

# PRESENTATION ON LONG FORM AUDIT REPORT

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# Introduction

- ✓ Long form Audit Report (LFAR) is a requirement of RBI from an Auditor.
- ✓ It was devised by RBI in 1985 and has been revised in 1992-93, 2003 and 2020.
- ✓ LFAR includes questionnaires for specialized branches –
  - For branches dealing in foreign exchange transactions.
  - For branches dealing in very large advances.
  - For branches dealing in recovery of NPA.
  - For branches dealing in clearing house operations (service branches).

# Objectives of LFAR

- ✓ Focus not only on advances but also on operational areas in the Branch.
- ✓ Covers operational Risk extensively.
- ✓ A tool for early warning signals.

# Master Circular/Master Directions

Brief Content	Dated	Reference No.
Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances	October 1, 2021	RBI/2021-2022/104 DOR.No.STR.REC.55/21.04.048/2021-22
Notification - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances - Clarifications	November 12, 2021	RBI/2021-2022/125 DOR.STR.REC.68/21.04.048/2021-22
Master Directions on Frauds – Classification and Reporting by commercial banks and select Fis (Updated as on July 03, 2017)	July 01, 2016 (Updated as on July 03, 2017)	RBI/DBS/2016-17/28 DBS.CO.CFMC.BC.No.1/23.04.001/2016-17

# Master Circular/Master Directions

Brief Content	Dated	Reference No.
Master Direction - Know Your Customer (KYC) Direction, 2016 (Updated as on May 10, 2021)	February 25, 2016 (Updated on various dates from time to time)	RBI/DBR/2015-16/18 Master Direction DBR.AML.BC.No.81/14.01.001/2015-16
Notification - New Definition of Micro, Small and Medium Enterprises - Addition of Retail and Wholesale Trade	July 7, 2021	RBI/2021-2022/67 FIDD.MSME & NFS.BC.No.13/06.02.31/2021-22
Notification - Resolution Framework 2.0 – Resolution of Covid-19 related stress of Micro, Small and Medium Enterprises (MSMEs)	May 5, 2021	RBI/2021-22/32 DOR.STR.REC.12/21.04.048/2021-22

# Master Circular/Master Directions

Brief Content	Dated	Reference No.
Notification - Resolution Framework – 2.0: Resolution of Covid-19 related stress of Individuals and Small Businesses	May 5, 2021	RBI/2021-22/31 DOR.STR.REC.11/21.04.048/2021-22
Notifications - Opening of Current Accounts by Banks - Need for Discipline	October 29, 2021	RBI/2021-22/116 DOR.CRE.REC.63/21.04.048/2021-22
Guidelines for Implementation of the circular on Opening of Current Accounts by Banks	August 04, 2021	RBI/2021-22/77 DOR.CRE.REC.35/21.04.048/2021-22

# Master Circular/Master Directions

<b>Brief Content</b>	<b>Dated</b>	<b>Reference No.</b>
Notifications - Long Form Audit Report (LFAR) - Review	September 05, 2020	RBI/2020-21/33 Ref.No.DOS.CO.PPG./SEC.01/11.01.005/2020-21
Notifications - Automation of Income Recognition, Asset Classification and Provisioning processes in banks	September 14, 2020	RBI/2020-21/37 Ref. No. DoS.CO.PPG./SEC.03/11.01.005/2020-21

# Automation of NPA- Classification & Provision

- ✓ To be implemented by 30th June, 2021.
- ✓ Manual intervention- on classification & provisioning to be removed.
- ✓ NPA classification to be made as day-end process: **Daily NPA.**
- ✓ System should be audited by independent expert.



# Changes in IRAC norms

Timeline for implementation of viable RP	Earlier Requirement	New Requirement
180 days from the end of Review Period	Additional provisions to be made as a % of total outstanding, if RP not implemented within the timeline	Additional provisions to be made as a % of total outstanding ( <b>FUNDED + NON-FUNDED</b> ), if RP not implemented within the timeline
365 days from the commencement of Review Period	20%	20%
	15% (i.e total additional provisioning of 35%)	15% (i.e total additional provisioning of 35%)

# Coverage

## I. Assets

- i. Cash
- ii. Balance with Reserve bank of India, State Bank of India and Other Banks
- iii. Money at Call and Short Notice
- iv. Investments
- v. Advances
- vi. Other Assets

# Coverage

## **II. Liabilities**

- i. Deposits
- ii. Other Liabilities
- iii. Contingent Liabilities

## **III. Profit & Loss Account**

# Coverage

## **IV. General**

- i. Deposits
- ii. Gold/ Bullion/ Security Item
- iii. Books & Records
- iv. Inter Branch Accounts
- v. Frauds
- vi. Implementation of KYC AML Guidelines
- vii. Management Information Systems
- viii. Miscellaneous

# Coverage

## I. Assets

### ❖ Cash:

- a) Cash in excess of Limits.
- b) Cash balance as per books tally with ATM balance. - Balances as per GL and as per ATM scroll
- c) Adequacy of Insurance to cover the cash-in hand and cash-in transit?
- d) System ensure effective joint custody of two or more officials.
- e) Periodic checking of cash balances at Branch and ATM.

# Coverage

- ❖ Balance with Reserve bank of India, State Bank of India and Other Banks:
  - a) Balance confirmation certificates and Reconciliation.
  - b) Any **matter** deserves special attention of the management.
- ❖ Money at Call and Short Notice:
  - a) Compliance with instructions/ guidelines.
  - b) **Year end balance confirmation and Reconciliation.**
  - c) **Recording of interest accrual up to year end.**

# Coverage

- ❖ Investments (For branches outside India):
  - a) Branch has acted in its delegated authority.
  - b) Physical verification of investments.
  - c) Valuation of investments is as per RBI or as per guidelines of the respective country **whichever are more stringent?**
  - d) details of matured or overdue investments which have not been encashed **and / or has not been serviced?**

# Coverage

## ❖ Advances:

For all large advances in respect of which the outstanding amount is in excess of 10% of outstanding aggregate balance of fund based and non-fund based advances of the branch or Rs.10 crores, whichever is less, the transaction audit / account specific details to be seen and commented, whereas below the threshold, the process needs to be checked and commented upon.



# Coverage

- a) List of Accounts examined for Audit.
  - i. Details of Accounts examined for audit is to be provided with % coverage.

A/c No.	Name	FB Balance	NFB Balance
Total		XXX	XXX
Branch total		YYY	YYY
% recovered		ZZ	ZZ

# Coverage

## b) Credit Appraisal.

- i. Compliance with procedures regarding loan applications, preparation of proposals for grant/ renewal of advances, enhancement of limits, etc., including adequate appraisal documentation in respect thereof.
- ii. Details of quick mortality in accounts, where the facility became non-performing within a period of 12 months from the date of first sanction.
- iii. Correct feeding of interest rate into the borrowers masters.
- iv. Periodic review of floating interest rate linked to MCLR.
- v. Details of Frequent renewal / rollover of short-term loans?
- vi. Credit rating properly fed into the system. - determining the correct Capital Adequacy of the bank

# Coverage

## c) Sanctioning / Disbursement.

- i. Credit facilities sanctioned beyond the delegated authority or limit fixed. Reporting of such cases to higher authorities?
- ii. **Disbursement** without complying with the terms and conditions of the sanction.
- iii. **Details of loans to companies for buy-back of shares/securities?**

# Coverage

## d) Documentation.

- i. Credit facilities released without execution of all the necessary documents.
- ii. Deficiencies in documentation, including non-registration of charges, non-obtaining of guarantees, etc.
- iii. Advances against lien of deposits granted **without** marking a lien on the **bank's deposit receipts and the related accounts**.

# Coverage

## e) Review/ Monitoring/ Supervision.

- i. Periodic review of advances, including periodic balance confirmation / acknowledgement of debts, followed by the branch? Details of the accounts overdue for review/renewal.

### Major shortcomings in monitoring, etc.

- between 3 to 6 months, and
- over 6 months

# Coverage

- ii. a) Stock/book debt statements and other periodic operational data and financial statements, etc., received regularly and duly scrutinized and action taken?
- b) Is the DP properly computed?
- c) Latest audited financial statements available for accounts reviewed /renewed during the year?

# Coverage

iii. a) Stock Audit reports obtained for all eligible Accounts.

b) Details of:

- cases where stock audit was required but was not conducted.
- where stock audit was conducted but no action was taken on adverse features.

iv. Details of cases of advances to non- corporate entities with limits beyond **that is set by the bank** where the branch has not obtained the duly audited accounts of borrowers.

# Coverage

v. Physical verification of the securities charged to the bank .

Details of substantial deterioration in value of security during financial year as per latest valuation report in comparison with earlier valuation report ?

vi. Cases of deficiencies, **including** in value of securities and inspection thereof or any other adverse features such as frequent/ unauthorized overdrawing beyond limits, inadequate insurance coverage, etc.?



# Coverage

vii. In respect of leasing finance activities, verification relating to security creation, asset inspection, insurance, etc.?

viii. Due diligence report in the form and manner required by the Reserve Bank of India in respect of advances under consortium and multiple banking arrangements. Give the list of accounts where such certificate/report is not obtained or not available on record.

(In case, the branch is not the lead bank, copy of certificate/report should be obtained from lead bank for review and record)

# Coverage

- 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? - average period account continued to remain in RFA list. Maximum 6 months- lift RFA status or classify it as Fraud
- x. Comment on adverse features considered significant in top 5 standard large advances and which need management's attention.

# Coverage

- f) Asset Classification, Provisioning of Advances and Resolution of Stressed Assets.
  - i. a) Classification of Advances into standard / substandard / doubtful / loss assets is as per RBI norms **through the computer system, without manual intervention? - NPA Automation Process**
  - b) **Classification of accounts into SMA-0, SMA-1, and SMA-2. If auditor disagrees the details of such advances with reasons should be given. Also MOC to be given.**

# Coverage

- ii. a) List the accounts which have either been downgraded or upgraded with regard to their classification as Non-Performing Asset or Standard Asset during the year and the reason thereof.

# Coverage

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

# Coverage

- iv. a) Whether the upgradations in non-performing advances is in line with the norms of Reserve Bank of India
  - b) Where the auditor disagrees with upgradation of accounts? If yes, give reasons thereof.
- v. Details where no legal action undertaken for recovery of advances or recalling of advances.

# Coverage

vi. Details wherein process under IBC is mandated but not initiated by the branch?

Whether there are any borrowers at the branch against whom the process of IBC is initiated by any of the creditors including bank? If yes, provide the list of such accounts and comment on the adequacy of provision made thereto? - provision on accounts after 180 days FB+NFB

vii. Details of claims for Credit Guarantee (ECGC and others) lodged and settled. If rejected provision has been made. - 0% provision on such claims.

# Coverage

- viii. In respect of non-performing assets, has the branch obtained valuation reports from approved valuer for the immovable charged to the bank, once in three years, unless the circumstances warrant a shorter duration?
- ix. In the cases examined by you, has the branch complied with the Recovery Policy prescribed by the controlling authorities of the bank with respect to compromise/settlement and write-off cases? Details of the cases of compromise/settlement and write-off cases involving write-offs/waivers in excess of Rs. 50.00 lakhs may be given.
- x. List the major deficiencies in credit review, monitoring and supervision.



# Coverage

- xi. 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.
- xii. Whether in the cases concluded the recoveries have been properly appropriated against the principal / interest as per the policy of the bank?
- xiii. In cases where documents are held at centralized processing centers / 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.

# Coverage

## g) Non Fund based facilities.

- i. List of borrowers with details of LCs devolved or guarantees invoked during the year.
- ii. List of borrowers where the LCs have been devolved or guarantees have been invoked but not paid with amount thereof.
- iii. List of instances where interchangeability between fund based and non-fund-based facilities was allowed subsequent to devolvement of LC / invocation of BG.

# Coverage

## ❖ Other Assets:

### ➤ Suspense Account/ Sundry Assets

- i. Details of outstanding entries in suspense account in excess of 90 days along with the reasons for delay in adjusting the entries may be provided. If not recoverable whether provision/write-off is required?
- ii. Are there any intangible items under this head e.g. losses not provided / pending investigation?

# Coverage

## II. LIABILITIES

### ❖ Deposits:

- a. Identification of dormant/ inoperative accounts and internal controls with regard to operations in such accounts?
- b. After the balance sheet date and till the date of audit, whether there have been any unusual large movements (whether increase or decrease) in the aggregate deposits held at the year-end? If so, obtain the clarifications from the branch and give your comments thereon.

# Coverage

- c. Whether the scheme of automatic renewal of deposits applies to FCNR(B) deposits?

Where such deposits have been renewed, report whether the branch has satisfied itself as to the 'non-resident status' of the depositor and whether the renewal is made as per the applicable regulatory guidelines and the original receipts / soft copy have been dispatched.

- d. Levy of charges on non-maintenance of minimum balance in individual savings accounts?

# Coverage

## ❖ Other Liabilities:

Bills Payable, Sundry Deposits etc.

- a. The number of items and the aggregate amount of old outstanding items pending for **one year or more** be obtained from the branch and reported under appropriate heads. Give details thereof.
- b. Does your test check indicate any unusual items or material withdrawals or debits in these accounts? If so, give details **thereof**.

# Coverage

- ❖ Contingent Liabilities.
  - a. List of major items of the contingent liabilities (other than constituent's liabilities such as guarantees, letter of credit, acceptances, endorsements, etc.) not acknowledged by the branch?

# Coverage

## III. PROFIT AND LOSS ACCOUNT

- a. Has the test checking of interest/discount/ commission/ fees etc. revealed excess/short credit of a material amount? If so, give details thereof.
- b. Has the branch complied with the Income Recognition norms prescribed by R.B.I.?
- c. Has the test check of interest on deposits revealed any excess/short debit of material amount? If so, give details thereof.



# Coverage

- d. 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?
- e. Are there any divergent trends in major items of income and expenditure, in comparison with corresponding previous year, which are not satisfactorily explained by the branch? If so, the same may be reported.

# Coverage

## IV. GENERAL.

- ❖ Gold/ Bullion/ Security Items.
  - Does the system ensure that gold/bullion is in effective joint custody of two or more officials?
  - Does the branch maintain adequate records for receipt, issues and balances of gold/bullion and updated regularly?

# Coverage

- Does the periodic verification reveal any excess/shortage of stocks as compared to book records and if any discrepancies observed have been promptly reported to controlling authorities of the bank?
- 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, Traveller's Cheques, Gift Cheques, etc.)?

# Coverage

## ❖ Books & Records.

➤ Whether there are any software / systems (manual or otherwise) used at the branch which are not integrated with the CBS? If yes, give details thereof. - list of various system used (CBS, NPA, ALM, CRAR etc.) and inquire the interface between these system.

a) In case the branch has been subjected to IS Audit whether there are any adverse features reported and have a direct or indirect bearing on the branch accounts and are pending compliance? If yes give details.

# Coverage

- b) Whether branch is generating, and verifying exception reports at the periodicity as prescribed by the bank.
- c) Whether the system of bank warrants expeditious compliance of daily exception reports and whether there are any major observations pending such compliance at the year end.

# Coverage

- d) Whether the bank has laid down procedures for manual intervention to system generated data and proper authentication of the related transactions arising there from along with proper audit trail of manual intervention has been obtained.
- e) Furnish your 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.

# Coverage

## ❖ Inter Branch Accounts.

- 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?

# Coverage

## ❖ Frauds.

### ➤ Furnish particulars of:

Frauds detected/classified but confirmation of reporting to RBI not available on record at branch. - significant and important area of the audit.

### ➤ Whether any suspected or likely fraud cases are reported by branch to higher office during the year? If yes, provide the details thereof related to status of investigation.



# Coverage

- In respect of fraud, based on your overall observation, please provide your comments on the potential risk areas which might lead to perpetuation of fraud. - verify the forensic audit report/internal memo prepared by the bank.

(e.g. falsification of accounts/false representation by the borrower; misappropriation of funds especially through related party/ shell company transactions; forgery and fabrication of financial documents like invoices, debtor lists, stock statements, trade credit documents, shipping bills, work orders and encumbrance certificates and avail credit; ....

# Coverage

...Use of current accounts outside consortium where Trust and Retention Account (TRA) is maintained, to divert funds; List of Debtors/ Creditors were being fabricated and receivables were not followed up/ write off of debt of related parties; Fake export/shipping bill, etc.; Over statement of invoice amounts, stock statements, shipping bills, turnover; fly by night operations -including the cases where vendors, related/ associate parties, manufacturing units etc. aren't available on the registered addresses; Round Tripping of funds, etc.)

# Coverage

- Whether the system of Early Warning Framework is working effectively and, as required, the early warning signals form the basis for classifying an account as RFA.
- ❖ Implementation of KYC AML Guidelines:
  - Whether the branch has adequate systems and processes, as required, to ensure adherence to KYC/AML guidelines towards prevention of money laundering and terrorist financing.
  - Whether the branch followed the KYC/AML guidelines based on the test check carried out by the branch auditors.

# Coverage

- ❖ Management Information Systems:
  - Whether the 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. Have you come across any instances where data integrity was compromised? - highlight discrepancies which cannot be rectified through MOC e.g. incorrect PSL classification, sector code classification, wrong input of repayment schedule used for ALM etc.

# Coverage

- ❖ Miscellaneous:
  - In framing your audit report/LFAR, have you considered the major adverse comments arising out of the latest reports 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 such inspection took place;

# Coverage

- vi. Income and Expenditure (Revenue) Audit;
  - vii. IS/IT/Computer/Systems Audit; and
  - viii. Any special inspection / investigation report?
- Are there any other matters, which you, as branch auditor, would like to bring to the notice of the management or the Statutory Central Auditors?

# Coverage

**Some Early Warning signals which should alert the bank officials about some wrongdoings in the loan accounts which may turn out to be fraudulent**

- Default in payment to the banks/ sundry debtors and other statutory bodies, etc., bouncing of the high value cheques.
- Raid by Income tax /sales tax/ central excise duty officials.
- Frequent change in the scope of the project to be undertaken by the borrower.

# Coverage

- Under insured or over insured inventory.
- Invoices devoid of TAN and other details.
- Dispute on title of the collateral securities.
- Costing of the project which is in wide variance with standard cost of installation of the project.
- Funds coming from other banks to liquidate the outstanding loan amount.
- Foreign bills remaining outstanding for a long time and tendency for bills to remain overdue.
- Onerous clause in issue of BG/LC/standby letters of credit.
- In merchanting trade, import leg not revealed to the bank.



# Coverage

- Request received from the borrower to postpone the inspection of the godown for flimsy reasons.
- Delay observed in payment of outstanding dues.
- Financing the unit far away from the branch.
- Claims not acknowledged as debt high.
- Frequent invocation of BGs and devolvement of LCs.
- Funding of the interest by sanctioning additional facilities.
- Same collateral charged to a number of lenders.
- Concealment of certain vital documents like master agreement, insurance coverage.

# Coverage

- Floating front / associate companies by investing borrowed money.
- Reduction in the stake of promoter / director.
- Resignation of the key personnel and frequent changes in the management.
- Substantial increase in unbilled revenue year after year.
- Large number of transactions with inter-connected companies and large outstanding from such companies.
- Significant movements in inventory, disproportionately higher than the growth in turnover.

# Coverage

- Significant movements in receivables, disproportionately higher than the growth in turnover and/or increase in ageing of the receivables.
- Disproportionate increase in other current assets.
- Significant increase in working capital borrowing as percentage of turnover.
- Critical issues highlighted in the stock audit report.
- Increase in Fixed Assets, without corresponding increase in turnover (when project is implemented).
- Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet.

# Coverage

- Liabilities appearing in ROC search report, not reported by the borrower in its annual report.
- Substantial related party transactions.
- Material discrepancies in the annual report.
- Significant inconsistencies within the annual report (between various sections).
- Poor disclosure of materially adverse information and no qualification by the statutory auditors.

# Coverage

- Frequent change in accounting period and/or accounting policies.
- Frequent request for general purpose loans.
- Movement of an account from one bank to another.
- Frequent ad hoc sanctions.
- Not routing of sales proceeds through bank.
- LCs issued for local trade / related party transactions.
- High value RTGS payment to unrelated parties.
- Heavy cash withdrawal in loan accounts.
- Non submission of original bills.

THANK YOU