CHAPTER VI
CORPORATE SOCIAL RESPONSIBILITY, INTERNAL CONTROL SYSTEM AND AUDIT COMMITTEE IN INDIAN OVERSEAS BANK

CORPORATE SOCIAL RESPONSIBILITY IN INDIAN OVERSEAS BANK

INTRODUCTION

Corporate Social Responsibility (CSR) has become the new buzzword and a key differentiator with research indicating a positive and statistically significant relationship between Corporate Social Responsibility and profitability. It has now to go beyond the realm of purchasing greeting cards from a Non-Government Organisation or donating to a charitable cause to entering long term commitments towards developing the society. Sharing his view, Keki Mistry, MD, HDFC, said that the corporates had increasingly begun to ponder over whether there is more to business than just financial numbers, leading to the emergence of concept of the “triple bottom line impact”. A company here basically tries to balance three critical aspects economic returns, social benefits and environmental sustainability. Socially responsible investors now aim at making companies accountable not only to shareholders and employees but also to all those affected by their operations. Companies are now required to discharge their stakeholder obligations and societal responsibilities, without compromising the shareholder wealth maximization goal.

CSR is now not merely about charity. It is also about companies being able to take up the role of corporate citizenship and ensuring that business values and behaviour are positioned in such a manner that they strike a perfect balance between improving and developing the wealth of business, while simultaneously bringing a positive change in society. A good Corporate Social Responsibility policy ensures that sales go up and customer loyalty is created. It enhances the corporate’s brand image and reputation in turn leading to better financial performance, apart from increasing a firm’s ability to both attract and retain qualified employees.
Good corporate governance and corporate responsibility towards society are so interlinked that we cannot separate one from the other. If providing good governance to its stakeholders and society at large is what is expected of a corporate, it is because it receives so much from society that it is only appropriate that the corporate gives back to it at least something in return in the form of good governance. It is thus understood that good corporate governance itself is part and parcel of corporate responsibility to society. Some of the important areas which need a continuous focus are: Activities of the trust, Providing training for employment, rural development activities such as economic development, health, education infrastructure facilities, eco-friendly environment, rehabilitation project, community relations like assisting community groups in micro financing and credit assistance, etc.

CREDIT FLOW TO WOMEN

Women’s development should be viewed not only as an issue in social development but also be seen as an essential component in every dimension of development. Various types of employment and development programmes are being introduced by the state and central governments. Under this programme, action is being taken to provide technical skills and upgrades the traditional skills of rural youth and finances are given for self-employment. The empowerment of women is an important necessity of the present day. Keeping this in view, Indian Overseas Bank has been giving training to the rural people on continuous basis. As women constitute more than 50% of the population making the literate, making them free from exploitation is the need of the hour.

TABLE – 6.1
CREDIT FLOW FROM IOB TO WOMEN BORROWERS

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<tbody>
<tr>
<td>Total</td>
<td>999.7</td>
<td>1,311.5</td>
<td>1,738</td>
<td>2269.63</td>
<td>2391.06</td>
</tr>
<tr>
<td>Bank’s Net Credit (%)</td>
<td>5.5%</td>
<td>5.56%</td>
<td>5.3%</td>
<td>5.18%</td>
<td>5.40%</td>
</tr>
<tr>
<td>Normal (%)</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Annual Report

The table reveals that there is a continuous and an increasing trend of total credit flow to women entrepreneurs. But as regards the bank’s Net credit in terms of percentage, there is an increase in the II yr and a marginal decrease in the III and IV year and finally shoots up to 5.40% in the V year as against the norm of 5%. The women beneficiaries were given this training programme so that they could set up their own units. Indian Overseas Bank empowers minority women to get bank loan.

SAKTHI IOB CHIDAMBARAM CHETTIAR MEMORIAL TRUST

This trust was setup jointly by the management of the bank, officers Association and workmen union in its pursuit of the objective of training women from lower strata of the society in various vocational activities in memory of the founder of the Bank – Shri M.CT.M. Chidambaram Chettiar

TABLE – 6.2
DETAILS OF TRAINING PROGRAMMES OFFERED BY IOB

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Vocational Training</td>
<td>1667</td>
<td>1083</td>
<td>1128</td>
<td>1228</td>
<td>1128</td>
<td>6134</td>
</tr>
<tr>
<td>EDPs for women</td>
<td>--</td>
<td>21</td>
<td>25</td>
<td>30</td>
<td>34</td>
<td>110</td>
</tr>
<tr>
<td>Beneficiaries</td>
<td>700</td>
<td>766</td>
<td>901</td>
<td>1119</td>
<td>1230</td>
<td>4716</td>
</tr>
</tbody>
</table>

Source: Annual Report

The present researcher understands from the above table that skill based vocational training is being imparted to girls and womenfolk for the above mentioned 5 years for 6134 candidates in total. There has been a constant
increase of conducting Entrepreneurial Development Programmes for women except in the I year. The number of beneficiaries is also on an increase. After the training programme, an interface meeting with the trainees is also organized. This shows that Indian Overseas Bank’s objective of training women from lower strata of the society is highly encouraging.

EDUCATION LOAN

Education has been looked upon as the most vital and crucial investment in human development. The task of providing education for all with concrete plans of action gained momentum. Though considerable progress is visible both on the literacy rate, we are still at a considerable distance from the goals of education. Keeping in mind the need to encourage students to get education, Indian Overseas Bank has granted education loan to the students especially for higher studies.

In tune with the National Agenda of Education to all, the bank vigorously implemented the educational loan scheme among the students aspiring for higher studies in India and abroad. During the year 2003-04, loans amounting to Rupees 141.3 crores, in 2004-05 Rupees 103.1 crores, and in 2005-06 Rupees One hundred and thirty two crores were disbursed under the Bank’s Vidya Jyothi Educational Loan Scheme benefiting five thousand seven hundred and seventy eight students in 2003-04, ten thousand three hundred and forty seven students in 2004-05 and fifteen thousand five hundred and fifty eight students in 2005-06. The data for the remaining two years could not be solicited.

SANJEEVINI SCHEME FOR MEDICAL PRACTITIONERS

Good health is most critical to human well-being. Besides facilitating appropriate mental and physical developments it also determines the ability of individuals to live happy lives. While we have thirty thousand MBBS graduates coming out every year, the entire rural health system for more than seven hundred and fifty million people never had doctors, medical practitioners to start nursing homes in rural areas. Thanks to Indian Overseas Bank’s corporate social
responsibility. Improvements in human resources, out patients cases, in patient care, availability of drugs doctors etc, had been reported from large number of beneficiaries.

During the Year 2003-04, the bank granted three hundred and fifty loans involving a credit outlay of Rupees One thousand six hundred and fifteen lakhs under Indian Overseas Bank’s SANJEEVINI scheme for the benefit of doctors / medical practitioners to establish nursing homes / hospitals / polyclinics and also to acquire sophisticated equipment, purchase of ambulance etc.

AGRIBUSINESS CONSULTANCY SERVICES

Agribusiness consultancy services has been making steady progress in offering consultancy services for hi-tech agricultural projects with a special thrust on projects for waste land development, dry land horticulture, herbal / medicinal plant cultivation, Food processing and setting up of cold storages / Rural Godowns for a nominal fee.

The bank’s ABC services prepared six projects with an outlay of Rupees 26.6 crores; four projects with an outlay of Rupees 9 crores; four projects with an outlay of Rupees 9 crores; four projects with an outlay of Rupees 10.31 crores for the year 2003-04, 2004-05, 2005-06 and 2006-07 respectively.

RURAL TRAINING CENTRES (RTC)

Indian Overseas Bank had setup three Rural Training Centres in the Lead District of Sivaganga, Tirunelveli and Thanjavur in the state of Tamil Nadu to impart both classroom and practical training to the farmers, members of Self Help Group’s Educated unemployed youths, Artisans and Beneficiaries belonging to weaker sections.

Rural Training Centre at Karaikudi was set up by the bank in association with National Bank for Agriculture and Rural Development (NABARD) and Indian Bank during the year 2005-06.
TABLE- 6.3
CONTRIBUTION OF RURAL TRAINING CENTRES OF IOB

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of training programme</th>
<th>No. of beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>79</td>
<td>2825</td>
</tr>
<tr>
<td>2007-08</td>
<td>95</td>
<td>2873</td>
</tr>
<tr>
<td>2008-09</td>
<td>100</td>
<td>3781</td>
</tr>
</tbody>
</table>

Source: Annual Report

Indian Overseas Bank established on its own, two rural training centres at Tirunelveli and Thanjavur and conducted seventy nine training programmes and trained two thousand eight hundred and twenty five beneficiaries in 2006-07. It conducted ninety five training programmes and trained 2873 beneficiaries in 2007-08. It conducted hundred training programmes and trained three thousand seven hundred and eighty one beneficiaries in 2008-09.

The table points out that, in 2006-07 two thousand eight hundred and twenty five beneficiaries in 2007-08, two thousand eight hundred and seventy three beneficiaries and in 2008-09, three thousand seven hundred and eighty one beneficiaries benefited. It is understood from this that, Indian Overseas Bank shows great concern for the upliftment of rural people as the results (no. of beneficiaries) are highly encouraging. The data for the first two years of study was not available, hence not incorporated.

IOB SAMPOORNA PROJECT – A TOTAL VILLAGE DEVELOPMENT PROJECT

Development implies an overall positive change in the physical quality of life of the people. This positive change includes both economic and social aspects and involves an improvement in the general standard of living. Therefore village development not only calls for economic growth, but also implies equitable distribution of the gains of economic growth. This translates
into improvement of quality of life through better health, education, housing and welfare.

The bank has recently launched an innovative rural development project aiming at total Village Development called Indian Overseas Bank sampoorna project in Kathambakkam and Padur Villages in Tiruvallur District in Tamil Nadu in 2007-08. It is a unique project encompassing several livelihood initiatives in the villages to ensure all-inclusive growth of rural population. This project comprises the credit and non-credit components such as financial inclusion (under total sanitation scheme) Information. Technology enabled banking operations with bio-metric smart cards, tree planting and social forestry cleaning water bodies, health care, skill training for youth in computer and Business Process Outsourcing, Rural business process outsourcing, promotion of non-conventional energy and rural tourism.

OTHER CONTRIBUTIONS

Apart from the above, the Indian Overseas Bank has been discharging its role as a corporate citizen to various sections of society. It participates in various charitable activities that benefit the common man during the needy hours. Liberal donations were made to specialized medical institutions for the provision of advanced medical treatment.

TSUNAMI RELIEF MEASURES

Natural and man made disasters often result in loss of lives; cause injury to people and lead to loss of livelihoods and damage the property. In case of recurring disasters like floods, the disaster prone communities often become victims so corporates should spread the culture of preparedness among all sections of society.

The bank rose to the occasion when devastation struck the southern part of the country and Andaman and Nicobar islands in the form of Tsunami in December 2004. The bank rushed to provide assistance in various forms to the
people affected by the calamity. The bank, on its own, contributed Rupees10 crore to the Prime Minister’s National Relief Fund while the IOBIANS donated a days’ salary for the purpose. It also launched a modified home improvement scheme to provide financial assistance on easier terms to the affected individuals for repair or modernization of houses destructed by the Tsunami. The bank also participated in various relief measures announced by the Government.

Contribution was made to the Tamil Nadu Chief Minister’s Relief Fund also in 2005-06. Also, to Cancer foundation and Research Centres to the tune of 1.25 crores, apart from organizations pertaining to the care of physically and mentally challenged persons were benefited by the philanthropy of the bank.

A minibus was donated to an orphanage at Madurai, located in a very remote area at a cost of Rupees 4,00,000. It also sponsored Traffic Awareness programmes in the city of Chennai with 250 message boards. It donated a van to a school in Orissa, which was highly affected by flood in 2006-07. A charity show was organized at Divine mother society, Chennai. Out of the total collections received, ¼ of the funds was utilized for the noble causes of the society.

A sum of Rupees Two crores was donated to Anna poorna Mahital at Pune in 2007-08. Rupee One crore to Government of Bihar for flood relief. Rupee One crore to Tamil Nadu Government Chief Minister’s Relief Fund; Rupees Twenty five lakhs towards the making of artificial limbs at Jaipur; Rupees Fifteen lakhs to a foundation at Hyderabad; a van worth Rupees Nine lakhs to a society at Bangalore; and another van worth Rupees Eight lakhs to VXL school, a mentally retarded school at Chennai are the other gifts of the bank.

PENSION SCHEME

Society is known by the way it treats its young and the aged. It has been the Indian tradition and a part of our ancient culture that families and communities take care of our elderly citizens. It is therefore our duty to ensure that they have a happy healthy and secure life in old age. The centre has asked
the state governments to implement new schemes and to ensure that all eligible persons are covered and that the pension is credited wherever possible into the post office or bank account of the beneficiary.

Accordingly, Indian Overseas Bank with a view to helping the pensioners handles payment of pension in respect of Central, Civil, Defence, Railways, Telecom and State Government, Tamil Nadu Electricity Board, Chennai Port Trust, Employees’ Provident Fund Organization pension, Malaysian Government pension and Coal Mines Provident Fund pensioners. During the year 2008-09, the bank disbursed pension arrears under 6th pay commission for Civil and Defence pensioners, as per Government directives.

INTERNAL CONTROL SYSTEM AND AUDIT COMMITTEE IN INDIAN OVERSEAS BANK

Ethics and values get short shrift in business in two ways; first, by the failure of management and second, by the failure of auditors. Auditors who are expected to be the watchdogs of the organization are often bought in by managements through some profitable assignments. This has led to the rise of the concept of corporate governance which is about promoting corporate fairness, transparency and accountability relating to various participants of organizations. Recent unearthing of corporate frauds both in developed countries and developing and transitional economies revealed the fact that auditors had failed to do what they were assigned to do. They involved themselves in unethical practices and failed to whistle-blow when things went wrong in the organization. To have a check on the auditors’ role and to prevent them from unethical practices, the Indian government and regulatory bodies as elsewhere have come out with many regulations, re-establishing corporate accountability and reinforcing investor confidence.

ROLE OF AUDITORS

The role of auditors who are expected to certify the veracity of accounts maintained by companies for the benefit of all stakeholders of the company including fair and transparent governance leaves a lot be desired.
DEFINING AUDIT

The Institute of Chartered Accountants of India (ICAI) has defined audit as, The independent examination of any entity, whether profit oriented or not and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. In other words, auditing is the process by which a competent independent person objectively obtains and evaluates evidence regarding assertions about an economic activity or event for the purpose of forming an opinion about and reporting on the degree to which the assertion conforms to an identical set of standards.

TYPES OF AUDIT

We can identify three types of audits, namely,

1. Financial Statement audit
2. Compliance audit and
3. Operational audit

FINANCIAL STATEMENT AUDIT An audit of financial transaction is conducted to determine whether the overall financial statements are stated in accordance with specified criteria. The financial statements commonly audited are balance sheet, the income statement, the cash flow statement and the statement of stockholders’ responsibility.

COMPLIANCE AUDIT The purpose of compliance audit is to determine whether the auditee is following specific procedures, rules or regulations set down by some higher competent authority.

OPERATIONAL AUDIT An operational audit is a review of any part of an organisation’s operating procedures and methods for the purpose of evaluating effectiveness and efficiency.
DEFINITION OF AN AUDITOR

An auditor is defined as a person appointed by a company to perform an audit. He is required to certify that the accounts produced by his client companies have been prepared in accordance with normal accounting standards and represent a true and fair view of the company. Chartered accountants are usually appointed as auditors.

An auditor is a representative of the shareholders, forming a link between government agencies, stockholders, investors and creditors.

TYPES OF AUDITORS

There are three types of auditors namely,

1. Internal auditors
2. Independent auditors and
3. Government auditors

INTERNAL AUDITORS Internal auditors are employed by the organization for which they perform audits. Their responsibilities vary and may include financial statement audits, compliance audits and operational audits. They may assist the external auditors in completing the financial statement audit or perform audits for use by management within the entity. Internal auditors must have no operating involvement in activities they audit.

INDEPENDENT AUDITORS Independent auditors are usually referred to as CPA (Certified Public Accountants) firms. The opinion of an independent auditor about financial statements makes the statements more credible for such users as investors, bankers, labour unions, government agencies and the general public.

GOVERNMENT AUDITORS Government auditors work in various local, state and federal or central government agencies performing financial compliance and operational audits. Local and state governments, for example,
employ auditors to verify that business houses collect and remit sales taxes and excise duties as required by law.

RESPONSIBILITIES OF THE AUDITORS

As per the Standard Auditing Practices (2), an auditor has the following responsibilities:

- He is responsible for forming and expressing his opinion on the financial statements.
- He determines whether the relevant information is properly disclosed in the financial statement.
- He has to ensure that his work involves exercise of judgments and
- He is not expected to perform duties which fall outside the scope of his competence. eg. the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.

If appropriate disclosures regarding the material misstatement affecting the prior period financial statements is not made, the auditor should issue a modified report on the current period financial statements modified with respect to the corresponding figures included. When the prior period financial statements are not audited, the incoming auditor should obtain sufficient appropriate audit evidence that the closing balances of the preceding period have been correctly brought forward to the current period and the opening balances do not contain mis-statements that materially affect the financial statements for the current period.

The auditors is also responsible to communicate that information (misstatement resulting from fraud) to management, those charged with governance and, in some circumstances, when so required by the laws and regulations, to regulatory and enforcement authorities also. The auditor should communicate these matters to the appropriate level of management on a timely basis and consider the need to report such matters to those charged with governance.
An audit firm needs to implement appropriate quality control policies and procedures to ensure that all audits are carried out in accordance with statements on Standard Auditing Practices.

**RESPONSIBILITIES OF AN AUDIT FIRM**

An audit firm needs to implement appropriate quality control policies and procedures to ensure that all audits are carried out in accordance with Statements on Standard Auditing Practices, cited earlier.

The objectives of the quality control policies to be adopted by an audit firm will ordinarily incorporate the following:

1. **PROFESSIONAL REQUIREMENTS** Personnel in the firm are to adhere to the principles of independence, integrity, objectivity, confidentiality and professional behaviour.

2. **SKILLS AND COMPETENCE** The firm is to be staffed by personnel who have attained and maintained the technical standards and professional competence required to enable them to carry out their responsibilities with due care and

3. **ASSIGNMENT** Audit work is to be assigned to personnel who have the degree of technical training and proficiency required in the circumstances.

**ROLES AND RESPONSIBILITIES OF EXTERNAL AUDITORS**

The external auditors are not, by definition, part of a banking organization and therefore are not part of its internal control system. Yet they have an important impact on the quality of internal controls through their audit activities, including discussions with management and recommendations for improvement to internal controls. The external auditors provide important feedback on the effectiveness of the internal control system.
While the primary purpose of the external audit function is to give an opinion on, or to certify, the annual accounts of a bank, the external auditor must choose whether to rely on the effectiveness of the bank’s internal control system. Hence, the external auditor’s conduct and evaluation of the internal control system in order to assess the extent to which they can rely on the system in determining the nature, timing and scope of their own audit procedures.

The exact role of external auditors and the processes they use vary from country to country. Professional auditing standards in many countries require that audits be planned and performed to obtain reasonable assurance that financial statements are free from material misstatement. Auditors also examine, on a test basis, underlying transactions and records supporting financial statement balances and disclosures. An auditor assesses the accounting principles used and significant estimates made by management and evaluate the overall financial statement presentation.

External auditors gain an understanding of a bank’s internal control process. The extent of attention given to the internal control system varies from auditor to auditor and from bank to bank. It is generally expected that the auditor would identify significant weaknesses that exist at a bank and report material weaknesses to management orally or in confidential management letters to the supervising authority. Furthermore, external auditors are subject to special supervisory requirements that specify the way they evaluate and report on internal controls.

**IOB’S ROLE IN CORPORATE GOVERNANCE**

The complexity and the growing size of business organizations, both in the private and public sector, have heightened the need and desirability for professional internal audit functions, which have increasingly become focused in the emerging global competitive environment for the survival of business organizations. Corporate Governance is the system by which companies are directed and controlled. It includes the policies and procedures adopted by a
bank in achieving its objectives in relation to shareholders, employees, customers, suppliers, regulatory authorities and the community at large. It prescribes a code of corporate conduct in relation to all the stakeholders, external and internal. Internal audit is an important tool to realize the corporate governance in the company.

**INTERNAL AUDIT**

Indian Overseas Bank’s Internal auditing has traditionally been viewed as confined merely to ensuring that the accounting and allied records have been properly maintained, the assets of the enterprise have been properly safeguarded, and the policies and procedures laid down by the management have been complied with.

The modern concept of internal auditing suggests that internal auditing need not be confined to financial transactions and its scope may be extended to the task of reviewing whether the resource utilization of the enterprise is efficient and economical. This would necessitate a review of all the operations of enterprise as well as an evaluation of the effectiveness of management.

The internal audit department in Indian Overseas Bank has an independent review function which provides assurance to the Board of Directors and the management that control functions and policies are functioning effectively in a synchronized fashion, and risks are adequately managed.

**THE ROLE OF THE INTERNAL AUDITORS OF THE BANK**

The internal auditing profession is increasingly changing to keep pace with the challenges of the current business environment. Influenced by competitive external providers and the demands placed on the board, the internal audit activity has evolved as a value-driven function focused on risk management, internal control and governance processes.
The most significant role of the internal auditors in Indian Overseas Bank is to independently appraise the adequacy and effectiveness of internal controls, and to evaluate compliance of business activities with policies and procedures, and laws and regulations. It indicates that companies recognize the importance of strong standards of internal controls and compliance. This is especially true for Indian Overseas Bank that is seeking significant foreign capital. It needs to demonstrate and establish the ability to manage their operations in an organized and well-controlled manner.

Internal auditors are often involved in providing input to management in adopting appropriate corporate policies and procedures. Many banks, in recent years, have been experiencing high growth in trade and business transactions. Clearly defined policies and procedures are vital to ensuring success. The involvement of internal auditor in drawing up policies and procedures could raise questions as to their objectivity in the later evaluation of such practices.

Some of the specific roles of an internal auditor of the bank are

- Internal investigations (including fraud and other malpractices)
- Risk management and
- Audit of subsidiary companies

While the ultimate responsibility for maintaining effective corporate governance and ensuring that the organization is “In Control” rests with the board, the extent and complexity of today’s business risks and related controls have led to a much increased expectations from an internal audit performed by the management.

The Internal auditors should aim at providing the management with a dynamic, value-adding tool, which makes a positive contribution towards the achievement of organization’s objectives. It must assist the Board and management in discharging their corporate governance responsibilities by assisting it with identifying and managing risks, providing objective evaluations of business risk, regular evaluations of organization’s system of control and effective reviews of operational and financial performance.
As the role of an internal auditor to assist the management in maximizing the opportunities and minimizing the threats to the organization, internal audit function must increasingly contribute to the achievement of overall corporate objectives, while remaining an independent and valued voice.

Both the Board and the management of Indian Overseas Bank, rely heavily on the internal auditor to prevent corrupt practices. Of course, internal auditors also monitor the internal control system to ensure that appropriate policies and safeguards are in place and are being followed.

**INTERNAL AUDIT REPORT**

The internal auditor’s report of Indian Overseas Bank contains conclusions and recommendations on the activities audited, which are expected to be accepted and acted upon by the management. The management may also use the report to evaluate the performance of the internal auditor. The contents of an Internal audit report are influenced by various factors, such as the nature of internal auditing function in the organization, level of reporting, degree of management support and capabilities of internal audit staff. However for preparing a good internal audit report the following general rules are to be observed by the bank’s Internal Auditors:

- Objectivity
- Clarity
- Accuracy
- Conciseness
- Constructiveness
- Readability and
- Timeliness
THREE PHASED AUDIT SYSTEM

There is growing expectation gap and demand from the public for re-evaluation of the contemporary Indian accounting and auditing norms. In order to meet the emerging challenges and to suit the changing environment especially in the backdrop of recent fraudulent transactions in listed companies, the Comptroller and Auditor General (CAG) has issued additional directions to the statutory auditors regarding third party confirmation in respect of bank and cash balances, investment, creditors and debtors while introducing more intensified, innovative, focused and result-oriented approach to financial audit by the System of Three Phased Audit. With a view to bringing substantial qualitative transformation in the audit process and methodology, Indian Overseas Bank felt that it is imperative to change the mind set of auditors along with innovative strategic transformation in audit approach, targeted to bringing value addition, usefulness, credibility, transparency, visibility and acceptability. Realizing that strengthening the financial reporting system of banks and implementing internationally benchmarked best corporate governance practices achieve the ultimate objective of audit, various innovative measures have been initiated for audit. Besides, the Three Phased Financial Audit System, added emphasis is given to risk-based audit approach, corporate governance and intensification of communication process with all the players concerned including statutory auditors, management and other regulators.

INTRODUCTION OF ‘THREE PHASED AUDIT SYSTEM’

The prime objective of supplementary audit is enhancing the quality of financial statements that are cluttered with innumerable notes on accounts, qualification without quantifying the impact, while certifying the financial statements as true and fair. There is a need for better understanding, effective communication, and exchange of views to bring consensus and convergence of ideas in regard to accounting principles, treatment of different accounting entries, application of mandatory accounting standards among the management executives, government auditors, and the statutory auditors, who are actively involved in the financial reporting and audit process with distinct roles and responsibilities. The
ultimate test of a qualitatively superior financial reporting is its readability, simplicity and usefulness to different stakeholders including investors in decision-making. Responsibility of an auditor whether he is functioning as statutory auditor or government auditor is essentially strengthening the financial reporting of the system in the enterprise.

The new audit approach of Indian Overseas Bank has three phases aiming at:

- establishing an effective communication and a coordinated approach amongst the statutory auditors, management and Comptroller and Auditor General’s (CAG) audit parties for removal of inconsistencies and doubts relating to the accounts presented by bank.
- identifying inconsistencies, if any, before approval of the accounts by the Board of Directors (BOD) of the bank, review the accounting of transaction ad highlight errors, omissions, non-compliances etc. for timely remedial action to improve the quality of accounts and
- reducing the time for supplementary audit after the accounts are approved by the BOD of bank.

AUDIT METHODOLOGY IN INDIAN OVERSEAS BANK

The audit of financial statements may be conducted in three phases as under:

PHASE – I

Following aspects are covered in the Phase-I audit:

- Understanding of the accounting system.
- A proper risk assessment, including review of internal control system.
- Analysis of accounting policies, notes to accounts with reference to the applicable laws and disclosures in conformity with the accounting standards.
• An effort of the external auditors of the bank to bring consistency in the accounting policies of the bank
• Compliance with the previous year’s assurances given by the management of Indian Overseas Bank and issues raised in the ‘Management letters’
• Previous year’s audit finding of the statutory auditors and
• Modification in the opening balances, if any, or rectification of errors committed by the bank are also reviewed to evaluate the efficacy of the internal control system

PHASE – II

This is conducted as a test audit at the end of the financial year (i.e in the month of April) based on the draft accounts received from the bank.

The following aspects are verified during this phase:

• Review of system of verification of cash and bank balances including fixed deposits, Investments and other items to be finalized at the year end and system of confirmation of balances of debtors, creditors, loans and advances, etc.
• Instructions issued for compilation/consolidation of accounts. Any deviation in the instructions from the accounting policies, accounting standards etc. are taken up with the bank.
• Proper documentation with relevant records of the audit/ vouching etc. done during the phase are maintained for subsequent use and reference.
• Preliminary audit finding noticed as a result of test audit and vouching in Phase – II are issued to statutory auditors. In the event of non-compliance with the accepted commercial accounting principles, applicable laws and accounting standards, the statutory auditors are required to report at the appropriate time on the financial statements.
PHASE – III

On receipt of financial statement/accounts duly approved by the Board of Directors and reported upon by the statutory auditors of Indian Overseas Bank, the following aspects are verified during this phase:

- Verification of action taken on the preceding audit observations
- Compliance with the consolidation/grouping instructions
- Review of memorandum of changes effected in the approved accounts vis-à-vis the draft accounts on which audit in Phase-II was conducted
- Accounting and disclosures of the events occurring after the balance sheet date
- Final disclosure made in the approved accounts
- Compliance with the financial reporting requirements of the relevant laws, rules and regulations, accounting standards etc.
- Examination of the Report of the statutory auditors especially the qualifications, opinions and compliance with relevant Auditing and Assurance Standards; and the issuance of draft audit observations to the statutory auditors as well as the management and to process the same for issuing as comments on accounts and
- Effective interaction among the government auditor, management and statutory auditor for ensuring successful implementation of the system.

BASEL II IN IOB

RISK MANAGEMENT

Risk is inherent in all kinds of banking activities and is an integral part of the banking business. In the normal course of business, a bank is exposed to various risks namely credit risk, market risk and operational risk. With a view to efficiently managing such risks, the Bank (Indian Overseas Bank) has put in place various risk management systems and practices. In line with the guidelines of the Reserve Bank of India issued from time to time, the Bank
continues to strengthen its various risk management systems that include policies, tools, techniques, monitoring mechanisms and Management Information System (MIS).

The Bank aims at enhancing and maximizing the shareholder values through achieving appropriate trade off between risks and returns. Bank’s risk management objectives broadly cover proper identification, measurement, monitoring / control and mitigation of the risks with a view to enunciating the bank’s overall risk philosophy. The risk management strategy adopted by the bank is based on clear understanding of the risks and the levels of risk appetite depending upon bank’s willingness to take on risks in normal course of business. A clear determination of risk appetite is a fundamental precondition and is established through consistent risk limit frameworks, in consideration of the portfolio composition, profitability targets, targeted customer segment, regions, business lines, expansion policy, plans and barriers etc.

The bank has set up appropriate risk management organization structure in the bank. Risk Management Committee of the Board (RMCB), a sub-committee of the Board, is constituted which is responsible for management of the credit risk, market risk, operational risk and other risks in the Bank. The bank has also constituted risk management committees namely Credit Policy Committee (CPC) for credit risk, Asset Liability management Committee (ALCO) for market risk and Operational Risk Management Committee (ORMC) for operational risk.

A full-fledged Risk Management Department is functioning at bank’s Head Office, independent of business departments, for implementing best risk management systems and practices in the bank. A General Manager is in charge of the department who is the Chief Risk Officer responsible for overall supervision on risk management in the bank. In addition, the Middle Office Groups in Treasury (Domestic and Forex) and sections of Business Groups form integral part of risk management organization structure, which is responsible for monitoring adherence / compliance to policies, risk limit framework and internal approvals.
In line with the guidelines issued by the Reserve Bank of India, the bank implemented New Capital Adequacy Framework (Basel II) with effect from March 31, 2008. The Basel II framework, as referred, is based on three mutually reinforcing pillars. While the first Pillar of the revised framework addresses minimum capital requirement for credit, market and operational risk, the second pillar (Supervisory Review process) intends to ensure that the banks have adequate capital to address all the risks in their business commensurate with bank’s risk profile and control environment. As required, the bank has put in place a Board approved policy on Internal Capital Adequacy Assessment Process (ICAAP).

The third pillar of Basel II framework refers to market discipline. The purpose of market discipline is to complement the minimum capital requirements detailed under pillar 1 and the supervisory review process detailed under pillar 2. In this context, and as guided by the RBI, a set of disclosures (both qualitative and quantitative) with regard to risk management in the bank, which will enable market participants to assess key pieces of information on the scope of application, capital risk exposures, risk assessment processes, bank’s risk profile and level of capitalization etc. are discussed.

### TABLE - 6.4

**DISCLOSURE IN RESPECT OF CAPITAL STRUCTURE IN IOB**

<table>
<thead>
<tr>
<th>Quantitative</th>
<th>Applicability to IOB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Summary information on the terms and conditions of the main features of all capital instruments eligible for inclusion Tier I or in upper Tier II</td>
<td>Applicable to the bank as it raises both Tier I and Tier II capital from the market to meet increase in capital requirements from time to time</td>
</tr>
</tbody>
</table>

**Source:** Annual Report
The above table discloses the IOB’s raising both Tier I and Tier II capital from the market as per the RBI guidelines.

**TABLE - 6.5**

**QUANTITATIVE DISCLOSURE IN RESPECT OF TIER I CAPITAL IN IOB**

<table>
<thead>
<tr>
<th>The amount of Tier I capital with separate disclosure of</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Paid up share capital</td>
<td>Rs.544.80 crores</td>
</tr>
<tr>
<td>Reserves</td>
<td>Rs.4197.90 crores</td>
</tr>
<tr>
<td>Perpetual Debt Instrument</td>
<td>Rs.480 crores</td>
</tr>
<tr>
<td>Total amount of Tier II capital</td>
<td>Rs.1856.60 crores</td>
</tr>
<tr>
<td>Debt eligible in lower Tier II capital</td>
<td>Rs.1975.00 crores</td>
</tr>
</tbody>
</table>

**Source:** Annual Report

The table reveals that IOB has paid-up share capital of Rs.544.80 crores and reserves of Rs.4197.90 crores, perpetual debt is less than Rs.480 crores.

**CAPITAL ADEQUACY**

**QUALITATIVE DISCLOSURES**

A summary discussion of the bank’s approach to assessing the adequacy of its capital to support current and future activities.

In order to strengthen the capital base of banks in India, the Reserve bank of India in April 1992 introduced capital adequacy measure in banks, based on the capital adequacy framework (Basel I) issued by Basel Committee on Banking Supervision (BCBS). Initially, the framework addressed capital for credit risk, which was subsequently amended to include capital for market risk. In line with the guidelines issued by the RBI, the bank has been compliant with regard to maintenance of minimum capital for credit and market risk.

Subsequently, the BCBS released the “International Convergence of Capital Measurement and Capital Standards: A Revised Framework” (Popularly known as Basel II document) on June 26, 2004. A comprehensive version (The
Revised Framework) was issued in June 2006. Based on these guidelines and keeping in view the consistency and harmony with international standards, the Reserve Bank of India issued draft guidelines in February 2005 and thereafter the final guidelines on 27th April 2007 for implementation of the New Capital Adequacy (Basel – II) Framework. In addition, the RBI has issued clarifications on 31st March 2008 on certain issues relating to the subject.

In line with the RBI guidelines, the Bank migrated to the revised framework from 31.03.2008. The bank continued the parallel run of Basel II framework by continuously tracking the exposures and studied the impact on Bank’s Capital to Risk-weighted Assets Ratio (CRAR) on quarterly basis with a view to ensuring smooth transition to revised framework.

Basel II framework provides a range of options for determining the capital requirements for credit risk, market risk and operational risk. The framework allows banks and supervisors to select approaches that are most appropriate for their operations and financial markets. In accordance with the RBI’s requirement, the Bank has adopted Standardized Approach (SA) for Credit Risk and Basic Indicator Approach (BIA) for Operational Risk to compute capital as on 31st March 2008. Additionally, the Bank continues to apply the Standardized Duration Approach (SDA) for computing capital requirement for market risks with effect from 31st March 2006. As such, in addition to maintaining capital for credit risk and market risk as hither to, the bank has been maintaining capital for operational risk from 31.03.2008.

**TABLE- 6.6**

**QUANTITATIVE DISCLOSURE IN RESPECT OF CAPITAL ADEQUACY IN IOB**

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total capital to Risk weighted Asset Ratio (CRAR)</td>
<td>11.62%</td>
</tr>
<tr>
<td>Total CRAR (subject to prudential floor)</td>
<td>11.13%</td>
</tr>
<tr>
<td>Tier I CRAR</td>
<td>07.31%</td>
</tr>
</tbody>
</table>

**Source:** Annual Report
The Reserve Bank of India instructs banks to maintain a minimum Capital to risk-weighted Assets Ratio (CRAR) of 9% with regard to credit risk, market risk and operational risk on an ongoing basis, as against 8% prescribed in Basel documents. RBI also prescribes prudential floor (as 100% of minimum capital requirement computed under Basel I for credit risk and market risk as on 31.03.2008) for maintaining capital as per revised framework. The total Capital to Risk Weighted Assets Ratio (CRAR) as per Basel II guidelines worked to 11.62% as on 31.03.2008. The CRAR, subject to prudential floor, stands at a healthy level of 11.13% against regulatory requirement of 9.00%. The Tier I CRAR stands at 7.31% as against RBI’s prescription of 6.00%.

**TABLE- 6.7**

**CAPITAL REQUIREMENTS FOR CREDIT RISK (UNDER STANDARDIZED APPROACH) IN IOB**

<table>
<thead>
<tr>
<th>Portfolios</th>
<th>5246.04 Crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scuritnization Exposures</td>
<td>NIL</td>
</tr>
<tr>
<td>Total</td>
<td>5246.04 Crores</td>
</tr>
</tbody>
</table>

**Source:** Annual Report

In computation of capital for credit risk under Standardized Approach, the bank has relied upon the borrower-wise data captured from each individual branch. Further, the Bank has developed in-house software programme which enables computation of capital for credit risk of the Loans and Advances portfolio of branches and generation of desired reports at Branch level, Regional level and Head office level. The software programme has been tested internally before being ported for use of branches. Necessary validation, checks and balances have been factored in the software programme to ensure the correctness and adequacy of the data at the time it captures itself at branches. Necessary training has been imparted to the field staff on various aspects of capital computation to ensure accuracy and adequacy.
CREDIT RISK: GENERAL DISCLOSURES
QUALITATIVE DISCLOSURES

(a) CREDIT RISK

Credit Risk is the possibility of losses associated with diminution in the credit quality of borrowers or counterparties. In the operations of a bank, credit risk arises mostly from lending activities of the Bank, as a borrower is unable to meet its financial obligations to the lender. It emanates from potential changes in the credit quality / worthiness of the borrowers or counterparties.

CREDIT RATING AND APPRAISAL PROCESS

The Bank manages its credit risk through continuous measuring and monitoring of risks at each obligator (borrower) and portfolio level. The bank has robust internal credit rating framework and well-established standardized credit appraisal / approval processes. Credit Rating is a facilitating process that enables the bank to assess the inherent merits and defects of a proposal. It is a decision-enabling tool that helps the bank take a view on acceptability or otherwise of any credit proposal. In order to widen the scope and coverage further and strengthen the credit risk management practices, the bank has developed additional risk sensitive rating models in-house during the year for use at branches in future.

The internal rating factors such as quantitative and qualitative issues relate to management risk, business risk, industry risk, financial risk and project risk. Besides, such ratings consider transaction of specific credit enhancement features while assessing the overall rating of a borrower. The data on industry risk is constantly updated based on market conditions.

Credit rating, as a concept, has been well-internalized within the Bank. The rating for every borrower is reviewed at least once a year. As a measure of robust credit risk management practices, the bank has implemented a three-tier system of credit rating process which includes validation or rating (third stage) independent of credit departments. In respect of proposals failing under the powers of bank’s Head Office, the validation of ratings are done at Risk Management Department. The bank uses the credit ratings for deciding the
interest rates on borrowal accounts. The advantage of credit rating is that it enables the bank to rank different proposals and do meaningful comparisons.

The bank follows a well-defined multi-layered discretionary power structure for the sanction of loans. Approval Grid has been constituted at all levels covering Exceptionally Large branches / Regional Offices / Central Offices for considering fresh / enhancement proposals. A structure namely New Business Group (NBG) headed by CMD has been constituted at the Central Office level for considering in-principle approval for taking up fresh credit proposals above a specified cut-off. The bank has put in place a risk management framework for new products which lay down minimum processing / assessment norms to assess risk in a new product prior to its introduction.

**CREDIT RISK MANAGEMENT POLICIES**

The bank has put in place a well-structured Credit Risk Management Policy duly approved by the Board. The Policy documents define organization structure, role and responsibilities and, the processes whereby the Credit Risks carried by the Bank can be identified, quantified and managed within framework that the Bank considers consistent with its mandate and risk tolerance.

Credit Risk is monitored by the bank on a bank-wide basis and compliance with the risk limits approved by Board/RMCB is ensured. The CPC takes into account the risk tolerance level of the Bank and accordingly handles the issues relating to Safety, Liquidity, Prudential Norms, Exposure Limits by aligning the experience and performance like default experience, recovery experience etc and also take into account any regulatory and legal issues. The quality of internal control procedures is also monitored and internal expertise is built up to tackle all the facets of Credit Risk.

The Bank has taken earnest steps to put in place best credit risk management practices in the bank. In addition to Credit Risk Management Policy, the bank has also framed Board approved Loan Policy, Investment Policy, Counterparty Risk Management policy and Country Risk Management Policy etc which form an integral part in the monitoring of credit risk in the bank. Besides, the bank has implemented a policy on Collateral management and Credit Risk Mitigation with the approval of the Board which lays down the
details of securities (both prime and collateral) normally accepted by the bank
and administration of such securities to protect the interest of the bank. These
securities act as mitigation against the credit risk to which the bank is exposed.

TABLE – 6.8
QUANTITATIVE DISCLOSURES IN RESPECT OF CREDIT RISKS IN
IOB

<table>
<thead>
<tr>
<th>Quantitative Disclosures</th>
<th>Applicability to IOB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total gross credit risk exposures, fund based and Non-fund based</td>
<td>FB 61,057,59 crs</td>
</tr>
<tr>
<td></td>
<td>NFB 31,366,29 crs</td>
</tr>
<tr>
<td>Geographic distribution of exposures, fund based and non-fund based</td>
<td>FB 57,260.46</td>
</tr>
<tr>
<td></td>
<td>NFB 27688.94 crs</td>
</tr>
<tr>
<td></td>
<td>3,797.13</td>
</tr>
<tr>
<td></td>
<td>3677.35 crs</td>
</tr>
<tr>
<td>Amount NPA’s (Gross)</td>
<td>511.83 crs</td>
</tr>
<tr>
<td>Substandard</td>
<td>454.19 crs</td>
</tr>
<tr>
<td>Doubtful</td>
<td>30.93 crs</td>
</tr>
<tr>
<td>Loss</td>
<td>363.20 crs</td>
</tr>
</tbody>
</table>

Source: Annual Report

It is revealed by the above table that the total gross credit risk exposures
of IOB works out to 92,423.88 crs comprising 61,057,59 crs – fund based and
31,366,29 crs – Nonfund based for both domestic and overseas. The Gross
NPAs to gross advances of the bank works out to be 1.63% and the Net NPAs to
net advances is 0.60%.

MARKET RISK: DISCLOSURES RELATING TO MARKET RISK IN
TRADING BOOK.

QUALITATIVE DISCLOSURES
(a) MARKET RISK

Market Risk is defined as the possibility of loss to a bank in on-balance
sheet and off-balance sheet positions caused by changes / movements in the
market variables such as interest rates, foreign currency exchange rates, equity
prices and commodity prices. Bank’s exposures to market risk arises from domestic investments (interest related instruments and equities) in trading book (both AFS and HFT categories), the Foreign exchange positions (including open position in precious metals) and trading related derivatives. The objective of the market risk management is to minimize the impact of losses on earnings and equity capital arising from market risk.

**TABLE – 6.9**

**QUANTITATIVE DISCLOSURES IN RESPECT OF MARKET RISK IN IOB**

<table>
<thead>
<tr>
<th>Type of market Risk</th>
<th>Risk weighted Asset (National) (in crores)</th>
<th>Capital Requirement (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Rate Risk</td>
<td>3030.56</td>
<td>272.75</td>
</tr>
<tr>
<td>Equity Position Risk</td>
<td>1950.56</td>
<td>175.55</td>
</tr>
<tr>
<td>Foreign Exchange Risk</td>
<td>115.99</td>
<td>10.44</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>597.11</strong></td>
<td><strong>458.74</strong></td>
</tr>
</tbody>
</table>

**Source:** Annual Report

In line with the RBI’s guidelines, the bank has computed capital for market risk as per Standardized Duration Approach (SDA) of Basel II framework for maintaining capital. The above table highlights the capital requirement for market risk in trading book of the bank. The total capital required under Risk Weighted Asset (national) mode is Rs.5097.11 crs an as per the actual capital mode is Rs.458.74 crs to cover interest rate risk, equity position risk and Forex risk.

**OPERATIONAL RISK GENERAL DISCLOSURES**

**QUALITATIVE DISCLOSURES**

**(a) OPERATIONAL RISK**

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk but excludes strategic and reputation risks.
POLICIES ON MANAGEMENT OF OPERATIONAL RISK

The bank has farmed Operational Risk Management Policy duly approved by the board. Other policies adopted by the Board which deal with management of operational risk are (a) Information Systems Security Policy (b) Forex risk Management Policy (c) Policy document on Know your Customers (KYC) and Anti Money Laundering (AML) Procedures and (d) IT Business Continuity and Disaster Recovery Plan (IT BC-DRP).

The Operational risk Management Policy adopted by the Bank outlines organization structure and detail processes for management of operational risk. The basic objectives of the policy is to closely integrate operational risk management system into the day-to-day risk management processes of the bank by clearly assigning roles for effectively identifying, assessing, monitoring and controlling / mitigating operational risks and by timely reporting of operational risk exposures including material operational losses. Operational risks in the Bank are managed through comprehensive and well-articulated internal control frameworks.

QUANTITATIVE DISCLOSURES

(b) In line with the final guidelines issued by RBI, IOB has adopted the Basic Indicator Approach for computing capital for operational risk. As per the guidelines, the capital of operational risk is equal to the average over the preceding three years of 15% of positive annual Gross Income as defined by RBI. As per such estimate, the capital requirement for operational risk as on 31.3.2008 was Rs.446.85 Crores.

TOWARDS BASEL II

Operational risk is a complex issue for bankers to tackle and is gaining increasing attention in today’s scheme of things. With globalization and deregulation of the banking sector and deployment of sophisticated technology, online and real-time transactions, outsourcing and consolidation through M&A
activity, operational risk is considered grave or serious, it not more, spectrum of the business and therefore is rather difficult to quantify, identify and measure.

Broadly the causes of operational risk can be: fraud – internal and external, theft and misuse of customer information, money laundering, loss on account of eventualities like natural calamities, terrorist activities, stem failures and the resultant disruption in operations, and unintentional yet critical mistakes on the part of employees.

Y.L. Madan, executive director of Chennai-based public sector Indian Overseas Bank, believes that operational risk generally arises out of non-compliance of instructions/guidelines – both internal and external – at different levels. Says he: “There may also be cases, where the bank may have to face the operational risk losses on account of system and systematic deficiencies apart from human failure. These have to be tackled differently. The bank has well defined and laid down systems and procedures which will minimize the operational risk losses to a great extent. Secondly the bank has a well-established training system to impart training to all its members of the staff at different centers, which is an on going process. This takes care of knowledge gaps at operating staff levels, which is the main cause for operational risk. Once, these two areas taken care of, the operational risk factors at individual level are properly addressed to, which would minimize the risk levels.”

**TECHNOLOGIES IN PLACE**

IOB has an alert system in respect of KYC/AML measures. This, says Madan, has a strong bearing on operational risk. Similarly an alert system is being thought of for compliance issues, which also have a critical influence on operational risk. Besides, the IT department of the bank constantly upgrades the CBS to meet the operational risk requirements.

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1 Glbal Best practices in Indian Banking , The Chartered Accountant August 2008 P- 319
AUDIT METHODS

According to Madan, IOB has risk-based internal audit systems (including risk templates) and information systems security audit as primary tools for determining/assessing the presence of operational risk. Apart from these tools, the bank has concurrent audit, revenue audit, stock audit systems, which would throw proper signals, especially about the presence of operational risk at the branches. The regional heads also undertake periodical visits to branches to assess the risk climate at the branch.

RISK TRAINING

Y.L. Madan also stated, IOB has identified Operational Research (OR) desk officers at regional offices who are responsible to collect the data and submit MIS to the central office. These offices have been given an intensive training in OR areas, collection of data, updation of formats, etc. This is an ongoing process. Apart from this, the training system has devised suitable modules for imparting operational risk concerns of the bank, in different programmes conducted for different levels of officers of the bank. Almost all the training programmes undertaken by the bank have a module on risk management.

ROLE OF CUSTOMER COMPLAINTS

At IOB, data on complaints is collected by operational risk team at central office periodically and evaluated and analyzed to ascertain the presence of operational risk elements. This data is placed before a high power committee for necessary directions and instructions. Wherever required, based on the directions received, necessary modifications are carried out to the systems and procedures of the bank.

OR DATABASE

At IOB, officers of the OR department at the regional office cull out the operational risk loss events from the paper-based data / source information and submit the information to the central office/ operations risk cell. The data received is entered into the operational risk database. The bank has a database on operational risk loss events and losses since 2006, says Madan.
Business managers have a very important role in mitigating / minimizing operational risk. Their task is to implement the directives of the bank in letter and spirit so that operational risk losses do not occur. They also have to access and accept the business keeping in view the risk parameters set out by the bank. They also identify the potential risk areas in the operating environment / office and take suitable preventive measures to ward off the potential losses. Similarly functional areas which have an element of latent risk will also have to be an identifier and steps initiated at the first opportunity to migrate the risk losses. It is one of the Business Manager’s responsibilities that they have to act as change–agents by educating and counselling the operating staff/support staff.

**ROLE OF BUSINESS MANAGERS**

Operation Research (OR) is owned and managed by the business and function, and business/function head is responsible to ensure compliance with the group and regulatory requirements in terms of:

i. OR structure and framework in business/function
ii. Adequate and trained OR resources.
iii. Robust processes and infrastructure including systems
iv. Early identification, and timely reporting and mitigation of operational risks and
v. Booking of operational losses and reconciliation with the OR loss database.

**AUDIT COMMITTEE IN IOB**

Efficiency of markets and standards of living of the people depend upon the quality of the auditors. Hence the need for setting up qualified and independent audit committee. While an auditor is required to give an independent and unqualified opinion, he invariably becomes susceptible to the management’s influence.
<table>
<thead>
<tr>
<th>Principle</th>
<th>Applicability</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualified and Independent Audit Committee (AC) should be set up. Minimum of 3 directors as members of whom 2/3rd shall be independent directors. All members should be financially literate and at least one should have accounting or related financial management expertise. Chairman to be an Independent Director, Chairman to be present at Annual General Meeting. Audit Committee may invite appropriate executives. Company secretary to act as secretary to the committee.</td>
<td>The composition, structure and functions of the Audit Committee are as per the guidelines issued by RBI in this regard. The constitution issued has been defined vide guidelines of RBI dated 9th April 1994 and the functioning of Audit Committee Board (ACB) with RBI circular dated 26th September 1995, which are being complied with.</td>
<td>Audit Committee constituted as per the directive of RBI, consists of Executive Director, Nominee of Government of India, RBI two non-official/non-executive directors. The Chairman of the ACB is a chartered Accountant. The chairman of the Audit committee in IOB is an independent director who is also a shareholder director. He was presiding the 6th AGM held on 16th June 2006. The General Managers concerned are being invited regularly to the meetings of AC of the Board. Regarding the information given in RBI circular, it has been decided to seek invitation. Clarification from RBI in this regard</td>
</tr>
</tbody>
</table>
since this is in variance from clause 49.

Source: RBI Guide lines and Primary Data

In IOB, Audit Committee consists of an Executive Director, nominee of Government of India, RBI, two non-executive directors. The chairman is a chartered accountant who is an independent director and shareholder director. Regular meetings are arranged by the chairman as per the instructions of the RBI; and the bank also seeks information / clarification from RBI on all matters from time to time. The chairman answers shareholders queries from the attendance book and the minutes book of the Annual General Meeting.

AUDIT COMMITTEE – MEETINGS

Audit committee is often specified as providing oversight of the external audit activities and should be charged with overseeing the overall relationship with the external auditor including the nature of non-audit services provided by the bank. Channels of disseminating information is as important as the content of information. Hence disclosure of information is provided in the legislation itself for which the formation and the pillar – Audit Committee.

TABLE – 6.11

ASPECTS RELATING TO AUDIT COMMITTEE – MEETINGS IN IOB

<table>
<thead>
<tr>
<th>Principle</th>
<th>Applicability</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meeting of audit committee. The audit committee should meet at least 4 times in a year</td>
<td>In terms of RBI circular dated 26th Sep, 1995, the meetings of ACB has to be held once in a quarter</td>
<td>In the case of IOB, for the year ended 31.03.2006, ACB met 10 times. The audit</td>
</tr>
</tbody>
</table>
and not more than 4 months shall elapse between two meetings. The quorum is either 2 members or 1/3rd of the members of the AC; whichever is greater. A minimum of 2 independent members should be present.

and should meet not less than 6 times in a year. Three members is a quorum for the ACB. Committee is headed by an Independent shareholder Director who is also a chartered Accountant. The ACB consists 5 members, comprising Executive Director, Government Director, RBI director, and two non-official director.

Source: RBI Guidelines and Primary Data

IOB has an efficient Audit Committee consisting of five members. It met ten times in the year 2006. Regular meetings are conducted every year and the attendance of the meeting is highly encouraging.

POWERS OF AUDIT COMMITTEE

Audit Committee should play a vital role fully involving themselves in a situation where they have to investigate any activity to have an effective governance, seek information from any employee to the best interest of all stakeholders and obtain legal opinion from experts if required.
### TABLE – 6.12
ASPECTS RELATING TO AUDIT COMMITTEE – POWERS IN IOB

<table>
<thead>
<tr>
<th>Principle</th>
<th>Applicability</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>To investigate any activity within its terms of reference.</td>
<td>The functioning and the powers of the Audit Committee Board are governed by the provisions/guidelines contained in the RBI circular of 26th September 1995 and 04.06.2002.</td>
<td>IOB fully complies with the same.</td>
</tr>
<tr>
<td>To seek information from any employee.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To obtain any outside legal opinion.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To secure attendance of outsiders with relevant experience.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** RBI Guidelines and Primary Data

IOB functions in accordance with the RBI circular dated 26.9.1995 and 4.6.2002 and the committee functions effectively in all the aspects as per the guidelines and within their powers assigned. To date, it has not carried out its functions beyond its powers. It effectively implements all the principles to the best satisfaction of shareholders, directors, creditors, government and employees.

**ROLE OF AUDIT COMMITTEE**

Audit Committee is the only pillar that has been viewed in the corporate governance code. This is a positive step towards maintaining auditors independent. It should review with the management the financial statements long before the submission to the board regarding any change in accounting policy,
major accounting entries, significant adjustments arising out of audit, compliance with accounting standards, adequacy of the internal audit and discussion, review the findings of any internal investigations, discussion with statutory auditors and review of the risk management policies and review of payments to stakeholders.

**TABLE – 6.13**

**ASPECTS RELATING TO AUDIT COMMITTEE – ROLE IN IOB**

<table>
<thead>
<tr>
<th>Principle</th>
<th>Applicability</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oversight of the banks financial reporting ensures that financial statement is correct. Review the annual financial report before presentation to the board. Review the quarterly accounts. Review the adequacy of the internal audit and discussion with them. Discussion with the statutory auditors. Discussion with the statutory auditors. Review the defaults in the payment to the depositors, shareholders, debenture holders etc.</td>
<td>The functioning and the powers of the ACB are governed by the provisions/ guidelines contained in the RBI circular of 26th September 1995 and 04.06.2002.</td>
<td>Additional Responsibilities entrusted to ACB by the RBI vide the letter dated 04.06.2002 is also taken care of (Formation of shareholders grievances committee, providing half yearly results to shareholders, review of the bank’s financial reporting, accounting policies and review of the findings of the internal investigations etc).</td>
</tr>
</tbody>
</table>

*Source: RBI Guidelines and Primary Data*
IOB has entrusted additional responsibilities to Audit Committee Board by forming shareholders grievances committee, providing quarterly and half-yearly results etc. Auditors shoulder these additional responsibilities which fall within the scope and complexity of the areas under review. They accept responsibility and accountability for the audit work performed on assigned projects. They also ensure that audit findings and recommendations are promptly communicated to the management.

REVIEW OF INFORMATION BY AUDIT COMMITTEE

The aspects relating to review of information by Audit Committee have been adhered to by ascertaining whether the relevant and stipulated information have been reviewed by the committee, any deficiencies or adverse findings have been suitably dealt with by the management in the report on corporate governance and the information reviewed that is consistent with the financial statements.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Applicability</th>
<th>Remarks</th>
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<tr>
<td>The audit committee should mandatorily review: 1. Management discussion and analysis of the financial conditions and results of operations</td>
<td>All the Information except point no:5 which is not applicable to the Bank, is being reviewed / complied with as the case may be by the Bank.</td>
<td>RBI vide their letter dated 25.01.06, addressed to Shri M.P. Mehrotra, shareholder nominee in the Board of Canara Bank stated / classified the following with particular...</td>
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<td>2. Related third party transactions.</td>
<td>reference to public sector banks:</td>
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<td>3. Management letters/letters of internal control weakness issued by the statutory auditors.</td>
<td>1. Composition of ACB is in agreement with Sec.292 A of the companies Act, 1956 and hence needs no amendment.</td>
<td></td>
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<td>4. Internal audit report relating to Internal control weakness.</td>
<td>2. If there is only one official CA director, he should not be rotated.</td>
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<td>5. The appointment, removal and terms of remuneration to chief Internal Auditor are subject to review by the Audit Committee.</td>
<td>3. The functions of ACB are already well-defined and hence needs no change.</td>
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<td>4. Finalization of the Board report of corporate Governance in consultation with ACB is left to the Bank Board and RBI cannot interfere.</td>
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<td>5. Interaction by the AFI Team with the members of ACB before/after finalization of their</td>
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</table>
IOB adheres to all the principles laid by the RBI letter dated 25.1.2006 accordingly, the composition of the audit committee on the Board needs no amendment, the directors of IOB are not rotated if there is only one Chartered Accountant-Director. Moreover, the function of ACB is vividly and explicitly defined and hence needs no changes. The decision of the bank board is final in matters relating to board reports. The IOB does not give room for the RBI to interfere in these matters.

**MEASURES ADOPTED BY THE BANK FOR FURTHERANCE OF CORPORATE GOVERNANCE**

- An investors relation cell has been created and headed by the General manager to redress the grievances of the shareholder in time.
- A Company Secretary to oversee the functioning of the registrars with particular reference to effecting of transfer, transmission, issuance of duplicate shares etc. with the prescribed time limit.
- Setting up of a board level committee for monitoring share transfer and shareholders grievances with shareholders nominees in the committee.
- Complying with all the provisions of the listing agreement in time.
- Shareholders are provided with quarterly accounts as against the required norm of providing only half yearly accounts.
- Laid down code of conduct applicable to the Board of Directors and the General Managers and obtained declaration from each of them for their adherence to the code of conduct.
- Framed the IOB Insider Trading Regulations and made them applicable to the Board of Directors, GMs, DGMs, AGMs and officers attached to CMD/ED/GMs/secretariat etc.
- All Board notes are circulated well in advance.
• Preparation of Board notes in detailed manner which enables the Director to take a considered-decision after a thorough discussion.

• Shareholders are provided with Investors updates, with valuable information to them.

• Minutes of Board/AGMs/EGMs are prepared in a detailed manner recording even the dissenting comments.

• The ACB of the Board is headed by an independent, Chartered Accountant Director who is also a nominee of the shareholders.

• Except one, all the other directors do not hold any other directorships.

• Continuous updating of the knowledge of Directors through reputed external training institutions and

• Appointment of compliance officers for ensuring adherence of the rules/regulations.