

Statutory Audit of Bank Branches

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LFAR & Certification

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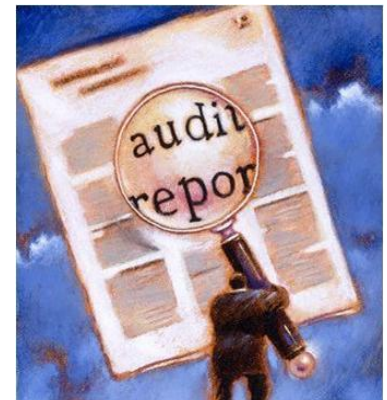
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Today's Agenda

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- Reporting & Certification
 - LFAR
 - MOC
 - Audit Report
 - Tax Audit Report
 - Jilani & Ghosh Committee
 - Other areas/certifications



Introduction - LFAR

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- Long Form Audit Report 'LFAR'
- Introduced in 1985 – to PSB and then to all banks
- Revised in 1992-93 & 2003
- Submission of LFAR by CA – below cut off
- Detailed questionnaire formulated by RBI (SBA)
- Not a substitute for AR under SA 700
- Important tool to communicate with Management and Central Statutory Auditor

Main Objective

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- Reporting on internal controls, processes and systems followed in branches
- Provide useful information to assist the banks and the regulators with regards to matters/ issues that come to the notice of the auditors in the course of statutory audits of banks/ bank branches
- Questionnaire Form – Reply by Auditor
- Descriptive & may be supported with Annexures
- Supported by MRL



Broad Areas Covered

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- Assets
 - Cash & Bank
 - Money at call & short notice
 - Advances
 - Investments
 - Other assets
- Liabilities
 - Deposits
 - Other liabilities
- Contingent Liabilities

Broad Areas Covered

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- Profit & Loss
 - Revenue Recognition
 - Divergent trends
- Other General areas
 - Books, & records
 - Reconciliations of control accounts & subsidiary records
 - Inter branch accounts
 - Audit & Inspection
 - Fraud
 - Other Miscellaneous

Areas Covered (Specialized Branches)

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- Dealing in FOREX
- Dealing in very large advances
- Asset Recovery Branches
- Clearing house operations / service branches

Certain Crucial Clauses

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- Assets - Cash
 - Cash balances in excess of fixed limits & its reporting
 - Adequate insurance cover
 - Effective joint custody
 - Checking at periodic intervals as per procedure prescribed by competent authority
- Balances with RBI/SBI & other banks
- Money at Call & Short notices
- Investments (Outside India & in India)

Certain Crucial Clauses

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- Assets - Advances
 - Large Advances
 - Credit Appraisal
 - Sanctioning/ Disbursement
 - Documentation
 - Review/Monitoring/Supervision
 - Guarantees and Letters of Credit
- Other Assets
 - Stationery and Stamps
 - Suspense Accounts/Sundry Assets

Certain Crucial Clauses

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- Liabilities - Deposits
 - Interest rate applied
 - Inoperative accounts
 - Window dressing
 - Matured and overdue deposits
- Other Liabilities
 - Sundry Deposits/Bills payables
- Contingent Liabilities

Certain Crucial Clauses

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- Profit & Loss
 - Interest rate applied
 - Income Recognition as per IRAC norms
 - System for adjustments for discrepancies
 - System of estimating and providing interest accrued on overdue/matured term deposits
 - Divergent trends in major items of income and expenditure

Certain Crucial Clauses

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- General
 - Books & Records
 - Computerization
 - Under CBS or not & extent of computerization
 - System of hard copies/regular back ups & data security
 - System of adequate contingency and disaster recovery plans
 - Suggestions for improvements
 - Reconciliation of control & Subsidiary books
 - Inter branch Accounts

Certain Crucial Clauses

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- General
 - Audit/Inspection
 - Concurrent Audit
 - Internal Inspection
 - RBI Inspection
 - AFI findings
 - Previous year's repost
 - Other inspection
 - Systems Audit
 - Reporting on adverse comments in any of the above

Certain Crucial Clauses

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- General
 - Frauds
 - Occurrence
 - Timely reporting
 - Suggestions
 - Window Dressing
 - Fixed Assets Related
 - Any Other Matters

Certain Takeaways

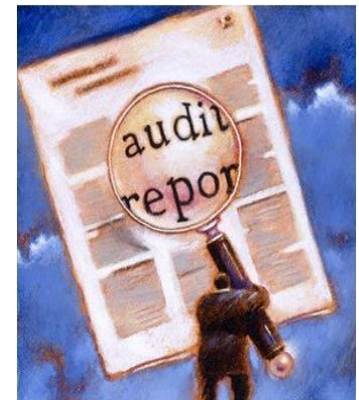
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- LFAR reporting is to be kept in mind while audit planning and verification of advances.
- Use LFAR as checklist & List of illustrative data given in GN.
- Adverse remarks/ observations are to be supported by instances .
- Specific and clear replies as against ambiguous and long.
- Give annexures, if required.
- Don't camouflage under provisioning or non reporting of NPA
- Random checking and Materiality (mention).
- Summary.
- Discussion with branch manager before finalization.

Memorandum of Changes 'MOC'

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- Important document need to be enclosed with the Bank Audit Report whenever the Auditor observes significant issues effecting the FS.
- Materiality levels.
- Bank Specific formats.
- Discussion with management.



Memorandum of Changes

‘MOC’

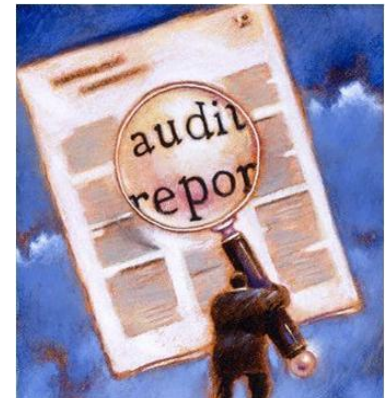
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- Relating to suggested changes in Balance Sheet.
- Relating to suggested changes in Profit and Loss Account.
- Relating to suggested changes in Advances portfolio of the bank.
- Relating to outstanding balances of the Advances.
- Yearly return of provisions.
- Details of accounts for various changes.
- Reconciliation balances in interest not collected account.
- Summary of Advance return.
- MOC for fixed assets.

Independent Auditor's Report

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- AS per SA 700
 - Revised Format
 - Modifications (SA705)
 - Emphasis of Matter (SA706)
 - As per the Banking Regulation Act, 1949



Independent Auditor's Report

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- The following is a summary of Memorandum of Changes submitted by us to the branch management.
- **Memorandum of Changes (summary)**
- | | | |
|------------|-----------------|-----------------|
| <u>No.</u> | <u>Increase</u> | <u>Decrease</u> |
|------------|-----------------|-----------------|
- a. In respect of Income
- b. In respect of expenditure
- c. In respect of Assets
- d. In respect of Liabilities
- e. In respect of Gross NPAs
- f. In respect of Provision on NPAs
- g. In respect of Classification of Advances
- h. In respect of Risk Weighted Assets
- i. Other items (if any)

Jilani and Ghosh Committee Recommendations

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Jilani Committee Recommendations

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- July 1995
- Objective: To review the efficacy and adequacy of internal control, inspection and audit system in a bank with a view to strengthening the supervisory system and reliability of data.
- 3 categories of recommendations based on areas of operations – EDP, Inspection/Internal Audit & Miscellaneous.



Jilani Committee Recommendations

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- Format containing **25 questions** to be answered as “Implemented” or “Not Implemented”
- Focus on internal vigilance of the internal controls in a computerized environment.
- Strength of the EDP system.



Jilani Committee Recommendations

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- Follow up on major / serious irregularities detected during the concurrent audit.
- Fraudulent transactions to be reported.
- Timely action to plug gaps in serious leakages.
- Control measures to prevent attacks on EDP.
- Regular checking of EDP.
- Verification of data out put from EDP system.

Ghosh Committee Recommendations

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- Accepted in 1993
- Recommendations are relating to frauds & malpractices
- Main objectives of Ghosh Committee :
 - Safety of assets.
 - Compliance with laid down policies and procedures.
 - Accuracy and completeness of accounting and other records.
 - Proper segregation of duties and responsibilities of the staff.
 - Timely prevention and detection of frauds and malpractices.

Ghosh Committee Recommendations

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- Out of 97 – 27 are applicable to branches, 43 to RO/ZO/HO and balance 27 to both.
- To be answered in “YES” or “NO”.



Ghosh Committee Recommendations

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- Joint and Dual Custody of cash & other valuables.
- Transactions in the Currency Chest.
- Adhering to RBI norms while issuing large payout, opening of accounts, large withdrawals.
- Monthly /bi-monthly inspection of stocks pledged
- Rotation of duties amongst staff.
- Financial & Administrative powers to be laid down.

Ghosh Committee Recommendations

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- Safe custody of unused stationery.
- Granting advances beyond powers.
- Instructions on phone.
- Exercising of caution at the time of opening new accounts.
- Safe guard of specimen signature cards.
- Monitoring of inoperative accounts.

Responsibility for implementation and Auditors' Role

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- Management's Responsibility
- Statutory auditor's responsibility is to verify and report on the status of implementation of these recommendations.
- A failure to comply with any of the recommendations of the two committees would be indicative of the weakness in the internal control system on the bank.



Other Certificates

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- Relating to DICGC
- Cash on hand on random dates
- Restructured Advance related
- Priority Sector Lending
- Advances to sensitive sectors
- Movement in NPA (Provision there off)
- Claim of subsidy (Export & Agriculture)
- Rural advances (Interest subvention)
- PMEGP
- Off Balance sheet items



Peer Review & Quality Control

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- Documentation of audit procedures
- MRL from management
- Working papers



