



Long Form Audit Report

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Introduction

- As part of Statutory Audit of Bank Branches, an Auditor is required to answer a detailed questionnaire prepared by Reserve Bank of India (RBI). This report is generally known as “Long Form Audit Report (LFAR)”.
- LFAR is a questionnaire, which asks specific questions for which replies should be specific. The auditor should not shirk his responsibility of answering any questions by remaining silent. At the same time he should not answer facts for which replies were never sought. What is important is a thorough reading and understanding of the questions and a specific, clear and unambiguous reply to the question. Key is to ensure correct presentation so as to state facts which have been verified.

Introduction

- Further, there is no need to take/accept more responsibility and liability. It is well understood that in the limited time, auditor can only do a macro level scrutiny on a random check basis prioritizing risks involved. While compelling the LFAR there are certain Auditing Standards, which the auditor should be aware of.
- Format of LFAR applicable to StCB and DCCB is given in the NABARD circular dated 30th June, 2008 vide circular number 106/Dos-19/2008/ Ref. No. NB.DOS.POL/1309/J.1/2008-09. (Given in the Annexure to the Guidance Note)

Introduction

- The terms of engagement of auditors of StCBs and DCCBs require them to furnish a long form audit report in addition to their report in pursuance of statutory provisions. The matters to be dealt with in long form audit reports by the auditors have been specified by NABARD.
- The auditor should ensure that the LFAR is submitted within the time limit stipulated in this behalf by the bank. In case no time limit has been so laid down, the LFAR should be submitted either along with the main report or within a short period thereafter.

Introduction

- The duties and responsibilities of auditors of banks and their branches are governed by the relevant statutes. In all cases, matters covering the central responsibilities of the auditors should be dealt within the main report and in this regard, the LFAR cannot in any way be a substitute for the main report. However, the matters included in the main report may be elaborated in the LFAR. Similarly, while framing his main report, the auditor should consider, wherever practicable, the significance of various comments in his LFAR. It may, however, be emphasised that the main report should be a self-contained document and should not make any reference to the LFAR.

Introduction

- The auditor needs to see whether modifications reported in the previous years have been resolved and if not, evaluate the impact of the same on the current year's audit report. In the preparation of LFAR, the auditor should call for and look into the previous reports to ascertain whether in respect of the accounts for the year under audit, there are any matters which deserve the attention of the management particularly as regards adverse comments of a material nature on which remedial action was warranted.
- Some of the matters dealt within the LFARs require compilation of detailed information/statements. It should be recognised that the responsibility for such compilation is that of the branch/bank concerned.

Background

- The LFAR Questionnaire is an excellent Audit Planning Tool, based on which the auditor may decide the areas to be covered.
- The work on LFAR should be started along with statutory audit right from day one in order to avoid duplication of work and enable timely completion of the statutory audit function.
- The Audit Report and LFAR, being two separate and distinct reports, any comments of qualificatory nature should not be included in LFAR. Such Audit Qualifications should be included in the Audit Report and not in LFAR. In deciding whether qualification in the auditors report is necessary, the auditor should use his discretion considering the facts and circumstances of each case.

Background

- Where the auditors have any reservation or adverse remarks with regard to any of the matters to be dealt with in their Long Form Audit Reports, they may give the reasons for the same. Also, where relevant instances of situations giving rise to their reservations or adverse remarks may also be given.
- Many of the matters to be dealt with by the statutory auditors in their LFARs will be based on the LFARs received from the branches.
- Where any of the comments made by the Branch Auditors in the LFAR is adverse, they should consider whether a qualification in the main report is necessary.

Coverage of LFAR

The statutory Auditors are expected to comment on important issues related with -

- Capital
- Assets
- Liabilities
- Profit and Loss Account
- Liquidity Management
- Foreign Exchange Transactions
- Systems and Controls
- General

Capital

- Share capital from member societies, individuals and Government and share holding of Government in the total capital; change of position from the previous year.
- System followed for share-linking to borrowings by member societies/borrowers.
- Arrears in collection of share capital from affiliated institutions/individuals.
- Net-worth as percentage to total assets, Capital to Risk weighted Assets Ratio (CRAR) and computation thereof.

Assets

Cash Balance

Balance with other Banks

Advances-

- Loan Policy
- Credit Appraisal
- Sanctioning/Disbursement
- Documentation
- Review/Monitoring/Supervision
- Large Advances
- Foreign Exchange Bills
- Coverage of Crop Loans under Crop Insurance
- Imbalances

Assets

Investments

Other Assets

- Stationery and stamps
- Suspense Accounts/ Sundry Assets and other items

NON-FUND BUSINESS

Assets

I. Cash Balance

- a) Does the branch generally carry cash balances, which vary significantly from the limits fixed by the HO of the bank?
- b) Whether excess balances have been reported to the controlling office/HO of the bank?
- c) Does the branch hold adequate insurance cover for cash on-hand and cash-in-transit?
- d) In case of single officer branch, comment on the arrangements for custody of cash and whether it is as per the guidelines of Head Office of the bank. Also comment on the joint custody arrangements in bigger branches where cash is maintained by two officials.
- e) Have the cash balances at the branch been checked at periodic intervals as per the procedure prescribed by the Head Office of the bank?

Assets

II. Balances with other banks

- a) Observations on the reconciliation statements may be reported in the following manner:
 - i) Cash transactions remaining unresponded (give details)
 - ii) Revenue items requiring adjustments/write-off (give details)
 - iii) Old outstanding balances remaining unexplained/unadjusted.

Give details for

- Outstanding between six months and one year; and
- one year and above.

Assets

II. Balances with other banks

- b) Were balance confirmation certificates obtained in respect of outstanding balances as at the year-end and whether the aforesaid balances have been reconciled? The nature and extent of differences should be reported.
- c) In case any item deserves special attention of the management, the same may be reported.

Assets

III. Advances (Loan Policy)

➤ Questions

- Existence of Loan Policy
- Specifying the prudential exposure norms
- Industry-wise exposures
- Regular updation of the policy
- Systems of monitoring and adherence thereto

➤ Significant Audit Checks

- Deficiencies/ lacunae in coverage – Below BPLR, circumstances for deviations, industry wise / risk perception wise benchmarks, basis for fixing internal exposure norms, ST loans, unsecured exposure, quantitative caps based on risk perception, hurdle rate
- Adherence to Policy guidelines and extent of deviations

III. Advances (Credit Appraisal)

➤ Questions

- Existence of a well laid-down system of appraisal of loan/credit proposals, including adequacy of information for appraising the credit worthiness of applicant, and adherence thereto

➤ Significant Audit Checks

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

Assets

III. Advances (Sanctioning/Disbursement)

➤ Questions

- In the cases examined by you, have you come across instances of credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch? Are such cases promptly reported to higher authorities?
- In the cases examined by you, have you come across instances where advances have been disbursed without complying with the terms and conditions of the sanction? If so, give details of such cases.

Assets

III. Advances (Sanctioning/Disbursement)

➤ Significant Audit Checks

- Obtain Operations Manual/Circulars prescribing delegated authority or limits of the branch officials.
- Whether telephonic sanctions by higher authorities are followed up by written confirmations.
- Whether Adhoc limits (increase) granted to borrowers for temporary/seasonal/peak periods are periodically reported to controlling authorities and whether the same is liquidated within the stipulated time.

III. Advances (Documentation)

➤ Question

- In respect of advances examined by you, have you come across instances of deficiencies in documentation, non-registration of charges, non-obtaining of guarantees, etc.? If so, give details of such cases

➤ Significant Audit Checks

- Examples/instances of deficiencies in documentation, non-registration of charges, non-obtaining of guarantees, etc. are given in Point no 3 of Glossary of Irregularities. The auditors should not put audit ticks on legal documents to avoid legal complications in future

Assets

III. Advances (Review/Monitoring/Supervision)

➤ Questions

- Are the stock/book debt statements and other periodic operational data and financial statements, etc., received regularly from the borrowers and duly scrutinized?
- Is suitable action taken on the basis of such scrutiny in appropriate cases?
- Has the branch identified and classified advances into standard/substandard/doubtful/ loss assets in line with the norms prescribed by the Reserve Bank of India.
- List the major deficiencies in credit review, monitoring and supervision

Assets

III. Advances (Review/Monitoring/Supervision)

➤ Significant Audit Checks

- Whether stock/book debt statements are being received regularly? If not, report
- Whether the same are being critically scrutinized for non-moving/ obsolete/damaged stock and action taken thereon?
- Whether such year-end stock/book debt statements compared to the audited Balance Sheet to ascertain variance in Stocks/book debts?
- How are the stock/book debts more than three months considered for DP and for classifying the loans (secured/unsecured)?

Assets

III. Advances (Review/Monitoring/Supervision)

➤ Significant Audit Checks

- On some issues, Bank Circular may interpret differently from the intention of RBI Circulars. Rely on RBI Circulars
- If auditor does not agree to any classification, mention detailed reasons and include in MOC and Main Audit Report.
- Examples of major deficiencies in credit review, monitoring and supervision are given in Point no 4 of Glossary of Irregularities.

Assets

III. Advances (Large Advances)

- Adverse features in respect of large advances considered significant and requiring management's attention.
- Compliance with exposure norms relating to advances as per the exposure norms stipulated by NABARD/RBI/provisions of Cooperative Societies Act.
- Review of the large advances by the Board of Directors and follow up action taken

Assets

III. Advances (Foreign Exchange Bills)

- Foreign bills negotiated under letters of credit.
- Including pre and post shipment credit.
- Whether the debits and credits are permissible under the rules, whether inward/outward remittances have been properly accounted for, adherence to the guidelines issued by the RBI regarding the above operations, violations of FEMA, if any.

Assets

III. Advances (Crop Loans under Crop Insurance)

- ❖ The following need to be examined:
 - I. Whether all the loanee farmers and crops have been covered as per the guidelines of Agricultural Insurance Company of India (AICI).
 - II. Whether premium is remitted to the insurance company in time.
 - III. Amount of claims preferred.
 - IV. Amount of claims settled by AICI
 - a) Of (iii) above, those pending adjustment at the bank level.
 - b) How much is adjusted to the loan accounts

Assets

III. Advances(Imbalances)

- No. of PACS with imbalances.
- Imbalance in principal account and interest account of the DCCBs
- Percentage of imbalances to total loans & advances outstanding.
- Reasons for the same and likely impact on the bank.
- Steps taken by the bank to reduce imbalances.

Assets

IV. Investments

➤ Questions

- Has the Branch kept money at call and short notice or purchased/sold investments during the year?
- If so, whether instructions/ guidelines, if any, laid down by Head Office/Controlling Authority have been complied with?
- Whether the securities held in the books of the branch are physically held by it?

➤ Significant Audit Checks

- Existence of Investment Policy, Investment Committee, Periodical review by the Board, Panel of Brokers, exposure limits on Non-SLR investments, broker-wise limits, trading policy, 'cut loss policy' stipulated, adherence to the various terms and conditions of Investment Policy, compliance with RBI/NABARD guidelines.

Assets

IV. Investments

➤ Significant Audit Checks

- System of purchase and sale of investments, delegation of powers, reporting systems, segregation of front, back and mid office functions, etc.
- Controls over investments, including periodic verification/reconciliation of investments with books/records.
- System of recording and accounting of income from investments.
- System of monitoring of income accrued and due but not received.
- System of monitoring matured investments and their timely encashment.

Assets

V. Other Assets (Stationery and Stamps)

➤ Questions

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

Assets

V. Other Assets (Stationery and Stamps)

➤ Significant Audit Checks

- Understand the system of issue and custody of stationery. The system will highlight the method adopted by the branch in the use and safe-custody of stationery. After being satisfied about the system being adopted by the branch, the auditor may check the implementation of the system and report on non-implementation of such systems, if any
- Mention details of missing/lost items of stationery (e.g. Drafts) Inform central statutory auditors to check provisioning there against, if encashed fraudulently

Liabilities



Deposits

Contingent Liabilities

Other Liabilities

- Bills Payable
- Sundry Deposits, etc.

Liabilities

I. Deposits

➤ Questions

- 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 management and give your comments thereon.

➤ Significant Audit Checks

- Apply cut-off procedure to ascertain any unusual large movements in deposits. To determine probable window dressing, if any.

Liabilities

II. Contingent Liabilities

➤ Questions

- List of major items of the contingent liabilities (other than constituents' liabilities such as guarantees, letters of credit, acceptances, endorsements, etc.) not acknowledged by the Branch?

➤ Significant Audit Checks

- Contingent liabilities, being an important “off balance sheet” item, seek reasonable assurance that all contingent liabilities are identified and properly disclosed. For e.g. Increase in rent of premises by landlord disputed by bank.
- Obtain a letter of representation to the effect that there are no contingent liabilities existing in the branch other than those disclosed in the financial statements.

Liabilities

III. Other Liabilities (Bills Payable, Sundry Deposits)

➤ Questions

- Does your test check indicate any unusual items or material withdrawals or debits in these accounts? If so, report their nature and the amounts involved.
- Does the scrutiny of the accounts under various sub-heads reveal old balances?

➤ Significant Audit Checks

- 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.

Profit and Loss account

Income

- Interest income
- Fees & commission
- Other income

Expenses

- Interest expenses
- Provision for doubtful debts
- Administrative expenses

Profit and Loss Account

➤ Questions

- Whether the branch has a system to compute discrepancies in interest/discount and for timely adjustment thereof in accordance with the guidelines laid down in this regard by the HO of the bank?
- Has the test checking of interest revealed excess/short credit of a material amount? If so, give details thereof.
- Whether the branch has a system to compute discrepancies in interest on deposits and for timely adjustment of such discrepancies in accordance with the guidelines laid down in this regard by the HO of the bank? Has the test check of interest on deposits revealed any excess/short debit of material amount? If so, give details thereof.

Profit and Loss Account

➤ Questions

- Does the branch has a system of estimating and providing interest accrued on overdue/matured term deposits?
- Has the branch complied with the Income Recognition norms prescribed by RBI?
- Are there any divergent trends in major items of income and expenditure, which are not satisfactorily explained by the branch? If so, the same may be reported upon. For this purpose, an appropriate statement may be obtained from the branch manager explaining the divergent trends in major items of income and expenditure.

Profit and Loss Account

➤ Significant Audit Checks

- The branch should have a system of verification of interest and discount so as to be able to detect discrepancies: Maker–Checker concept
- Verify that adjustments of discrepancies have been done in accordance with the laid down guidelines
- In case discrepancies exist in large number of cases taken for test checking, the auditor should consider its impact on the accounts and ascertain whether qualifying Auditors Report would be required. For this purpose, get the total amounts quantified from the Branch Officials and selectively verify its veracity.

Profit and Loss Account

➤ Significant Audit Checks

- Review revenue audit/concurrent audit reports for any short/excess recoveries, reasons thereof and remedial measures taken to avoid repetition of mistakes.
- One point deleted from old LFAR but should be reported by Branch auditors as part of normal audit procedure is “Indicate the effect of changes, if any, in accounting policies on the items of Income & Expenditure”
- For identified divergent trends, obtain supporting evidences like monthly weighted average figures, composition of the income/expenditure, etc.

Liquidity Management

❖ **Statutory Liquidity Ratio (SLR) /Cash Reserve Ratio (CRR) Requirements -System of Ensuring Compliance**

- System of compiling and monitoring Demand and Time Liability (DTL) position.
- Records maintained for the above purpose.
- System of ensuring compliance, defaults paid, if any and review of the position by CEO/Board.
- Violations, if any in the maintenance of CRR/SLR, details thereof and reasons for the same.

Foreign Exchange Transactions

- Foreign bills negotiated under Letters of Credit (LCs), FCNR and other non-resident accounts, whether the debits and credits are permissible under the rules, whether inward/outward remittance have been properly accounted for. Ensure adherence to the guidelines issued by RBI regarding the above operations, statements to be submitted, etc.

General



Books and Records

Reconciliation of control and Subsidiary Records

Inter Branch Accounts

Audits/Inspections

Frauds

Miscellaneous

General

Books and Records

➤ Questions

- In respect of computerized branches: Whether hard copies of accounts are printed regularly?
- Indicate the extent of computerization and the areas of operation Covered
- Are the access and data security measures and other internal controls adequate?

➤ Significant Audit Checks

- The main difficulty would be in tracking back Changes made in soft copies in case hard copies are not taken
- Check if Information Systems Audit is conducted and that its report is satisfactory

General

Inter Branch Accounts

➤ Questions

- Does the branch forward on a daily basis to a designated cell/ Head Office, a statement of debit/credit transactions in relation to other branches?
- Does a check of the balance in the Head Office Account as shown in the said statement during and as at the year-end reveal that the same is in agreement with the Head Office Account in the general ledger?
- 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 unresponded/uncomplined queries or communications? If so, give details?

General

Inter Branch Accounts

➤ Questions

- Are there any outstanding debits in the Head Office Account in respect of inter-branch transactions?
- Have you come across items of double responses in the Head Office Account? If so, give details
- Are there any old/large outstanding transaction/entries at debits as at year-end which remain unexplained in the accounts relatable to inter-branch adjustments?

General

Inter Branch Accounts

➤ Significant Audit Checks

- Being a back-office function, Inter Branch Reconciliation (IBR) is generally seen as a neglected area. The auditor needs to critically understand the IBR system prevalent in the branch and accordingly prepare an audit plan to review the IBR transactions. The large volume of Inter Branch Transactions and unreconciled entries in the banking system makes the area fraud-prone.
- Check the head-office inward communication to branch to ascertain date upto which statements relating to inter-branch reconciliation have been sent

General

Inter Branch Accounts

➤ Significant Audit Checks

- If outstanding debits in HO Account are not confirmed/recorded by HO, review critically and recommend provision for e.g. unrecorded revenue expenses, etc.
- Based on the review of details and norms of RBI with respect to IBR transactions, the auditor should consider the extent of non-reconciliation in forming his opinion on the financial statements. Where the amounts involved are material, the auditor should suitably qualify his audit report. Attention is drawn on the paper on “Certain Significant Aspect of Statutory Audit of banks” issued by the Council of ICAI in March, 1994, published in the CA journal.

Application of Prudential Norms

- The auditors should verify the adoption/application of Income Recognition and Assets Classification as also Provisioning norms by RRBs as prescribed in RBI's circular and comment on the same in the LFAR.
- The Auditors should also make an attempt to prepare a Divergence Statement indicating the accounts in which wrong classification has been done by the bank and work out the short provisioning.

Application of Prudential Norms

- ❑ **The Auditors are required to comment on the following specifically –**

I. Income recognition

- a) Whether the bank has recognized as per instructions in vogue.
- b) The total amount of income derecognized as on 31st March(cumulative).
- c) The amount of recognised income recovered during the year.
- d) The procedure followed by the bank for accounting derecognised income. Provisioning made by the bank for net debit entries under Branch Adjustment Account as on 31st March.

Application of Prudential Norms

II. **Asset Classification**

Comment on the system of asset classification adopted by the branches as also provisioning done by them. Or whether the final asset classification is done by the HO by consolidating the figures obtained from branches and total provisioning is arrived at.



Thank You