

**Western India Regional Council (WIRC)
Virtual CPE Meeting**

**Core Issues in LFAR
(revised) – Bank
Branch Audit**

**CA Vikas Kumar
20th March '21**

INTRODUCTION

- ✓ **Vide notification DOS.CO.PPG./SEC.01/11.01.005/2020-21 dated September 05, 2020, Reserve Bank of India (RBI) has revised the format of Long Form Audit Report (LFAR)**
- ✓ **LFAR Comprises of 3 sections –**
 - **Annexure I - Statutory Central Auditor**
 - **Annexure II – Branch Auditors**
 - **Annexure III – Large / Irregular / Critical account for branch auditors (tabular format, information sheet for large exposures)**
- ✓ **Formats are put into operation for the period covering 2020-21 and onwards.**
- ✓ **If the SCA feels the need of any material additions, etc., this may be done by giving specific justification by the SCA and with the prior intimation of the bank's Audit Committee of Board (ACB).**

Guiding principles on objective, strategy, scope and coverage of LFAR for branch auditors

- ✓ **Transaction testing** - provide inputs to the Statutory central Auditors - adequacy of implementation of various policy and regulatory requirements, efficacy of the system and assurance functions (risk management, compliance and internal audit) at branch level.
- ✓ **Transaction above threshold** - transaction **detailing needs to be seen and commented upon**
- ✓ **Transaction below threshold** - the system and processes should be checked and commented upon
- ✓ **Verification of data integrity** and **data related control systems** and processes should be carried out and commented upon – special thrust to data inputs.
- ✓ **Professional Judgement** – If comments made by the auditors in their LFAR is adverse, they should consider whether a qualification in their main report is necessary

Notes

- ✓ **Amendment** – in following slides, only amendment in New Format vis a vis earlier format has been detailed.

- ✓ In most of the cases, the new requirements are self explanatory in nature.

- ✓ **For Section Assets – Advances**
 - Requires examination of **all large advances**.
 - Large advances – lower of;
 - o/s amount in excess of 10% of o/s aggregate fund and non fund based advances of the branch
 - Rs. 10 Crores
 - List of accounts examined to be given – account name, account no., Year end balance for fund and non fund based advances.

Assets - Cash

No major changes, few minor updation detailed below;

Earlier

i. Have the cash balances at the **branch** been checked at periodic intervals as per the procedure prescribed by the controlling authorities of the bank?

ii. Does the branch generally carry cash balances, which vary significantly from the limits fixed by the controlling authorities of the bank?

Whether excess balances have been reported to the controlling authorities of the bank?

New

i. Have the cash balances at the **branch/ATMs** been checked at periodic intervals as per the procedure prescribed by the controlling authorities of the bank?

ii. Does the branch generally maintain / carry cash balances, which vary significantly from the limits fixed by the controlling authorities of the bank?

Action Point

i. Along with cash balance at branch now ATM balance checking at periodic interval by branch also to be reported.

ii,. Answering to second part as highlighted is not required in revised LFAR format.

iii. Balance in ATM vis a vis bank books to be commented

Assets – Money at Call & Short Notice

Two new additions under the same;

Earlier

- i. not required to comment upon.
- ii. Not required to comment upon.

New

- i. Has the year-end balance been duly confirmed and reconciled?
- ii. Has interest accrued up to the year-end been properly recorded?

Action Point

- i. Year end confirmation process for same to be reviewed and reconciliation to be commented upon.
- ii. Accrual of interest upto year end in line with the underlying details to be verified.

Assets – Investments

Investments for branches in India & for branches outside India;

Earlier

i. Reporting for Investment for branches in India and outside India, both were required to be given.

New

i. As per revised format only reporting for investment for branches outside India is required.

Action Point

i. No changes in the required within the said aspects.

Assets – Advances – Credit Appraisal

Cont.

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- i. Note to be given for compliance of Credit Appraisal Process.
- ii. No requirement earlier.
- iii. No requirement earlier.
- iv. No requirement earlier.

New

- i. Beside note as before, also to specifically comment upon major short comings in the credit appraisal process.
- ii. Details of **quick mortality** accounts to be given.
- iii. Whether in borrowal accounts the applicable interest rate is correctly fed into the system?
- iv. Whether the interest rate is reviewed periodically as per the guidelines applicable to floating rate loans linked to MCLR / EBLR?

Action Point

- i. Self explanatory.
- ii. Details of facility became NPA within a period of 12 months from the date of first sanction – Account No., Account Name and Balance as at year end to be given.
- iii. System configuration for ROI to be seen. **Must contain all aspects where interest is to be charged**
- iv. Compliance of process of periodic review of rates in system at each change / intervals.

Assets – Advances – Credit Appraisal

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- v. No requirement earlier.
- vi. No requirement earlier.

New

- v. Cases of frequent renewal / rollover of short-term loans to be reported.
- vi. Whether correct and valid credit rating, if available, of the credit facilities of bank's borrowers from RBI accredited Credit Rating Agencies has been fed into the system?

Action Point

- v. Give details of such cases **with comments on the same.**
- vi. This may impact the interest rates and other terms and conditions.

Assets – Advances – Sanction / Disbursement / Documentation

Sanction / Disbursement - An additional aspect added as detailed below;
Documentation – No changes

Earlier

- i. No such requirement earlier.
- ii. Disbursement without complying with conditions and documentation

New

- i. Did the bank provide loans to companies for buy-back of shares / securities?

Action Point

- i. Self Explanatory.
- ii. Important condition to ensure

Assets – Advances – Review / Monitoring

Cont.

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- i. No specific requirement to comment on shortcomings of process.
- ii. Account overdue for review / renewal. Analysis to be given for ageing a. 6 months to 1 year, b. over 1 year.
- iii. No such requirement earlier.
- iv. No such requirement to report specifically earlier.
- v. No such requirement to report specifically earlier.

New

- i. Along with comment on process, shortcomings also to be reported.
- ii. Analysis to be given for ageing a. 3 - 6, b. over 6 months.
- iii. Is the **DP properly computed?**
- iv. Whether the latest audited financial statements are obtained for accounts reviewed / renewed during the year?
- v. Details of cases where stock audit was required but not conducted and where conducted but no action taken on adverse features.

Action Point

- i. Self explanatory.
- ii. Analysis period has become more stringent.
- iii. Earlier was checked as a process, now to be reported specifically.
- iv. Self explanatory, now to be reported upon specifically.
- v. Policy and sanction document to be reviewed to access applicability of stock audit, reports to be reviewed and commented upon accordingly.

Assets – Advances – Review / Monitoring

Cont.

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

vi. Reporting Limit - advances to Non corporate entities where audited account of borrowers not obtained – Rs. 10 Lakh.

vii. No such requirement earlier.

viii. No such requirement earlier.

New

vi. Reporting Limit - advances to Non corporate entities where audited account of borrowers not obtained – Set by Bank.

vii. Non availability of DD report (as per RBI requirements) for advances under consortium/ multiple arrangement to be reported. (or to be called from lead bank)

viii. Whether there is substantial deterioration in value of security during the year as per the latest report?

Action Point

vi. Limits set by respective banks to be seen.

vii. DD report to be taken and commented upon in consortium / multiple arrangement cases.

viii. Old vs new report to be compared to comment on same. This could even impact the classification and provisioning of accounts.

Assets – Advances – Review / Monitoring

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- ix. No requirement earlier.
- x. No requirement earlier.
- xi. Are credit card dues recovered promptly?

New

- ix. Whether the branch has any red-flagged account? If yes, whether any deviations were observed related to compliance of bank's policy related with Red Flag Accounts?
- x. Comment on adverse features considered significant in top 5 standard large advances and which need management's attention.
- xi. Removed .

Action Point

- vi. Same was reviewed earlier too, now to be specifically reported.
- vii. Must be seen in detail. Other than all the points which are already specifically reported.
- viii. Not required to be reported now.

Assets – Advances – Asset Classification, Provision, Resolution of stressed asset Cont.

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- i. Classification of asset to be reported.
- ii. Classification review was limited to standard, sub standard, doubtful & Loss.
- iii. Not applicable.
- iv. Not specifically required.

New

- i. Classification of asset through the computer system without manual intervention.
- ii. Beside same classification also to be reviewed for SMA 0, SMA 1 & SMA 2 accounts.
- iii. Account o/s > 10 cr. which are either downgraded or upgraded from NPA or standard during the year to be reported.
- iv. RBI guidelines on income recognition and provisioning has been followed.

Action Point

- i. System configuration to be reviewed to identify mechanism of asset classification by system. Report to be generated by auditors and to be seen.
- ii. Besides classification, focus on such large cases for sickness. **All deviations to be reported**
- iii. Self Explanatory.
- iv. Same was reviewed earlier too, now to be specifically reported.

Assets – Advances – Asset Classification, Provision, Resolution of stressed asset Cont.

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- v. Not required.
- vi. Not required.
- vii. Not required.

New

- v. Whether the branch has reported accounts restructured or rephased during the year to Controlling Authority of the bank?
- vi. Whether the RBI Guidelines for restructuring on all such cases have been followed?
- vii. Whether the branch complies with the regulatory stance for resolution of stressed assets, including the compliance with board approved policies in this regard, tracking/reporting of defaults for resolution purposes among others?

Action Point

- v to vii. All points are self explanatory. Adherence of RBI guidelines and bank policies to be seen for restructured and stressed assets.

Assets – Advances – Asset Classification, Provision, Resolution of stressed asset Cont.

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- viii. Not required.
- ix. Have all NPA been promptly reported to the relevant Controlling Authority of the bank? Also state whether any rehabilitation programme in respect of such advances has been undertaken, and if so, the status of such programme.
- x. Not required.
- xi. NPA cases – valuation to be obtained for **fixed assets** charged to bank.

New

- viii. Upgradations in non-performing advances is in line with the norms of RBI, auditor disagreement to be reported with reason.
- ix. Report - accounts wherein IBC is mandated but not initiated and where IBC is initiated by other banks / creditors. Adequacy of provision thereupon.
- x. Report – credit guarantee claim rejected and adequacy of provision thereupon.
- xi. NPA cases – valuation report to be obtained for **immovables** charged to bank.

Action Point

- viii. Compliance with RBI guidelines for NPA upgradation to be adhered and reported.
- ix to xi. Self explanatory points.

Assets – Advances – Asset Classification, Provision, Resolution of stressed asset

Major changes by way of additional aspects to be reported detailed as follows;

Earlier

- xii. Not required.
- xiii. Not required.
- xiv. Not required.

New

- xii. Is the branch prompt in ensuring execution of decrees obtained for recovery from the defaulting borrowers? Give Age-wise analysis of decrees obtained and pending execution.
- xiii. Whether in the cases concluded the recoveries have been properly appropriated against the principal / interest as per the policy of the bank?
- xiv. In cases where documents are held at centralized processing centres / office, whether the auditor has received the relevant documents as asked by them on test check basis and satisfied themselves. Report the exceptions, if any

Action Point

xii to xiv. Self explanatory points.

Assets – Advances – Non Fund Based

Change by way of addition and deletion of a point each.

Earlier

- i. Not required.
- ii. Details of the outstanding amounts of letters of credit and co-acceptances funded by the Branch at the end of the year may be obtained from the Management

New

- i. List of instances where interchangeability between fund based and non-fund-based facilities was allowed subsequent to devolvement of LC / invocation of BG.
- ii. Removed.

Action Point

Self explanatory points.

Other Assets

Changes detailed as follows;

Stationery & Stamps – **No reporting required as per new LFAR.**

Suspense Account & Sundry Assets – **detailed in table below;**

Earlier

- i. Details for old o/s items in such account to be obtained and ascertain the reason.
- ii. Not required earlier.

New

- i. Details for o/s items for more than 90 days in such account to be obtained and ascertain the reason.
- ii. Are there any intangible items under the head e.g. losses not provided / pending investigation?

Action Point

Self explanatory points.

Liabilities – Deposits

Change by way of addition and deletion of a point each.

Earlier

- i. Has bank laid down any **guidelines** with respect to conduct and operations of Inoperative Accounts?
- ii. Not required earlier.
- iii. Not required earlier.
- iv. Are there any overdue/ matured term deposits at the end of the year? If so, amounts thereof should be indicated.

New

- i. Does the bank have a system of identification of dormant / inoperative accounts and internal controls with regard to operations in such accounts?
- ii. Automatic renewal of deposits applies to FCNR(B) deposits? If yes, for such cases adherence wrt to NR status of depositor, compliance of regulatory guidelines and whether original receipts / soft copy have been dispatched.
- iii. Minimum balance requirement and levy of charges on non-maintenance of minimum balance in individual savings accounts?
- iv. Removed.

Action Point

Self explanatory points.

Other Liabilities – Bills Payable, Sundry Deposits etc. & Contingent Liabilities

Contingent Liabilities – No change in reporting.

Other Liabilities – Minor change detailed below;

Earlier

i. The number of items and the aggregate amount of old outstanding items pending for three years or more may be obtained from the branch and reported under appropriate heads.

New

i. The number of items and the aggregate amount of old outstanding items pending for one year or more may be obtained from the branch and reported under appropriate heads.

Action Point

Self explanatory point.

Profit and Loss Account

Minor changes detailed below;

Earlier

- i. Reporting on system to compute discrepancies in interest / discount and interest on deposit and timely adjustment thereof in accordance with requisite guidelines.
- ii. Does the bank have a system of estimating and providing interest accrued on overdue / matured term deposits?

New

- i. Not required.
- ii. Does the bank have a system of estimating and providing interest accrued on overdue / matured / unpaid / unclaimed term deposits including in respect of deceased depositors?

Action Point

Self explanatory points.

General – Gold / Bullion / Security Items

Minor change by adding a new reporting requirement detailed below;

Earlier

i. Not required earlier.

New

i. Does the system of the Bank ensure adequate internal control over issue and custody of security items (Term Deposit Receipts, Drafts, Pay Orders, Cheque Books, Traveler's Cheques, Gift Cheques, etc.)? Whether the system is being followed by the branch? Have you come across cases of missing/lost items?

Action Point

Self explanatory points.

General – Books & Records

Major change in reporting, more inclined towards IT control, detailed below;

Earlier

- A. Manual Account
- B. Computerized Accounts:
 - a. Hard copies of accounts are printed regularly?
 - b. Extent of computerization and the areas of operation covered.
 - c. Access and data security measures and other internal controls adequate? Report in case measures are found inadequate.
 - d. Regular back-ups of accounts and off-site storage are maintained as per the guidelines of the controlling authorities of the bank?
 - e. Adequate contingency and disaster recovery plans are in place for loss/encryption of data?
 - f. Do you have any suggestions for the improvement in the system regarding computerized operations of the branch?

New

- A. Removed.
- B. Other -
 - a. Any software / systems (manual or otherwise) which are not integrated with the CBS? Details.
 - b Adverse feature in the IS Audit Report having a direct or indirect bearing on the branch accounts and are pending compliance? Details.
 - c. Generation and verification of exception reports periodically.
 - d. System of bank warrants expeditious compliance of daily exception reports and any major observations pending such compliance at the year end.
 - e. Procedures for manual intervention to system generated data and authentication of the related transactions along with audit trail.
 - f. Comments on data integrity (including data entry, checking correctness/integrity of data, no back ended strategies etc.) which is used for MIS at HO / CO level.

Action Point

Detailed ITGC analysis to be carried to comment on the requirements as per new LFAR.

Specific rather than generic comments.

No comments required on back ups and DRP

General – Inter Branch Account / Reconciliation of Controls and Subsidiary Records

Changes in the above two cases as detailed below;

- a. Reconciliation of control and subsidiary records – **Removed**
- b. Inter Branch Accounts – **out of the 6 questions earlier, only one is applicable now with minor changes detailed below;**

Earlier

i. Does the branch expeditiously comply with / respond to the communications from the designated cell / Head Office as regards unmatched transactions? As at the year-end are there any un-responded / un-complied queries or communications? If so, give details?

New

i. Does the branch expeditiously comply with / respond to the communications from the designated cell / Head Office as regards unmatched transactions? As at the year-end are there any un-responded / un-complied queries or communications beyond 7 days? If so, give details?

Action Point

Self explanatory points.

General – Frauds

Major change detailed below;

Earlier

Furnish particulars of frauds discovered during the year under audit at the branch, together with your suggestions, if any, to minimise the possibilities of their occurrence.

New

- a. Fraud detected / classified but confirmation for reporting to RBI not available.
- b. Any suspected or likely fraud case reported to higher office. Details and status thereof.
- c. Comment – potential risk areas which might lead to perpetuation of fraud.
- d. System of early warning framework is working effectively and signals from same forms basis for classifying as account as RFA.

Action Point

- a. Specific reporting.
- b. If such cases are there, why not treated as fraud
- c. Needs detailed understanding on the type of advances. Also, specific items given in LFAR
- d. System for compliance based on parameters for 42 EWS.

General – Implementation of KYC AML guidelines / Management Information System

Both are newly added paras in LFAR for branch detailed below; Also these are very important

New

A. KYC AML

- a. adequate systems and processes, to ensure adherence to KYC/AML guidelines towards prevention of money laundering and terrorist financing.
- b. branch followed the KYC/AML guidelines based on the test check carried out by the branch auditors.

B. MIS System

- a. branch has the proper systems and procedures to ensure data integrity relating to all data inputs which are to be used for MIS at corporate office level and for supervisory reporting purposes. Instance where data integrity was compromised to be reported.

Action Point

- ✓ Needs understanding of KYC/AML guidelines and checking of compliance thereof.
- ✓ Identify the key data used for MIS at corporate office level and for supervisory reporting purposes and check the basis of ensuring the integrity of the same.

General – Miscellaneous

Under same out of 3, 2 points has been removed and a new point has been added, detailed below;

Earlier

- a. Not required earlier.
- b. Does the examination of the accounts indicate possible window dressing?
- c. Maintenance of records of all the fixed assets acquired and held irrespective of whether the values thereof or depreciation thereon have been centralised? Where documents of title in relation to branch or other branches are available at the branch, whether the same have been verified.

New

- a. In framing your audit report / LFAR, major adverse comments from following considered, such as:
 - i) Previous year's Branch Audit Report / LFAR; ii) Internal audit/ Snap Audit/ concurrent audit report(s); iii) Credit Audit Report; iv) Stock audit Report; v) RBI Inspection Report, if any, vi) Income and Expenditure (Revenue) Audit; vii) IS /IT / Computer / Systems Audit; and viii) Any special inspection / investigation report?
- b & c. Removed.

Action Point

Self explanatory, however, accountability and responsibility enhanced.

Specialized branches

- A. For branches dealing in recovery of Non Performing Assets such as Asset Recovery Management Branches – **additional requirement for 2 points detailed below.**
- B. For branches dealing in very large advances such as Corporate Banking branches and Industrial Finance Branches or branches with advances in excess of Rs.100 crore – **Removed**

New

- a. Age-wise analysis of decrees obtained, for recovery from the defaulting borrowers, and not executed.
- b. Give particulars of recoveries, (accounts settled / written off / closed) which are pending for appropriation as on year-end with reasons thereof.

Action Point

Self Explanatory.

Annexure III

A separate '**Annexure III - Long Form Audit Report (LFAR) for Large / Irregular / Critical Advance Accounts**' has to be obtained by the Branch Auditor from branches. Contains among other following information in tabular form;

- a. Name of borrower
- b. Address
- c. Nature of business
- d. Total exposure to branch (funded and non funded)
- e. Proprietor/ Partner / Director
- f. Asset classification branch (current and previous)
- g. Asset classification Auditor (current & previous)
- h. Adverse feature in RBI inspection or any other report.
- i. Date of NPA
- j. Facilities sanctioned
- k. If, Consortium facility – other banks' and lead bank's name
- l. Credit rating in line with policies
- m. Primary Security – verification and valuation evidence
- n. Collateral Security – verification and valuation evidence
- o. Details of guarantee – CG, SG, Bank or FI etc. – Date, validity & Value
- p. Compliance of sanction terms & conditions** (further detailed information – charge, mortgage, registration, insurance, guarantee, asset coverage, document submission, inspection etc.).
- q. Key Financial indicators** – last two years and projections for current year. (tabular form – T/o, increase, PBT, Reserves, Capital etc.)
- r. Observation on operation of account – i. Instances where balance > DP / sanctioned limit – reason thereof and whether same was reported and approved. ii. Total **Dr / Cr summation in account.**
- s. Branch Managers overview.
- t. Booking of unrealized income in NPA accounts and action taken against NPA.

MUST DOs

- ✓ Study the Questionnaire thoroughly.
- ✓ Avoid vague or general comment - answer should be precise.
- ✓ Give specific instances of weakness/shortcomings.
- ✓ Main Audit Report and LFAR are two separate reports.
- ✓ Qualification remarks MUST be part of the main report.
- ✓ Main Report is a self contained document and should not contain any references to LFAR.
- ✓ Should be sufficiently detailed and quantified to enable expeditious consolidation.
- ✓ Do not make current year's LFAR a replica of previous year.

Thank
You

