

Chapter II

Audit Methodology

2.1 Audit Objectives

The audit was taken up with the following objectives:

- i. To assess whether objective parameters were adopted for recapitalisation of PSBs and to check consistency of their application across all PSBs;
- ii. To assess whether the release of capital funds was monitored and check whether conditions attached to recapitalisation were complied with and objectives of recapitalisation were achieved.

2.2 Audit Criteria

The sources of audit criteria are the following:

- Approvals by the Cabinet Committee on Economic Affairs / Policy Announcements
- Circulars/Directives issued by DFS
- Circulars / Guidelines issued by RBI
- Memoranda of Understanding (MoU) between DFS and PSBs
- Statement of Intent (SOI) parameters as finalised between DFS and PSBs
- Sanction letters for release of funds to PSBs
- Minutes of Quarterly Review meetings chaired by Finance Minister / Secretary, Department of Financial Services (DFS)
- Reports of Parliamentary Standing Committee on Finance on 'NPA of financial institutions'

2.3 Audit Scope and Scope Limitation

2.3.1 Audit focused on recapitalisation of PSBs by Government through DFS during 2008-09 to 2016-17. For this purpose, Audit examined the records available in DFS. DFS had advised Audit that it might not be advisable to seek the internal records of individual banks due to the legalities involved. Audit had requisitioned some bank documents, namely Internal Capital Adequacy Assessment Process

(ICAAP¹⁰) reports and the Annual Financial Inspection (AFI¹¹) reports. DFS could not make available these documents and clarified that they did not access the records of PSBs as the commercial decisions of banks were taken by the banks themselves. Audit did not have access to individual bank records. The audit exercise, therefore, was limited to records of DFS.

2.3.2 Audit engaged National Institute of Bank Management (NIBM), Pune as a consultant to assist the audit exercise.

2.4 Audit Process

The audit commenced with an Entry Conference on 31 October 2016. Audit relied on review of reports and documents in DFS for the audit. After completion of the audit, the draft audit report was issued to DFS on 17 May 2017. The reply of DFS was received on 9 June 2017 and has been suitably incorporated. An exit conference was held on 14 June 2017.

2.5 Acknowledgements

Audit wishes to acknowledge the co-operation received from the Ministry of Finance, Department of Financial Services during the audit process. Audit is thankful to the Reserve Bank of India, for furnishing essential bank-wise data. Audit would like to place on record its appreciation for the assistance extended by National Institute of Bank Management.

¹⁰ ICAAP: In terms of the guidelines on Basel II, the banks are required to have a board-approved policy on internal capital adequacy assessment process (ICAAP). ICAAP clearly demarcates the quantifiable and qualitatively assessed risks and includes stress tests and scenario analyses, to be conducted periodically, particularly in respect of the bank's material risk exposures, in order to evaluate the potential vulnerability of the bank to some unlikely but plausible events or movements in the market conditions that could have an adverse impact on the bank's capital.

¹¹ AFI : AFI evaluates performance of banks on the following parameters:

- (i) Banks' financial condition and performance highlighting Asset Quality, Solvency and Capital Adequacy, Earnings Performance and Liquidity**
- (ii) Management and operating conditions focusing on Management (board and senior management), Systems and Internal controls, including risk management strategies;**
- (iii) Compliance with Regulations including integrity of reporting and compliance to guidelines.**