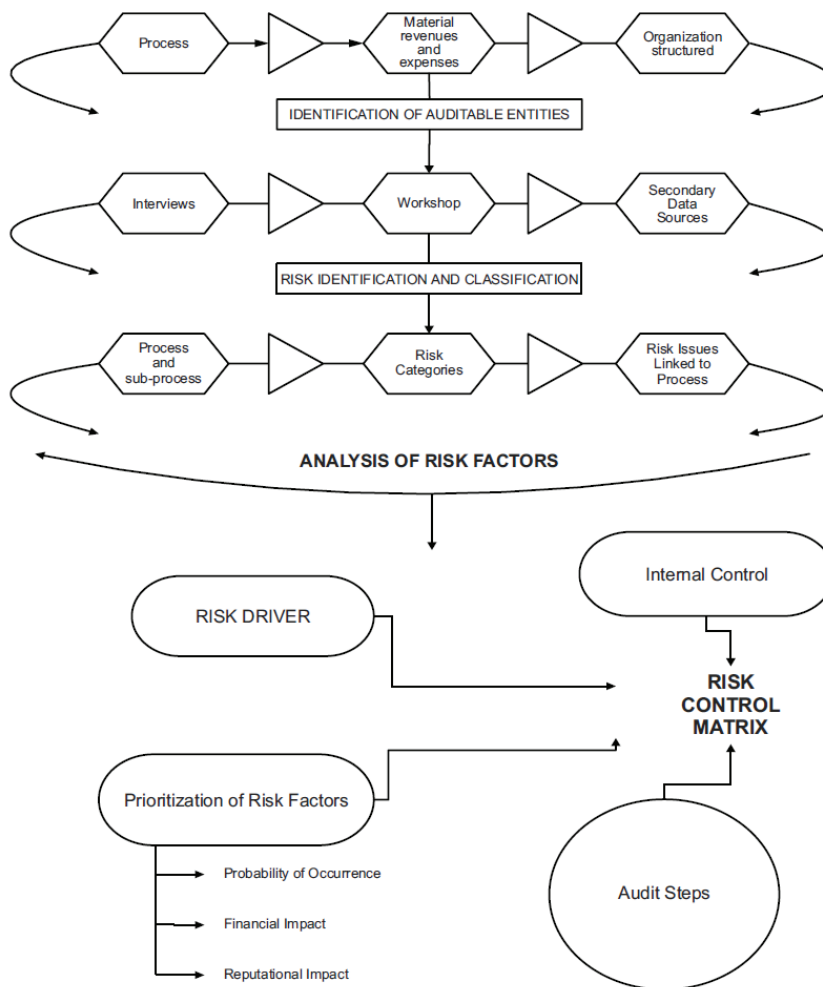


Diagram-2

Risk Based Internal Audit Cycle

The audit cycle has been depicted in the diagram 2



The Internal Audit and Risk Management activities which were the two concepts that are considered independently of each other in the past are becoming to enter into interaction with each other and use each other's outcomes intensely now-a-days. For this reason, in many organisations, the Internal Audit adopts a Risk-based Approach and Internal Audit plans are developed in this framework.

Risk-based Internal Auditing, is an Audit approach based on the basis of the determination of Risk status of Enterprise, the Audit Process in accordance with the Risk status of Enterprise and to allocate Audit resources accordingly and is aimed at the Audit Efficiency.

With Risk-based approach to Internal audit's perspective on Risk and Audits changed and Internal Auditors have been offered an opportunity to create more value.

Annexure - V

A Specimen of RBIA Format for Co-operative Banks

Note: Readers are to be Noted that this a '**Specimen / Model** RBIA Report' – So far, no 'Standard Report' defined by Regulator in this regard.

Based on the Types of Bank Products / Business / Transactions etc. and its Risks. Banks are developed on their own Formats. Hence, it will differ different types of Co-operative Banks (This is due to variety of Deposit / Advance / Miscellaneous Products offered by the Co-operative Banks and its Process).

Following Specimen of RBIA Covers Broadly the Common Areas of Risks in Co-operative Banks' Business / Transactions / Products etc.

Risk Based Internal Audit Report

EXECUTIVE SUMMARY

Branch Code		Classification	
Branch Name		Category	
		Date of Opening	

Details of Present / Previous Branch Managers:

Name of the Present Manager					
Code No:		Grade:		FROM	TO
Name of the Previous Manager:					
Code No:		Grade:		FROM	To DATE
Date of Inspection:				FROM	To DATE
Name of the Inspector:					



KEY PERFORMANCE INDICATORS.

(₹ in lakhs)

Particulars	Last FY	This FY	Difference	Remarks
Total Business				
Deposits: Target				
Actuals				
% Of growth				

3. Low-cost deposits	Last FY	This FY	Difference	Remarks
Current Deposits				
Savings Deposits				
Term Deposits				
Total				
% To total deposits				
4. Deposit Mix (CD:SB:TD)				
6. Advances (Fund Based)				
Gold Loans				
Mortgage Loans/Project Loans				
Over draft a/c's				
Small Business Loans				
Swagruha Loans (Housing)				
Other loans				
Target				
Actuals				
% Of growth				
7. CD Ratio				
8. Per Employee Business				

Particulars	Last FY	This FY	Difference	Remarks
9.NPAs- As on-----				
10. Net Profit				
11. Interest income				
12. Non-Interest Income				
13. Interest Received on HO				
14. Interest Paid to Deposits				
15. Establishment Expenses				
15a.Non-Interest Expenditure				
15b. Interest paid on HO				



Brief Report on the following areas:

1. Business Development:

Deposits:

- Low-cost Deposits:
- Term Deposits:
- Per Employee Business:
- CD Ratio:

2. Credit Management:

3. Recovery Management:

4. Profitability:

5. Housing Keeping:

6. Customer Service:

7. Response to Inspection & Audit:

8. Response to Head Office (HO) Correspondence:

9. Branch Administration:

10. Information System Audit:

11. Any Special Initiative by Branch in Improving Business / Bank Image:

12. Strengths and Weakness of the Branch:

()

Inspector Signature



Details of Present / Previous Inspections:

Particulars	From	To	Man-days
Dates of Present Inspection			
Period under Review			
Dates of Previous Inspection			
Period under Review for Previous Inspection			

Details of Present / Previous Inspectors:

Name of the Inspector		
Present Inspection		
Previous Inspection		

RATINGS:

Particulars	Percentage	Rating
Risk Rating under RBIA (Present Inspection)		
Risk Rating under RBIA (Previous Inspection)		

(₹ In lakhs)

Advances	Last FY	This FY	Difference	Remarks
Target for Advances				
Total Advances (actuals)				
% Achievement of Target				
Growth in Advances - in □.				
Growth in % terms				
Average Advances (26 Reporting Fridays)				
Growth in Average Adv - %				
Priority Sector Adv - Target				
Priority Sector Adv - Actuals				
Interest earned on Advances				
Average Yield on Adv (%)				
Asset Quality	Last FY	This FY	Difference	Remarks
✓ Standard Assets				
✓ Sub Standard Advances				
✓ Doubtful Advances				
✓ Loss Assets				
Total Advances				
NPAs as % of Total Adv				
CD Ratio - Target				
CD Ratio - Actual				



(₹ In lakhs)

Particulars	Last FY	This FY	Difference	Remarks
O/B at the beginning of year				
Add: Fresh additions				
Less: Recoveries				
C/B at the end of the year				
Recoveries in NPA accounts	Last FY	This FY	Difference	Remarks
-- By Upgradation				
-- By Recovery				
-- By Compromise				
-- By Write-off				
Total recovery / reduction				

(₹ In lakhs)

Suit Filed Accounts	Last FY	This FY	Difference	Remarks
a) Total No. of Suit Filed A/cs				
b) Total Amt under S/F a/cs				
c) Of (a) above No. of a/c with DRTs				
d) Total Amt o/s in DRT cases				
e) Of (a) above No. of Decreed Debts		NIL		
f) Total amount o/s. in decreed debts				
No. of cases where provisions of Securitization Act have been invoked				
Total amt. outstanding on account of accounts where SARFAISE is invoked				
Written off accounts				
Total				
Recoveries during the current year.				

**Name of Borrowal Accounts with aggregate Limits of ₹ 50 Lakhs and above as on date of inspection**

Name of the borrower	Date of sanction	Limit	Liability	Overdue
KVR GOLDEN HOMES				----
BALA TRIPURA SUNDARY CONSTRUCTIONS				----
SAI GANESH BUILDERS				----
SYED FAKEER AHAMAD				----

(₹ In lakhs)

PROFIT & LOSS ACCOUNT	31.03.--	31.03.--	31.03.--	As on date --/--/---
Profits – Targets				
Profits – Actuals				
Interest Earned on Loans & Advs				
Interest Earned on HO Balances				
Other Income				
Total Income				
Interest paid on Deposits				
Interest paid on HO Balances				
Establishment expenses –				
All other expenses				
Total Expenses				

Revenue Leakages

(₹ In lakhs)

Revenue Leakage Detected				
Revenue Leakage Recovered				
Revenue Leakage Pending Recovery				

Lockers

(₹ In lakhs)

Total No. of Lockers available				
Total No. of Lockers allotted				
% Occupancy for Lockers				
Total overdues of Locker Rents				


Top 10 Non-Performing Assets of the Branch as the end of Previous Quarter

Sl. No	Name of the Borrower	Facility	Limit	Liability	Security / DP	Other Remarks

1. Summary of Risk Rating:

Sub-Risks (Marks in %)	Previous RBIA-Rating As on --/--/----	Current RBIA-Rating As on --/--/----
Credit Risk		
Legal Risk		
Earnings Risk		
Operational Risk		
Business Risk		
Internal Control Risk		
Compliance Risk		
Control Risk		
Overall Rating		

Applicability of Additional Riders (Based on NPA & Frauds at the Branch the Final Rating to be arrived):

Non-performing Assets	Number of Frauds & Amount	Final Rating

Risk Trend:

Movement in Risk of the Branch (Increased / Decreased)	
Reasons for Up Gradation / Down Gradation:	1. 2. 3.
Features of Risk Perception of Branch:	1. 2. 3.



Positive Features (Explain Briefly):	1. 2. 3.
Negative Features (Explain Briefly):	1. 2. 3.
Comments on High-Risk Areas (if any) and Suggestions to Mitigate the Risk.	High Risk Areas: 1. 2. 3. Suggestions to Mitigate the Risk: 1. 2. 3.

(Based on Risk Rating (For High-Risk Areas-Controllers are to be Closely Monitor the Branch)

2. Number of Irregularities Reported in RBIA:

Credit Risk: -----

Operational Risk: -----

Total: -----



2.1 Previous RBIA Details:

Date of Previous RBIA	Date of Closure	No. of Irregularities Reported in Part - 1	No. of Irregularities Reported in Part - 2	Rectification Approved by RBIA Department of the Bank (Part - 1 & its %)	Rectification Approved by RBIA Department of the Bank (Part - 2 & its %)
1	2	3	4	5	6

Balance of irregularities to be approved by RBIA Department? (Column No: 5 & 6 mentioned in the above Table)	Yes / No	
If yes, summary of un-rectified irregularities of previous RBIA:	Type of Irregularity	Number of Irregularities
Certificate of Closure of Previous Audit Report is kept on Record:	Yes / No	

2.2 Present RBIA Details:

Sl. No.	RBIA Report Part I (Credit Risk / Part II (Operational Risk)	Reported in Previous RBIA	Reported in Current RBIA	Increase / Decrease Since Last RBIA	Spot Rectification of Irregularities in Current RBIA	% Of Spot Rectification in Current RBIA (6/4%)
1	2	3	4	5 (4-3)	6	7
A						
B						
C						

3. **Special Report:** Whether any Irregularities requiring **Special Report** (Serious Irregularities in Credit and Operational Risks) are observed by Auditor and any 'Special Report' is made separately: Yes / No

If yes, the details there of:

**A. Special Report for Non-Credit Portfolio:**

Sl. No.	Short Description	Amount Involved	Report Submission Date

B. Special Report for Credit Portfolio:

Sl. No.	Name of A/c	A/c No.	Amount Involved	Report Submission Date

4. Position of Time Barred Documents:

Sl. No.	Segment (Retail / Agriculture / MSME / C&I etc.)	No. of A/cs	Amount (₹ In Lakhs)
1			
2			
3			

4.1 List of Major Time Barred Documents (Above ₹10.00 Lacs.):

Sl. No.	Name / Account Number	Outstanding Amount (In Lakhs)
1		
2		

4.2 Renewal Accounts (Working Capital A/cs) is updated in CBS: Yes / No.**5. Position of Suits Filled / Decreed Cases in Civil Courts:**

Sl. No.	Description	No. of A/cs	₹ In Lakhs
1	No. of Cases of Civil Suits / DRT / NCLT.		
2	Out Sl. No. 1 How many are Decreed / Final Order.		
3	Out of Sl. No. 2 Time Barred Decreed		

6. Position of Claim with Agriculture Insurance Company:

Sl. No.	Particulars	Eligible Cases for Revocation of Claim	Actual Cases where Claim is revoked
1			

6.1 Status of Reconciliation of A/c with other Banks:

- A. If Branch is maintaining A/cs with other Banks: Yes / No.
- B. If yes, then whether it is Reconciled & Latest details of outstanding entries is kept on record: Yes / No.
- C. Details of pending entries in reconciliation for more than 1 month with balance > ₹5,000/-



Sl. No.	Description	Pending for Reconciliation Since	Amount	Remarks for Follow-Up (In Short)
01				
02				

6.2 Administrative Accounts opened for parking funds to be remitted etc.:

A. Branch is maintaining A/cs for Parking of Funds / Parking Accounts for onward Remittance / Administrative Account: Yes / No

B. Details of pending entries in Reconciliation for more than 1 month:

Sl. No.	Description	Pending for Reconciliation Since	Amount	Remarks for Follow up (in Short)
01				

7. Pending entries in Office Accounts (System Suspense A/cs) - Summary of Pending entries involving sizable amounts and pending beyond 1 Months.

Sl. No.	Office Accounts	No. of Entries	Amount (In Lakhs.)	Remarks for Follow up (In Short) **
1	Clearing House-Credits			
2	Clearing House-Debits			
3	Interest Subvention Claims			
4	Subsidy to be Received from State / Central Government for Government Sponsored Accounts			
10	Suspense A/c (Amount Debit Fraud Case)-Not reversed.			
11	No. of ATMs System Suspense Account Entries.			

** Remarks such as No Follow up/Follow up Not Adequate/Follow-Up Adequate/Recommended for Write-off to Head Office etc. may be incorporated.

8. Outstanding Debit balances in Savings and Current Accounts:

Sl. No.	Description	No. of A/cs	Amount (In Lakhs)
1	Debit Balance in Current A/c		
2	Debit Balance in Saving A/c (Excluding sanctioned limit of Salary A/cs / Jan Dhan A/cs)		



8.1 Details of Temporary Over Draft sanctioned on Individual Basis in A/cs having Debit Balance > ₹25,000/- (Excluding Debit Balance exclusively due to Non-recovery of Minimum Balance / Cheque Return Charges and Interest thereof, Temporary Overdraft within Sanctioned Limit of Salary Loans Scheme / Jan-Dhan Yojana etc.)

Sl. No.	Name of A/c Holder	A/c No.	Amount (In Lakhs)	Documents for Temporary Overdraft on Record Yes / No	Remarks for Follow up (In Short) **

** Remarks such as No Follow up / Follow up not adequate / Follow up adequate / Recommended for Write-off to Head Office etc. may be incorporated.

9. Income Leakage:

Income Leakage detected during Audit	₹
Of which: Recovered during Audit	₹
Un-recovered Income leakage	₹

Major Area of Income Leakage:

1. Less Interest Charged on Advances:
2. Processing Charges Not Recovered:
3. Cheque Return Charges:
4. Locker Rent Not Recovered / Short Recovered:

(Please mention only Name of areas and incorporate A/c wise details)

10. Comments on Abnormal Debits in Interest (In connection with Payment of Interest on Deposits):

11. Submission / Periodicity of various Control Returns:

Particulars	Whether Submitted Regularly	Date of Last Submission
Excess / Temporary Drawing Statement		
Advances Sanctioned by Branch Manager.		
Any Other Report (Like Branch Managers Monthly Certificate etc.)		



12. Laxity, if any observed during the course of Audit in "Non-Credit Portfolio" and "General Branch Administration":

- a.
- b.
- c.

13. Observation on Compliance of KYC Norms:

- A. Deposit Portfolio:
- B. Credit Portfolio:

14. Any other irregularity, which needs to be brought to the Notice of Head Office (Other than A/cs where 'Special Report' is submitted):

(Here mention only those cases which Needs immediate attention of Controlling Office)

A. Major Irregularities / Serious Lapses for **Non-Credit Portfolio**:

Sl. No.	Short Description	Amount (In Lakhs)	Major Irregularities / Serious Lapses observed by Auditor
1			
2			

B. Major irregularities / Serious Lapses for **Credit Portfolio**:

Sl. No.	Name of A/c	A/c Number	Amount (In Lakhs)	Major Irregularities/ Serious Lapses observed by Auditor
1				
2				

15. Consolidated Irregularities of Advances Portfolio (For all Advances):

Note: Wherever the Branch **Not Implemented / Followed-up** the Bank Systems & Procedures (In respect of Advances and Non-fund-based business etc., those irregularities Number of Accounts and Amount to be mentioned in below Statement).

Sl. No.	Irregularity Description	No. of A/Cs	Amount (In. Lakhs)
	Pre-Sanction: Value Statements		
1	Applications are Completely filled in.		
2	All Primary Security and Collateral Securities are Inspected Periodically and Visit Reports Placed on Record.		



3	Credentials and Antecedents of the borrower(s) / guarantor (s) are ensured.		
4	Due Diligence carried out in Identification of the Borrower and KYC documents duly verified.		
5	'No Objection Certificate' for Creation of Charge obtained from Concerned Authorities in Applicable Cases (Builder / Housing Societies etc.).		
6	Personal Information Forms of All Borrowers along with Necessary Documents are on Record / Complete / Net worth ascertained.		
7	Personal Information Forms of All Guarantors along with Necessary Documents are on Record / Complete / Net worth ascertained.		
8	Prescribed / Standard Applications as designed by the Bank are obtained.		
9	Prescribed Documents are Obtained & Kept on Record (For Regular Sanctions + Temporary Overdraft / Excess Drawings).		
10	Prescribed Processing Charges, Documentation Charges, Inspection Charges and other Service Charges / Commission are Collected for fund based and Non-Fund-Based Limits.		
11	Quotations from Vendors are obtained.		
12	Releases are made against Original Invoice / Delivery Challans / Inspection Notes in case of Supply Bills.		
13	Renewal Application Submitted by the Borrower in Time and processed by the Bank.		
14	Scrutiny of Documents are carried out.		
15	Search / Verification of Existing Mortgage / Charge wherever required CERSAI etc.		
16	Vetting of Documents by Panel Advocate / Law Officer as per extant Guidelines. Deficiency observed by Panel Advocates if any, are Rectified.		
	Sanction: Value Statements		
1	All Sanctions within the Delegation Powers given by the Bank.		
2	Any Stipulations made in the Sanctions / Completed before disbursement of the Loan.		
	Post Sanction: Value Statements		



1	All formalities regarding Creation of Mortgage / Charge, including Pari Pasu / Second Charge is Completed.		
2	All Pre and Post release Terms and Conditions of Sanction are separately specified. The same are conveyed to the Borrower and Acknowledgement obtained.		
3	Annual Review, Mid-year Review and other Periodical Reviews are carried out in respect of Term Loans etc.		
4	Acceptance of Terms and Conditions of sanction by Borrower/s and Guarantor/s are on Record.		
5	Balance / Security Confirmation are obtained and Signature of the Borrowers / Guarantors thereon verified.		
6	Contribution of Borrower i.e., Margin is ensured while making Disbursement.		
7	Copy to Sanction Letter on record / Signed by the Sanctioning Authority.		
8	Disbursements are made as per terms of Sanction / prescribed Norms, Margin is ensured, and proper Rate of Interest is applied.		
9	Diversion of Funds, is Monitored and Steps taken to safeguard Interest of the Bank.		
10	Documents obtained are Signed by all the Parties concerned.		
11	End use of Funds is Physically Verified after Disbursement / continuous basis as per requirement.		
12	In case of Loan against Deposits, Fixed Deposit Receipts are Obtained, Duly Discharged & Charge of Lien is Registered in CBS.		
13	In case of Vehicles - Banks Hypothecation Charge is Registered with RTO and Blank Transfer Form 29 and 30 with Borrower's Signed (Owner of Vehicle) are obtained.		
14	In respect of Equitable Mortgage, Bank's Charge is Notified to Central Registry / Revenue Authority (CERSAI).		
15	In respect of Equitable Mortgage, Form-A (Confirmation of EM) is on Record.		
16	In respect of Equitable Mortgage, Original Title Deeds are held on record.		
17	In respect of loans sanctioned for Purchase of Vehicles / Articles / Machineries etc., Loan proceeds are released by Direct Payment to the Suppliers / Dealer and Documentary Evidence is held by the Bank.		



18	Notice of Intimation of Equitable Mortgage is given to Sub-Registrar within 30 days wherever applicable.		
19	Penal Interest / Additional Interest is charged for Overdue Loans etc.		
20	Renewal Premium is Remitted Well in Advance to ensure Timely Renewal of Insurance Policies and Recovered from respective Borrower (For Both Primary and Collateral Security Properties given to the Bank for the Loans & Advances).		
21	Repayment Period, Moratorium Period, Margin, Surety, Security etc. is Stipulated / Obtained as per Bank Guidelines. Deviation if any Approved / Permitted by the Competent Authority. This Information feed in CBS.		
22	Required Margins is brought in and necessary Certificates for Infusion of Margins are Obtained.		
23	Review Note Prepared & Kept on Record (including Agriculture Cash Credit Accounts).		
24	Sanctioned Limits are Opened in the CBS Properly. Information of all Fields Especially Repayment Schedule and Security Values are filled in System Correctly.		
25	Securities have been Insured for Full Value Covering all Stipulated Risks with Bank Clause.		
26	The Documents Obtained are Complete – Valid, Enforceable, Adequately Stamped and all Covenants duly Incorporated.		
27	Timely Review / Renewal / Enhancement of the Accounts Done as Stipulated.		

(Note: The Auditors may add points as per his / her observation. The details of Accounts along with Account Number and other particulars in respect of 'Irregular Accounts' Statement is to **attached to the Audit Report** based on the each '**Value Statement**' mentioned above for rectification by the Branches 'Post Audit Report' submitted by the RBIA Auditor to the Branch).

16. Observation of Auditor on various Branch Aspects / Functioning:

Sl. No.	Area / Parameter	Observation of Auditor
20.1	Upkeep of Credit portfolio and General Health of Advances.	
20.2	Observation of Auditor on: a) Arresting Fresh slippages. b) NPA Recovery. c) Timely Action for Legal Recourse.	



20.3	Staff Punctuality / Staff Discipline.	
20.4	Customer Service Quality.	
20.5	Branch Ambiance.	

17. Extent of Computerization:

• Secrecy of Pass Word Maintained.	Yes / No
• Exceptional Reports Generated & Checked Regularly.	Yes / No
• Regular Checking of Vouchers list generated by CBS.	Yes / No
• Proper Control is exercised on Modification in Parameter Files in CBS.	Yes / No
• Disaster Recovery Plan is in Place.	Yes / No
• Business Continuity Plan is in Place.	Yes / No
• 'Biometric Access' System is followed for every CBS User.	Yes / No

18. Compliance of Various Audit:

Sl. No.	Audit	Date of Audit	Date of 1 st Rectification Report Submitted	Date of Last Rectification Report Submitted	Date of Closure of Report.
1	Internal Audit.				
2	Surprise Audit.				
3	Statutory Audit (Annual).				
4	Concurrent Audit (Immediate Last 3 Months).				
5	Revenue Audit / Income – Expenditure Audit.				
6	Any Other Audit (Please Specify).				

**19. Observation on KYC / AML Compliance on the Basis of Test Checking:**

1	Opening of Account by requisite documents.	Yes / No
2	The Turnover in the Account does not exceed Allowable Limits in case, Account is opened with Introduction of the Existing Account Holder.	Yes / No
3	Exercise on Classification of Account into High Medium & Low Risk.	Yes / No
4	KYC Compliance on Renewal of Deposit.	Yes / No
5	Observation on any Abnormal Transactions.	Yes / No
6	Cash Deposited / Withdrawals of ₹.10 lakhs & above is promptly reported to Controlling Office.	Yes / No
7	Submission of Monthly KYC Compliance Report to Controlling Office.	Yes / No
8	Obtaining of Photographs / Address Proof / PAN Card.	Yes / No

Discrepancies / Irregularities in the Account opened:

Abnormal Transaction observed:

[If during the course of Audit, the Auditor comes across any Information / Records which he Suspects as Fraudulent Activity the same should be reported to Controlling Office under Copy to Audit Department, Head Office and Fraud Monitoring Cell, Head Office].

Any other information to be Reported to Head Office:

Signature of the RBIA Auditor

Name of the Auditor:

Date:

Observations of Audit Cell-in-Charge on Contents of Summary Report:

Scrutinized the Audit Summary submitted by the RBIA Auditor and Confirm / Not Confirm the Contents of the Report. (In case Contents are Not Confirmed the Details are Furnished Below):

Name of the Branch	
Date of Audit	
Name of the Auditor & ID No.	
No. of Days Allotted and Consumed	



THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

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