



LONG FORM AUDIT REPORT & OTHER REPORTS

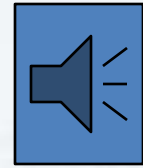
Presented by :-

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Scope of this presentation



- General about Bank Branch Audit
- RBI guidelines on LFAR of Branches
- Major issues /areas which needs to be commented upon in LFAR
- Ghose & Jilani Committee Reports

Risks faced by a Bank Branch

Credit risk

Operation risk

Exchange risk

Market risk

Accounting risk

Liquidity risk

Control risk

Main Items in Bank Branch's Financials

Balance sheet

Assets

- Advances *
- Investments
- Cash & bank balances
- Other assets *

Liabilities

- Deposits *
- Other liabilities *

Profit & Loss account

Income

- Interest income *
- Fees & commission
- Other income

Expenses

- Interest expenses *
- Provision for doubtful debts *
- Administrative expenses

** Critical audit areas*

Audit Assertions

- **Completeness**
- **Existence**
- **Accuracy**
- **Valuation**
- **Ownership**
- **Presentation**



Time Management

Specify Start date and End date

Communicate Requirement Check-list

Working late including on Sat, Sun & Public holidays

Discuss Audit Program with BM

Monitor Information flow judiciously

Depute suitable sized competent audit team

Record all Communications

General – about LFAR



LFAR revised by RBI in 2003

Study LFAR Questionnaire thoroughly

**Plan the LFAR along with
statutory audit right from day one**

**Complete & submit Main Audit Report
as well as LFAR simultaneously**

General – about LFAR...

Main Audit Report and LFAR are two separate reports. Comments in LFAR should not be *qualificatory* in nature

Include Audit Qualifications in Main Audit Report and not in LFAR

LFAR-Background

- In the course of audit of a Bank or branch of a Bank, the auditor may come across several matters which are not included in the main audit report but nevertheless considered important enough to be communicated to the Bank Management
- The format of LFAR as devised by RBI in 1985 and revised in 1992-93 and 2003
- LFAR is a type of management letter which draws attention of head office/top management of the Bank on various issues requiring rectification /modification / improvement of processes at the Branch

LFAR- GENERAL . . .

- The LFAR questionnaire is a useful tool for planning the statutory audit of a bank's branch
- Complete & submit the Main Audit Report as well as the LFAR simultaneously
- Be specific while replying LFAR – avoid vague comments & ambiguity
- Give instances of shortcomings/weaknesses existing in the respective areas of the branch functioning in the LFAR
- The LFAR should be sufficiently detailed and quantified so that not only it can be expeditiously consolidated by the bank but even help the bank in rectifying the identified problems immediately on conclusion of audit
- The main audit report should be a self-contained document and should contain no reference of any point made in the LFAR
- Preparatory work - [List of requirements for LFAR.shs](#)

COVERAGE IN LFAR

- The statutory Auditors are expected to comment on important issues related with
 - Advances I
 - Liquidity and funds management II
 - Internal controls III
 - Automation and computerization IV
 - Profitability V
 - Systems and Controls VI
 - Applicable to Specialized Branches VII
- The list of areas to be covered in LFAR are illustrative
- The decision to include any matter other than those covered by LFAR – should be taken based on judgment by the Auditor

I - ADVANCES

- General
 - Large advances are those in respect of which outstanding amount is in excess of 5% of the aggregate advances of the branch or Rs. 2 crore whichever is less
 - Adequate provisioning for restructuring of Advance in compliance with RBI Circulars
 - Adequate provision made for the loss in PV terms for all the receivables due from the borrowers covered under the Debt relief scheme (RBI/2009-10/160 dated Sept 16, 2009)
 - Comments on adverse features considered significant and which need management's attention
- Issues
 - Instances of non detection of adverse comments in other audits/ monitoring mechanism.
 - Exchange of information, sharing of reports/ documents in consortium/ multiple banking accounts.
 - Compliance of CDR, restructure package stipulations

I - ADVANCES

- Credit Appraisal

- Prescribed forms and procedures/instructions for preparations of proposals/ grant/ renewal/ enhancement of limits
- Suggestions of Auditor's in case of any major shortcomings
- Policy of maintaining rejected proposals
- Credit rating of major advances
- Review loans approved by an executive before retirement

- Issues

- Efficacy of appraisal systems, Credit risk rating models, status of rating by external rating agencies.
- Projections vis-a-vis underlying assumptions, Advance payment BGs, short term loans, project finance v/s ALM and proper due diligence, take over norms etc.
- Adherence to the appraisal system

I - ADVANCES

- Sanction / disbursement
 - beyond the delegated authority or limit fixed for the branch
 - without complying with the terms and conditions of the sanction
- Issues
 - Control mechanism to oversee judicious use of delegated powers and monitoring thereof
 - System to ensure compliance of terms of sanction/ creation of security before release of facility
 - Revalidation of facility in case of delay, change in underlying assumptions or conditions.

I - ADVANCES

- Documentation

- System of ensuring that documents are executed as per the terms of sanction.
- Nature of documentation defects observed during audit and suggestions to avoid such defects.
- System of documentation in respect of joint/consortium advances.
- advances against lien of deposits
- Renewal of documents.

- Issues

- Vetting of documents , creation of charge
- Consortium/ multiple banking a/cs
- Analysis of irregularities and action plan for prevention

I - ADVANCES

Review/Monitoring / Supervision

- Analysis of the accounts overdue for review/renewal between 3 months to 6 months
- Periodic balance confirmation / acknowledgement of debts.
- Receiving regular information, Stock/Book Debt statements, Insurance of security, Financial Statements etc.
- Receiving audited accounts in case of borrowers with limits beyond Rs. 10 lakhs.
- System of scrutiny of the above information and follow-up by the bank.
- System of periodic physical verification or inspection of stocks, equipment and machinery and other securities.
- System and periodicity of stock audits;
- Inspection reports and their follow up.
- Norms and awarding of Credit Rating.
- Review/renewal of advances including enhancement of limits.
- NPA promptly reported to the relevant Controlling Authority of the bank and rehabilitation programme if any

I - ADVANCES

- Review/Monitoring / Supervision
 - Monitoring and follow - up of overdues arising out of other businesses such as leasing, hire purchase, credit cards, etc.
 - System of monitoring of off - balance sheet exposures including periodic reviews of:
 - claims against the bank not acknowledged
 - L/C's
 - L/G's
 - forward transactions
 - co-acceptances
 - swaps, etc.
 - Identification and classification of advances into standard/sub standard/doubtful/loss assets
 - O/s amounts of guarantees invoked, LC's and co-acceptances funded
 - Comment on guarantees expired but not cancelled
 - Overexposure of such facilities to certain parties
 - major deficiencies in credit review, monitoring and supervision
- Issues
 - Effectiveness and adequacy of Credit monitoring system, portfolio review, credit audit
 - Shortcomings/ gaps in monitoring mechanism and extent of adherence to existing system

I - ADVANCES

- Recovery Policy in respect of and Bad/doubtful debts/ NPAs
 - Existence of Recovery Policy, regular updation thereof; monitoring and adherence thereto: compliance with the RBI guidelines.
 - Effectiveness of the system for compiling data relating to the bad and doubtful debts and the provision in respect thereof.
 - System for identification, quantification and adequacy of provision (including at foreign branches).
 - System for suspension of charging of interest and adherence thereto.
 - Ascertaining the realisable value of securities (including valuation of fixed assets) and the possible realisation from guarantors including DICGC/ECGC;
 - Assessment of the efficacy of rehabilitation programmes.
 - Method of appropriation of recoveries against principal, interest, etc.
 - System of compromise settlements : Review all such cases and cases of recovery of over Rs. 50 lacs and also the cases wherein limits of sacrifice laid down in the Recovery Policy is exceeded. Compliance with RBI guidelines.

I - ADVANCES

- Recovery Policy in respect of and Bad/doubtful debts/ NPAs
 - Provision / write-off: under proper authority.
 - Recovery procedures including that relating to suit filed and decreed accounts.
 - System of identifying and reporting of willful defaulters.
 - CDR – calculation of sacrifice upon compromise etc
 - Sale/disposal of distressed asset and compliance to Guidelines
- Issues
 - Effectiveness/ reliability of the application for IRAC, Single ID, data capturing and modification thereof, data integrity
 - Security valuation policy and extent of adherence
 - Judicious exercise of OTS/ Write-off discretionary powers

II – LIQUIDITY AND FUNDS MANAGEMENT

Investment

- For Branches in India
 - If investment held at the Branch:
 - ✓ Physical verification
 - ✓ Income Accrual and receipt
 - ✓ Matured Investments – if not encashed
 - ✓ RBI guidelines regarding transactions in securities and valuation of investment
- For Branches outside India
 - purchase and sale of investments, has the branch acted within its delegated authority
 - Physical verification
 - Matured Investments – if not encashed
 - RBI guidelines regarding valuation of investment

II – LIQUIDITY AND FUNDS MANAGEMENT

- Cash

- System of monitoring of cash at branches / ATM's ; management of cash through currency chest operations.
- Insurance cover (including insurance for cash in transit).
- System and procedure for physical custody of cash (Dual Custody)
- Cash Carrying limits and exceptions thereto
- Checking of cash balances at the Branch at periodic intervals

- Issues

- Cash management system. Cash retention limits Dynamic/static
- Functioning of currency chest- instances of penalties
- Exposure limits on other banks, control /reporting system of O/s balances

II – LIQUIDITY AND FUNDS MANAGEMENT

- Balance with RBI, SBI and Other Banks
 - Balance confirmation certificate as at the year end with reconciliation and nature and extent of differences should be reported
- Issues
 - Confirmation certificate/statements whether received regularly and tallied/reconciled , extent of difference and nature thereof
 - Old Outstanding balances remaining unexplained/unadjusted

II – LIQUIDITY AND FUNDS MANAGEMENT

- Call Money operations
 - System relating to inter-bank call money operations

May not be relevant for most of Branches

- Issues
 - System and its efficacy for optimum use of funds
 - Adherence to prudential limits under call money market.

III – INTERNAL CONTROLS & SYSTEMS

Other Assets

- Stationery / Stamps etc custody, issue and missing/lost items
- Suspense accounts, sundry deposits
 - System for clearance of items debited/ credited to these accounts
 - unusual items
- Issues
 - System in CBS environment and its effectiveness

III – INTERNAL CONTROL

Liabilities

- Deposits
 - guidelines with respect to conduct and operations of Inoperative Accounts.
 - Clarification of unusual large movements in the aggregate deposits held at the year–end
 - overdue/ matured term deposits
- Other Liabilities
 - old outstanding items pending for three years or more
 - unusual items or material withdrawals or debits
- Contingent Liabilities
 - major items of the contingent liabilities other than constituents' liabilities

III – INTERNAL CONTROL

Profit & Loss A/c

- system to compute discrepancies in interest/ discount and for timely adjustment thereof
- complied with the Income Recognition norms
- to compute discrepancies in interest on deposits and for timely adjustment
- system of estimating and providing interest accrued on overdue/ matured term deposits
- divergent trends in major items of income and expenditure

III – INTERNAL CONTROL

- Books and Records
 - general scrutiny of books of account maintained manually
- In respect of computerised branches:
 - hard copies of accounts are printed regularly
 - extent of computerization and areas covered
 - Whether access and data security measures and other internal controls adequate
 - Regular Back ups and off site storage
 - adequate contingency and disaster recovery plans
 - suggestions for the improvement in the system if any

III – INTERNAL CONTROL

- Reconciliation of control and subsidiary records
 - System of monitoring the position of balancing of books/reconciliation of control and subsidiary records.
 - Computerized Accounts or CBS environment
- Issues
 - Migration audits- Migrated Accounts
 - GL heads where balancing is not taken care by the system

III – INTERNAL CONTROL

- Inter branch reconciliation
 - forward on a daily basis to a designated cell/ Head Office, a statement of debit/ credit transactions in relation to other branches
 - check of the balance in the HO a/c in agreement with the HO a/c in the general ledger
 - O/s debits in the HO a/c in respect of inter–branch transactions
 - expeditiously comply with/ respond to the communications from the designated cell/ HO as regards unmatched transactions
 - double responses
 - old/ large outstanding transaction/ entries at debits which remain unexplained
- Issues
 - Gaps in reconciliation through CBS environment and controls
 - Reconciliation status of old entries

Inter-Branch Accounts...

Ensure

Whether the branch responds promptly to error advices received from H.O.

Whether the branch is vigilant about expeditious clearance of high-value entries?

Whether IBR st. are regularly received from HO & promptly attended?

Whether branch has written details on IBR st. for pending entries?

Test-check IBR St. to ascertain existence of high-value items

Whether originating debit entries/ cash transactions are liquidated within a reasonable period of time?

III – INTERNAL CONTROL

- Audits/ Inspections

- branch covered by concurrent audit or any other audit/ inspection
- In framing audit report, consider the major adverse comments arising out of the latest reports of the previous auditors, concurrent auditors, stock auditors or internal auditors, or in the special audit report or in the Inspection Report of the Reserve Bank of India

- Frauds / Vigilance

- Observation on major frauds discovered during the year under audit
- System of follow up of frauds/ vigilance cases

- Issues

- Level and adequacy of Off Site surveillance
- Analysis of frauds and extent of corrective actions initiated
- Comments on systemic failure, if any.

III– SYSTEMS AND CONTROLS

- Systems and Controls

- Existence of systems and procedures for concurrent and internal audits, inspections, EDP audit of computer systems / software, etc., monitoring and follow - up of such reports:
- Existence of Management Information System: method of compilation and accuracy of information.
- Reliability of regulatory reporting under the Off Site Surveillance System of the RBI.

- Issues

- Quality of compliance and authority for closure
- Analysis of audit observations and its effective use for strengthening the systems and control
- Status of BPR

III – INTERNAL CONTROL

- Miscellaneous
 - examination of the accounts indicate possible window dressing
 - maintain records of all the fixed assets acquired and held by it irrespective of whether the values thereof or depreciation thereon have been centralised
 - Other matters

IV –AUTOMATION AND COMPUTERISATION

- General

- Existence of Computerisation and Automation Policy; progress during the year under.
- Critical areas not covered by automation.
- Procedures for back-ups, off-site storage, contingency and disaster recovery and adherence thereto
- Existence of Systems/ EDP audit; coverage of such audit.
- Electronic Banking; existence of systems and procedures; monitoring; regular updation of technology; method of review and audit of procedures.
- Suggestions, if any, with regard to computerisation and automation.

- Issues

- IT,IS Security, IS Audit, BCP ,BPR Policies, their implementation and gaps
- Standalone applications and extent of interface IS Audit infrastructure
- Scope/adequacy of IS Audit of Branches, EDPs, CBS, BCPs, Networking, Internet/Mobile Banking, ATMs, Application soft wares, Data centre, outsourcing arrangements
- Status of migration audit
- Analysis of audit observations and corrective actions initiated.

V – PROFITABILITY/AR

- Profitability
 - Analysis of variation in major items of income and expenditure compared to previous year.
 - Important ratios such as RoA, RoE, etc: comparison and analysis in relation to previous year.
 - Policy relating to general provisions/ reserves.
- Issues
 - Gaps with respect to profit planning
 - Divergent Trends – to be fully explained
 - Early indications for meaningful corrections

VI- Applicable to Specialised Branches

- For Branches dealing in Foreign Exchange Transactions
 - any material adverse features pointed out in the reports of concurrent auditors, internal auditors and/ or the RBI inspection report which continue to persist in relation to NRE/ NRO/ NRNR/ FCNR–B/ EEFC/ RFC and other similar deposit accounts
 - Whether the Branch has followed the instructions and guidelines of the controlling authorities of the bank with regard to the following-
 - ✓ deposits
 - ✓ advances
 - ✓ export bills
 - ✓ bills for collection
 - ✓ dealing room operations (where a branch has one)
 - ✓ any other area
 - Nostro/Vostro Accounts - regularly operated, balance confirmations, reconciled

VI- Applicable to Specialised Branches

- For Branches dealing in very large advances such as Corporate Banking, Industrial Finance and branches with advances in excess of Rs100 crore
 - In respect of borrowers with outstanding of Rs 2 crore and above, the information in the specified format should be obtained from the Branch Management
 - Opinion on major shortcomings in credit appraisal, monitoring, etc.
 - List the accounts (with O/s in excess of Rs1 crore), which have downgraded or upgraded with regard to their classification as NPA or, Standard Asset during the year and the reasons thereof

VI- Applicable to Specialised Branches

- For branches dealing in recovery of NPA's such as Asset Recovery Management Branches
 - In respect of borrowers with outstanding of Rs 2 crore and above, the information in the specified format should be obtained from the Branch Management
 - List the accounts (with O/s in excess of Rs 2 crore), which are downgraded or upgraded with regard to their classification as NPA or, Standard Asset during the year and the reasons thereof
 - system of updating periodically, the information relating to the valuation of security charged to the bank
 - Age-wise analysis of the recovery suits filed and pending
 - execution of decrees obtained for recovery from the defaulting borrowers
 - recoveries and their appropriation against the interest and the principal and the accounts settled/ written off/ closed during the year
 - new borrower accounts transferred to the Branch during the year-
 - ✓ relevant documents and records also transferred
 - ✓ obtained confirmation that all the accounts of the borrower (including non-fund based and deposits also transferred

VI- Applicable to Specialised Branches

- For branches dealing in Clearing House Operations, normally referred to as Service Branches
 - system of periodic review of the outstanding entries in clearing adjustments accounts
 - review of the clearing adjustments accounts (inwards/ outwards) reveals any old/ large/ unusual outstanding entries, which remain unexplained
 - Has the Branch strictly followed the guidelines of the controlling authority of the bank related to clearing transactions

Ghosh Committee

- A high level committee was set up to enquire into the various aspects of frauds and malpractices in the bank and to make recommendations to reduce such instances.
- Main Objectives - Safety of Assets
- All answers are strictly to be in YES/NO/NA mode only and replies such as “Being done” are not permitted.
- Categorization on Implementation of Ghosh
 - Group A - Recommendations which have to be implemented by the banks immediately.
 - Group B - Recommendations requiring RBI's approval.
 - Group C - Recommendations Requiring approval of Government of India.
 - Group D - Recommendations requiring further examination in consultation with IBA.

Out of 97 Recommendations 27 are required to be reported at Branch level, 43 at RO/ZO/HO level and 27 at both levels.

Major Recommendation of Ghosh Committee

- Branch Level - Group A.
 - Joint custody & dual responsibility of cash and other Valuables.
 - Rotation of Staff/ duties.
 - Designation of one of the officers as compliance officer.
 - Financial and administration powers of officials to be laid down.
 - Precautions against theft of cash.
 - Execution of caution at the time of opening of new deposits of all types.
 - Precautions in preparations drafts / mail transfer. h. Precautions for averting frauds in letter of credits, guarantees.
 - Screening / selection of employees in EDP cell, computer area
 - Standards for fully computerized branches.

Contd....

Major Recommendation of Ghosh Committee

- **Branch Level - Group B**

- Banks to introduce portfolio inspection in critical areas such as credit, investment, off balance-sheet items.
- Periodical movements between bank officials & investigating officials of CBI/Police.
- Six months prior to retirement officials should exercise their sanctioning powers jointly with next higher authority. d. Paper used for cheque/drafts should be such that any use of chemical for making material alternation in instrument should be visible to naked eye.

- **Branch Level - Group C**

- Chief Vigilance officer should directly refer to CVC, cases having vigilance angle involving CMD.
- Fraud cases upto Rs.25,000/- having involvement of an insider should not be reported to police , where recovery not doubtful.
- Introduce a return of staff members to ensure strict submission of information of assets & liabilities and proper scrutiny thereof.

- **Branch Level - Group D**

- BRs should not be outstanding for more than 7 days.
- Obtain photographs of depositors at the time of opening of accounts

Jilani Committee

- The Reserve Bank of India set up a Working group under chairmanship of Mr.Jilani.
- To review internal controls, inspection and audit systems in banks with a objective to strengthen the supervisory system and ensure reliability of data
- Main Objectives - Safety of Assets
- The answers should be either “implemented” or “Not implemented”.
- 3 Categories of Recommendation
 - EDP environment in banks .
 - Inspection / internal audit in the banks
 - Miscellaneous aspect of functioning of a bank.

Major Recommendation of Jilani Committee

- Co-ordination between Inspection & Operational wings to be ensured
- Broad Guidelines to establish accountability for inspectors/ auditors to be laid down.
- A database on training inventory of each inspector / auditor to be developed for updating of knowledge.
- A copy of the booklet incorporating RBI circulars to be supplied to each inspecting/ audit official periodically.
- Profiles of Banks branches in thrust areas such as audit ratings ,asset quality, level of NPA's, revenue Leakages etc. to be maintained on computer so as to enable the banks to pin- point inadequacies for remedial action.
- A manual of instructions for inspectors/auditors to be maintained
- Inspection Audit to be completed within 2 months and for very large branches 3 months.
- All poorly rated branches to be inspected within 12 months & others between 12 & 18 months of previous inspection.
- Revenue/income audit to be conducted at selected branches where leakages are noticed and there is no concurrent audit.

Contd....

Major Recommendation of Jilani Committee

- Inspection audit report to be updated/ revised periodically. An executive summary to be prepared after every inspection to be submitted to the higher authorities.
- Banks should have system for ratings of its branches on the basis of inspection reports.
- A computerized track record of efficiency rating over the previous 4-5 inspections to be maintained.
- Major irregularities detected during concurrent audit to be immediately taken up with Head Office.
- Irregularities pointed out in case of smaller/ medium branches to be rectified within 4 months.
- Majority of irregularities are to be rectified during the course of audit itself.
- Immediate action to be taken to plug gaps in serious irregularities.
- Items for discussion at audit committee meetings & periodicity of meetings to be decided upon.
- A separate report to be submitted on inspection findings related to frauds.

Contd....

Major Recommendation of Jilani Committee

- Appropriate control measures to be devised & documented to prevent the computer system from attacks of unscrupulous events.
- Various tests to be carried out to ensure that EDP applications have resulted in consistent & reliable system for inputting, processing and generation of output of data.
- Entire domain of EDP activities to be brought under scrutiny of inspection & audit including financial aspect.
- If outside computer agencies are engaged, banks should ensure that they have the right to inspect the process of application & ensure the security off data/inputs given to those agencies. 23. Changes to standard software to be approved , inspected & monitored by senior management.
- Internal vigilance machinery to be strengthened & its working to be reviewed by the board every six months.
- Regular checking by inspectors to verify correctness of information compiled by branches.

Audit Procedures for reporting upon implementation of Ghosh & Jilani committee recommendations

- Report on implementation status of Ghosh and Jilani committee shall be forwarded to Head office. [Ghose Comm Report.shs](#)
- [Jilani Report.shs](#)
- Review a copy of implementation status report so prepared and submitted
- Test check to ensure that recommendations which have been said to have implemented have indeed been implemented by management
- Non Implementation bring to notice of Management.
- Reconsider the nature timing and extent of audit procedure for carrying out the audit and timings.
- Status of compliance of previous Statutory Audit Report.

Responsibility for implementation and Auditors Role

- Management is responsible for the implementation of Jilani committee recommendations.
- The responsibility of the statutory auditor is to verify and report on the status of implementation of these recommendations.
- The results of the verification carried out and comments to be given in Main Report separately.

Challenges ...

**Don't let the
situation
confuse you...**





Questions

Thank you

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