BACK-OFFICE FUNCTIONS/ HANDLING UNRECONCILED ENTRIES IN BANKS

In the banking industry**, front office and back office** are two distinct areas that **serve different functions.**

FRONT OFFICE

- This is the **customer-facing or client-facing area** where customer interactions take place.
- It is responsible for providing **services directly to customers and managing customer relationship**s.

FUNCTIONS

- Assisting customers with their **inquiries, account opening, and providing general banking assistance**.
- **Promoting and selling banking products** and services to customers,

- Building and managing **relationships with high-value customers**, often involving personalized financial advice and assistance.
- Handling **cash transactions, deposits, withdrawals**, and managing customer accounts.

BACK OFFICE

- The back office in a bank is the **operational and administrative area** that supports the overall functioning of the bank.
- It typically involves tasks that are **not directly customer-facing** but are essential for the smooth operation of the bank.

FUNCTIONS

- Maintenance of the **General Ledger and other books** of account to ensure accurate and up-to-date financial records.
- Balancing of branch accounts, reconciling entries, and sub-systems to **ensure consistency and accuracy in financial data**.

- **Preparation of financial statements**, including income statements, balance sheets, and cash flow statements.
- Calculation and posting of **interest on deposits, service charges**.
- **Loan-related processes**, including loan origination, loan servicing, loan modifications, default management, and collections.
- Customer **grievance redressal system** to address and resolve customer complaints in a timely and satisfactory manner.
- Handling e-banking transactions, **including internet banking, mobile banking, ATMs, and card-based payments**.

RECONCILIATION FUNCTION IN BANKS

RECONCILIATION OF BANK ACCOUNTS WITH RBI AND OTHER BANKS AND INSTITUTIONS

Balances with RBI

- Banks maintain **current accounts and other accounts with the RBI** for transactions related to Cash Reserve Ratio (CRR), Repo and Reverse Repo operations, clearing/RTGS.
- The reconciliation process **involves comparing the bank's records with the RBI's statements** to identify and resolve any discrepancies.

Balances with Other Institutions and Banks

- Banks maintain **accounts with other institutions and banks** for various purposes such as **clearing/collection, investments, and short-term money market activities**.
- The bank **compares its internal records** with the **statements provided by other banks or institutions**.

Reconciliation of Accounts with Correspondent Banks

- Banks maintain **correspondent relationships with other financial institutions** worldwide to facilitate international transactions.
- The reconciliation process involves **comparing the bank's records** with the **statements or advice received from the correspondent bank** to resolve any discrepancies.

RECONCILIATION OF INTRA BRANCH ENTRIES

- **Balancing the books of account** is a crucial task in branch-level accountancy.
- Balancing the books involves **comparing the balances in the control account and the subsidiary ledgers**, identifying any discrepancies, and taking corrective actions to reconcile them.
- It involves ensuring that the **primary books of account are accurately tallied, and the general ledger (GL) is balanced**.
- The reconciliation of control and subsidiary records helps in **identifying errors, detecting fraudulent activities, and maintaining proper internal controls** within the branch's accounting processes.

RECONCILIATION OF INTER BRANCH/OFFICE ENTRIES

- Interbranch transactions occur **when branches of the same bank engage in financial transactions with each other**.
- The reconciliation process involves verifying and reconciling the **origination and response (reversal) of interoffice transactions**.

- It ensures that interbranch transactions are **appropriately recorded in the respective branch's books**.

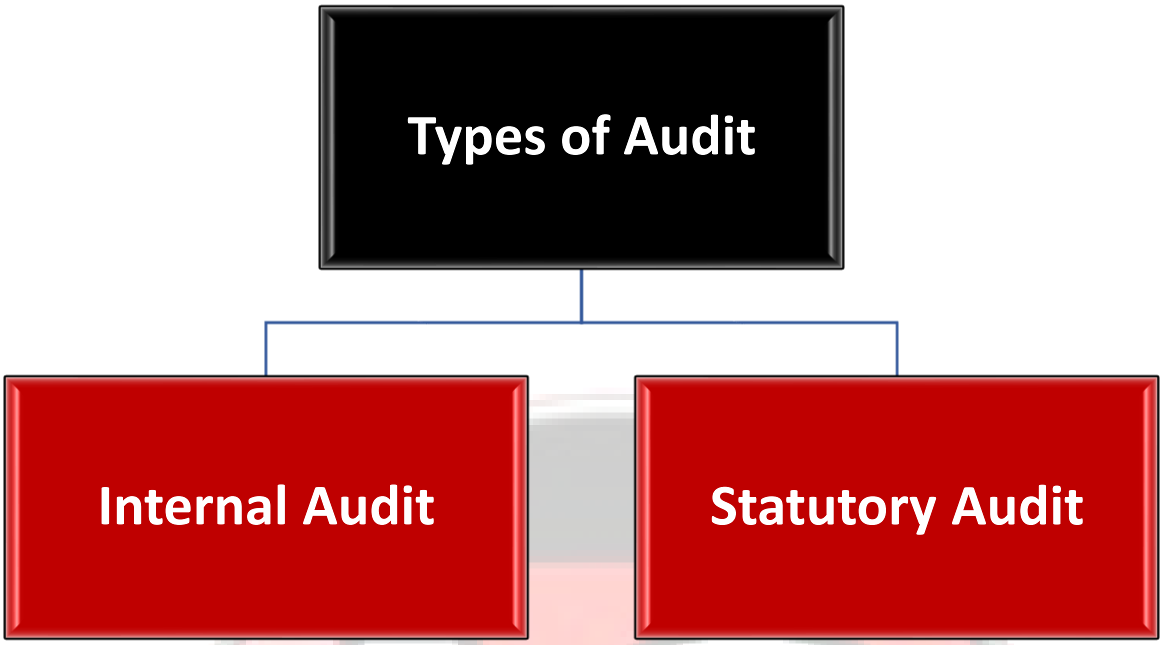
RECONCILIATION OF ACCOUNTS FOR PAYMENT TRANSACTIONS INVOLVING INTERMEDIARIES

- **Electronic/Online payment modes** for payments to merchants have become increasingly popular in the country.
- **Intermediaries such as aggregators and payment gateway service** providers play a role in facilitating electronic payments between customers and merchants.
- Reconciliation of accounts for payment transactions involving intermediaries is a crucial process to ensure accuracy and transparency in financial records

BANK AUDIT & INSPECTION

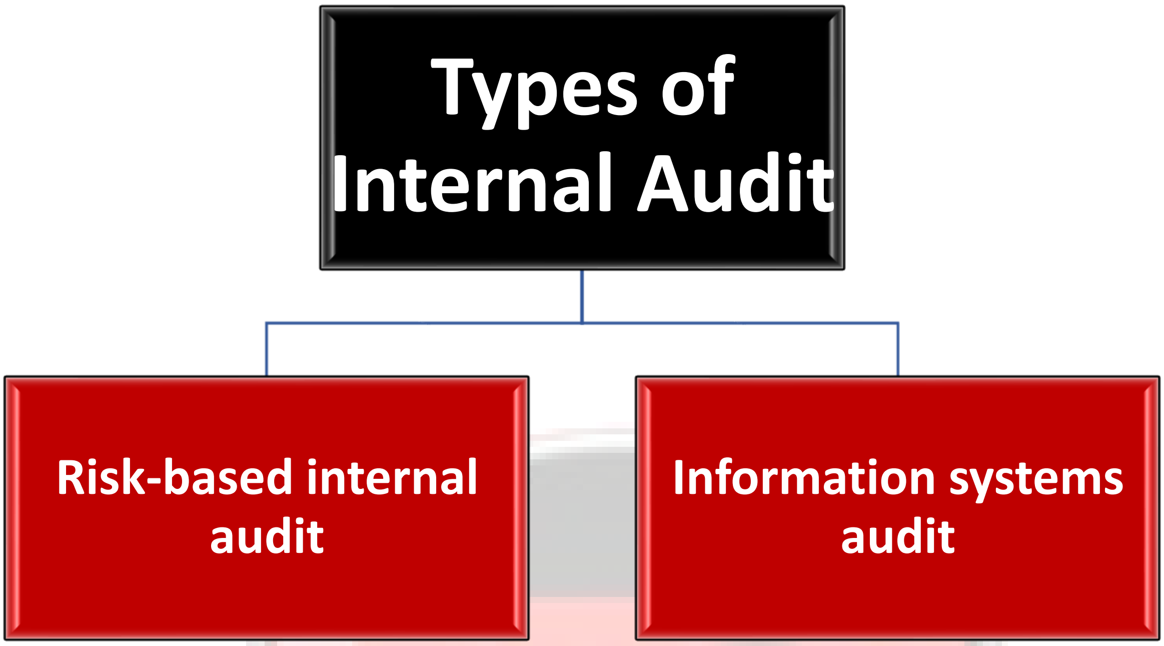
AUDIT OF BANKING

- It is an **examination and evaluation of a bank's financial records**, operations, and internal controls by an independent auditor.
- The primary objective of a bank audit is to **provide assurance on the accuracy, reliability, and compliance of the bank's financial** statements and processes.



INTERNAL AUDIT

- It is **undertaken by bank's own staff** and to some extent by the firms of Chartered Accountants.
- Its main objective is **ensuring the accuracy and correctness of the books of account of banks**.



RISK-BASED INTERNAL AUDIT (RBIA)

- This audit focuses **on identifying and assessing risks within a bank** and tailoring audit activities to address those risks effectively.
- RBI vide **circular dated December 27, 2002**, had **introduced Risk-Based Internal Audit (RBIA) system** in Scheduled Commercial Banks (SCBS).

RBI CIRCULAR

RBI **vide circular dated December 27, 2002**, had introduced Risk-Based Internal Audit (RBIA) system in Scheduled

Commercial Banks (SCBS) as part of internal control framework.

Important Guidelines

International Internal Audit standards

To **promote consistency** in risk-based internal audit practices, banks are advised to consider incorporating **the International Internal Audit standards**, such as those issued by the Basel Committee on Banking Supervision (BCBS) and the Institute of Internal Auditors (IIA).

Standardize Internal Audit Function

In order to **standardize the approach adopted by banks** and align the expectations regarding the Internal Audit Function with best practices, the following guidelines are advised.

Authority and Independence

To ensure that **internal auditors can do their tasks objectively**, the internal audit department within the bank needs to **have enough power, independence, and resources.**

Competence

Banks should make sure that the **internal audit function is equipped with the necessary expertise** to audit every aspect of the bank.

Staff Rotation

The Board should consider the **possibility of assigning staff from other departments who possess specialized knowledge** relevant to the audit function to serve in the internal audit function,

Tenor for appointment of Head of Internal Audit

The HIA shall be **appointed for a reasonably long period**, preferably for a minimum of three years.

Reporting Line

- The Head of Internal Audit (HIA) **should have a reporting** line directly to either the **Audit Committee of the Board (ACB), MD & CEO, or Whole Time Director (WTD**) within the bank.
- In the case of **foreign banks operating in India** as branches, the HIA should report to the internal audit function at **the head office**.

Remuneration

Remuneration policies for internal audit staff should be structured in a way that **avoids linking their compensation to the financial performance of the business lines they audit**.

Outsourcing

Internal auditing duties **cannot be contracted out**. However, **experts, including former employees, might be engaged** on a contractual basis when necessary.

INFORMATION SYSTEMS AUDIT (IS)

- It involves **examination and evaluation** of an organization's **information systems, processes, and controls** to ensure the confidentiality, integrity, and availability of information assets.
- The purpose of an Information Systems Audit is to identify **vulnerabilities, risks, and weaknesses** in an organization's IT systems and **recommend appropriate controls and measures to mitigate those risks**.

RBI CIRCULAR

- The Reserve Bank of India (RBI) issued a **circular on April 30, 2004, titled "Information Systems Audit** - A review of Policies and Practices."

SCOPE OF IS AUDIT

Planning and Oversight Assessment

Evaluate the effectiveness of **planning and oversight** mechanisms in place for IT activities.

Adequacy of Operating Processes

Assess the adequacy of **operating processes related to IT activities** and identify any gaps or areas for improvement.

Evaluation of Internal Controls

Review the Internal controls implemented within the IT environment to ensure they are sufficient and effective.

Identification of Deficient Controls

Identify any controls that are **deficient or not functioning properly**, **posing risks to IT activities.**

CONCURRENT AUDIT

- It refers to the examination of **financial transactions and other operational activities of an organization** in real-time or on a regular basis.

- It is conducted **concurrently with the occurrence of transactions** to provide timely feedback on the **adequacy and effectiveness of internal controls and complianc**e with policies and procedures.

RBI's Guidelines on Concurrent Audit System in Commercial Banks

RBI has revised the guidelines on Concurrent Audit System in Commercial Banks vide RBI Circular Reference No. **DBS.CO.ARS.No.BC.01/08.91.021/2019-20 dated 18th September 2019.**

The revised guidelines cover the following

- Coverage
- Appointment of Auditors
- Accountability
- Tenure
- Remuneration
- Review of effectiveness of Concurrent Audit
- Reporting System

Computer-Assisted Audit Techniques (CAATS)

- Computer assisted audit techniques (CAAT) is a method of gathering and reviewing electronic records.
- CAAT is used to **simplify or automate the data analysis and audit process,** and it involves using computer software to analyze large volumes of electronic data for anomalies.

CAATs may be used to perform the following audit procedures.

- Test of transactions and balances, such as recalculating interest
- Analytical Review procedures, such as **identifying inconsistencies or significant fluctuations**
- Compliance tests of general controls: testing set up or configuration of the operating system or **access procedures to the programme libraries.**
- **Sampling programmes to** extract data for audit testing
- **Compliance tests of application controls** such as testing functioning of a programmed control.

- Re-**calculating entries performed by** the entity's accounting Systems

STATUTORY AUDIT

- It is an **independent examination** of the **financial statements and records of an organization** to ensure their accuracy, fairness, and compliance with relevant laws, regulations, and accounting standards.
- It is a **legal requirement for entities**, such as companies, corporations, and government agencies, **to undergo a statutory audit on an annual basis.**

Audit reports

These are **official documents prepared by auditors** that summarize the **findings, conclusions, and recommendations** resulting from an audit engagement.

Types of Audit Reports to be issued by Statutory Auditors.

- Statutory Audit Report (As per SA 700/705/706 Issued by ICA!)
- Long Form Audit Report (As per the requirements of RBI guidelines)
- Tax Audit Report (As per Income-tax Act, 1961)

Appointment of Statutory Auditors in Banks

- The **auditors of Private Banks** are appointed at the Annual General Meeting of the shareholders.
- The **auditors of Public Sector Banks** are appointed by their Board of Directors. (As per RBI guidelines).

Some of the Important Auditing, Review and Other Standards applicable to the audit of Financial Statements as prescribed by the Institute of Chartered Accountants of India are given below.

- 300 (Revised) Planning and Audit of Financial Statements
- 220 (Revised) Quality Control for an Audit of Financial Statements
- 210 (Revised) Agreeing to terms of Audit Engagement
- 510 (Revised) Initial Audit Engagements - Opening balances

- 315 Identifying and Assessing the Risks of Material Misstatements through Understanding the entity and its environment
- 299 Responsibility of Joint Auditors
- 600 Using the work of Another Auditor
- 250 Consideration of Laws and Regulations in an Audit of Financial Statements
- 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
- 330 The Auditors Responses to Assessed Risks

VARIOUS OTHER TYPES OF AUDITS UNDERTAKEN BY BANKS

REVENUE AUDIT

Revenue audit refers to the examination and evaluation of an **organization's revenue-related processes, transactions, and controls**.

FORENSIC AUDIT

It is a detailed examination and investigation of financial records, transactions, and activities to **uncover potential**

fraud, financial irregularities, or other misconduct within an organization.

MANAGEMENT AUDIT

It is an evaluation or assessment of an **organization's management practices, policies, and processes.**

TAX AUDIT

This is an **analysis of the tax returns** submitted by an individual or business entity to see that tax Information and resulting income tax payment is valid.

Q:1 Which of these statements accurately defines Audit?

a) A procedure for examining the tangible assets of a company.

b) An evaluation of surveys measuring customer satisfaction.

c) A planning exercise focused on formulating strategies for future expansion.

d) An examination and evaluation of the financial records of an organization.

Q:2 Bank Audit is an examination and evaluation of a bank's financial records, operations, and internal controls by an independent auditor. Which of these is an objective of a Bank Audit?

a) Verifying the accuracy of the bank's financial records and statements.

b) Assessing the reliability of the bank's internal controls and procedures.

c) Ensuring compliance with relevant laws, regulations, and accounting standards.

d) All of the above

Q:3 Which of these statements defines Internal Audit?

a) It is an independent evaluation of a bank's internal controls, risk management processes, and overall governance structure.

b) Internal Audit which is generally undertaken by bank's own staff and to some extent by the firms of Chartered Accountants

c) Its main objective is ensuring the accuracy and correctness of the books of account of banks.

d) All of the above

CASE STUDY ON RISK-BASED INTERNAL AUDIT (RBIA)

Risk-Based Internal Audit (RBIA) focuses on evaluating and addressing the specific risks that could impact the bank's operations and objectives. This approach involves identifying and assessing risks related to financial transactions, regulatory compliance, operational processes, credit risk, and market fluctuations. Instead of auditing all processes uniformly, RBIA focuses on areas with the highest risk potential, such as credit risk, market risk, operational risk, and compliance with regulatory requirements.

Q:1 Which of the following is not a primary objectives of adopting Risk-Based Internal Audit (RBIA) in banks?

a) To enhance risk management effectiveness

b) To minimize operational costs

c) To strengthen internal control systems

d) To Compliance with Regulatory Requirements

Q:2 Which of these statement is not correct Functional Independence of Risk Based Internal Audit ?

a) The Internal audit department should be independent from the internal control process in order to avoid conflict of interest.

b) It should not be assigned the responsibility of performing other accounting or operational functions.

c) The management should ensure that the Internal audit staff perform their duties with objectivity and impartiality.

d) None of the above

Q:4 To promote consistency in risk-based internal audit practices, banks are advised to consider incorporating standards issued by_____________.

a) International Monetary Fund (IMF) and World Bank

b) International Accounting Standards Board (IASB)

c) Securities and Exchange Board of India (SEBI)

d) Basel Committee on Banking Supervision and Institute of Internal Auditors

Q:5 RBI vide circular dated December 27, 2002, had introduced Risk-Based Internal Audit (RBIA) system in Scheduled Commercial Banks (SCBS) as part of internal control framework. Important Guidelines of this circular includes_____________.

I. International Internal Audit standards
II. Authority, Independence, and Competence
III. Staff Rotation and Remuneration
IV. Outsourcing and reporting line

a) I, II, IV

b) I, II, III

c) II, III, IV

d) I, II, III, IV