



## Risk Based Internal Audit Mechanism in Indian Banks – How Far How Good

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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. If objective of auditor is to establish fairness of the financial result it is called External Auditing, when exercise has been done with an objective to judge 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

**Various Risk Involved in Banking Sector are as follows :-**

**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. **Operational Risks** - 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. **Earnings at risk** - 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.

**Deposit risk** -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).**E. 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.

**How Risk is assessed :-** 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.

**Why RBIA was introduced:-**The evolvement of financial instruments and markets has enabled banks to undertake varied risk exposures. In the context of those developments and the progressive deregulation and liberalization of the Indian financial sector, having in place effective risk management and internal control systems had become crucial to the conduct of banking business. Those were also significant in view of introduction of the Basel Capital Accord under which capital maintained by a bank is more closely aligned to the risks undertaken and Reserve Bank's proposed move towards risk-based supervision (RBS) of banks.

**Factors assuring success of Risk-based Internal Audit :-** It appropriately defines the audit universe and identifies the auditable 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 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. This 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.

**Failures of RBIA in Indian Context :-** After implementation of RBIA it was assumed that there no longer be any risk prone area in the Indian Banking System and if there is any will be detected early and process of rectification will take place as early as possible. The Central Bureau of Investigation registered about 190 cases of bank frauds in the year 2020, involving alleged misappropriation of close to 60,000 crores. In about a dozen of cases, the companies and their top functionaries were accused of cheating the bank of more than 1000 crores. An analysis of the FIRs reveals that over 70 cases, the prima facie embezzled amount exceeded Rs. 100 Crores. Major recent frauds in Indian Banking System are as follows :-

Date of Fraud	Name of Affected Bank/Financial Organization	Nature of Fraud and it's Modus operandi	Impact on Banking Industry
February 2018	PNB	A handful of PNB bank staffers at Bradys House Branch issued fake bank guarantees in excess of Rs. 13,800 crores over the years, aiding companies of two jewellery groups – led by diamond magnate Nirav Modi and Mehul Choksi. They received credit from overseas banks to fund their business/ imports. CBI arrested 8 PNB officials in connection with the case.	In March 2018 the RBI scrapped banking instruments such as letter of undertaking. The government also approved Fugitive Economic Offenders Bill to stop economic offenders from escaping Law.
2013-2019	All Banks	A mix of aggressive and carefree lending alongside willful loan defaults/ frauds and economic slowdown resulted in a rapid rise in bank NPAs. Not a single public and private sector bank had been spared	The impact after six years is acute: from operation concerns such as higher provisioning for bad loans and lower profitability.
March 2018	IDBI Bank	Former Aircel promoter-C Sivasankaran, his son and companies controlled by them Axcel Sunshine Ltd. And WinWin D Oy were accused by the CBI of defaulting on loans worth Rs. 600 Crores from IDBI Bank. Fifteen bank officials – including MD and CEO Kishore Kharat who worked when the loans were sanctioned (2010-14) to Sivasankaran's companies were named in the FIR registered on a complaint from central Vigilance Commission	The government indicated indirectly that it is not keen to provide additional capital to the lossmaking IDBI Bank. Bank has said it requires Rs. 7000 crores as regulatory requirement

September 2019	Laxmi Vilas Bank	Financial Services Firm Religare Finvest has accused the bank management of misappropriation of Rs. 790 crores (which it kept as fixed deposit). In a report filed with Economic Offence Wing	The RBI intensified its “Fit and proper” checks on the management of the bank and indiabulls with whom the merger was sought.
September 2019	Punjab and Maharashtra Cooperative (PMC) Bank	Cooperative lender PMC is in the midst of a scam for under reporting NPAs. The managing director of the firm, in his confession letter claimed that the bank had created new accounts to keep its loan to reveal estate firm HDIL as standard loans which had ideally become NPA. The bank has lent nearly 70% capital to the developer which is against RBI norms.	Existing Bak account holders are allowed to withdraw Rs. 10000 per month from their account.

**To be successful at all times a system should be dynamic and there has to be an inherent mechanism of identification of shortcomings, their measurement and needed correction at regular interval, no static system can last for long. Value addition on constant basis is the factor which is common in all successful mechanism. In view of the above Limitations of RBIA are clearly evident and a regular system upgrade is required with changes in technology and social developments to safe guard interest of all the stakeholders of banking industry is needed.**

