

INTERNAL CONTROLS - BANKS

INTRODUCTION

Additional responsibilities cast on the auditors and the scope of their work getting in the areas of reporting on frauds, fraudulent activities, foul play in banking transactions require the auditor to address these.

Audit Risks

- a) These arise inter alia, due to :
 - **Lack of** internal control systems;
 - **Inadequate** internal controls ; and
 - **Breach of** internal controls.
- b) In EDP environment :
 - Loss of audit trail
 - Non – review of exceptional reports (systems/ transactions)
 - Lack of security systems (hardware/ software)

The exercise of internal control evaluation if properly carried out, assists the auditor to determine the effectiveness or otherwise of the control systems and accordingly, enables him to strengthen his audit procedures, and lay appropriate emphasis on the risk prone areas. It may be noted that transactions in banks are voluminous but repetitive, and fall into limited categories/heads of account. It may, therefore, be more appropriate that the evaluation of the internal controls is made for each class/category of transactions.

Internal controls would include:

- a) accounting controls, and
- b) administrative controls.

Accounting controls cover areas directly concerned with recording of financial transactions and maintenance of such registers/ records as ensure their reliability. Broadly, these controls relate to execution of transactions as are in conformity with:

- a) general or specific authority and delegation of powers laid down by the management,
- b) generally accepted accounting principles and practices, (of which significant accounting policies are expected to be disclosed), and
- c) legal requirements and those of the regulatory bodies, so that the financial statements and data are drawn up based on transactions as are authorised and provide reasonable assurance as to reliability thereof.

Internal accounting controls also envisage such procedures as would determine responsibility and fix accountability with regard to safeguarding of the assets of the bank.

It may not be out of place to mention that there is a distinction between accounting systems and internal accounting controls. Accounting system envisages the processing of the transactions and events, their recognition and appropriate recording. Internal controls are techniques, methods and procedures so designed and usually built into systems, as would enable prevention as well as detection of errors, omissions or irregularities in the process of execution and recording of transactions/events. **(Reference is also drawn to AAS 6 and in particular Para 5 relating to Accounting System and Internal Control).**

Administrative controls, broadly, are concerned with the decision processes and laying down of authority / delegation of powers, by the management.

Internal Accounting Control Techniques

Prevention of errors, omissions and irregularities:

The internal accounting controls as would ensure prevention of errors, omissions and irregularities would include the following:

- a) No transaction can be recognised/recorded unless it is sanctioned/approved by the designated authority.
- b) Built-in dual control/supervisory procedures ensure that there is an independent automatic check on inputs/ vouchers.
- c) No single person has authority to initiate a transaction and record it through all stages to the general ledger; and each day's transactions are promptly and accurately recorded, and the control and subsidiary records are kept balanced through personnel independent of each other.

Detection of errors, omissions and irregularities:

The following internal control techniques are useful as would enable detection of errors, omissions and irregularities:

- a) Independent external evidence/direct confirmation procedures.
- b) Internal/concurrent audit/inspection/special surprise checks.
- c) Balancing of control and subsidiary records.

The Auditor would be well advised to look into other areas as may lead to detection of errors, omissions and irregularities, inter-alia the following:

- a) Missing/loss of security paper stationery forms.
- b) Extensive use of and accumulation of transactions/balances in nominal heads of accounts like Suspense, Sundries, Inter-branch accounts, or other nominal heads of accounts particularly if these accounts are frequently used to balance books, despite availability of information.
- c) Accumulation of old/large unexplained/unsubstantiated entries in accounts (as may also appear in the periodic reconciliation statements), with other banks and institutions.
- d) Transactions represented by mere book adjustments not evidenced/ substantiated or upon non-honouring of contracts/commitments (e.g. dishonour of Bankers' Receipt/SGL Forms in the Investment Department).
- e) Unexplained and old credits, capable of being misused. These could also arise by creation or retention of credits, also represented by holding in physical custody, issued but undespached Deposit Receipts of constituents Banker's cheques, Pay Orders and similar instruments (particularly not in dual custody)
- f) Originating debits in Head Office Accounts (inter-branch accounts).
- g) Results of periodic analytical reviews, if observed as adverse.
- h) Serious irregularities pointed out in internal audit/ inspection/special audit/credit audit/stock audit reports and in "Know Your Customers" norms and frequent infraction of delegated authority.
- i) Complaints/matters pending in the Vigilance/Grievances Cell, as regards discrepancies in accounts of constituents, etc.
- j) Exceptional daily reports in the EDP environment as regards systems and transactions and how these are addressed.
- k) Delays in reporting critical transactions and events.
- l) Operations(credits) in advances being disproportionate with sanctions, disbursements of funds.