

PRESENTATION ON LONG FORM AUDIT REPORT

- CA JAYESH KALA

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 |

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Master Circular/Master Directions

| Brief Content | Dated | Reference No. |
|------------------------------------------------------------------------------------------------------------|--------------------|--------------------------------------------------------------------|
| 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.

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

- i. Income Expenditure

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

❖ 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. Quick mortality accounts - facility became non-performing within a period of 12 months from the date of first sanction.
- ii. Correct feeding of interest rate into the borrowers masters.
- iii. Periodic review of floating interest rate linked to MCLR.

c) Sanctioning / Disbursement.

- i. Loans to companies for buy-back of shares/securities.

Coverage

- d) Documentation.
- e) Review/ Monitoring/ Supervision.
 - Red-flagged account
 - Deviations 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.

Coverage

- f) Asset Classification, Provisioning of Advances and Resolution of Stressed Assets.
- Classification of Advances into standard / substandard / doubtful / loss assets is as per RBI norms
 - Classification of accounts into SMA-0, SMA-1, and SMA-2.
 - Accounts restructured.
 - Process under IBC is mandated but not initiated by the branch.

Coverage

- Recoveries have been properly appropriated against the principal / interest as per the policy of the bank.
- Documents are held at centralized processing centers / office.

g) Non Fund based facilities.

- 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.

Coverage

II. LIABILITIES

❖ Deposits:

- a. Identification of dormant/ inoperative accounts and internal controls .
- b. Unusual large movements.
- c. Automatic renewal of deposits applies to FCNR(B) deposits.

❖ 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?

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Coverage

III. PROFIT AND LOSS ACCOUNT

- a. Income Recognition norms prescribed by R.B.I.
- b. Test check of interest on deposits revealed any excess/short debit of material amount.
- c. Estimating and providing interest accrued on overdue/matured/ unpaid/ unclaimed term deposits **including in respect of deceased depositors**.
- d. Divergent trends in major items of income and expenditure.

Coverage

IV. GENERAL.

- ❖ Gold/ Bullion/ Security Items.
- ❖ Books & Records.
 - software / systems (manual or otherwise) used at the branch which are not integrated with the CBS.
 - list of various system used (CBS, NPA, ALM, CRAR etc.) and inquire the interface between these system.

Coverage

- a) IS Audit.
 - b) verifying exception reports at the periodicity as prescribed by the bank.
 - c) procedures for manual intervention to system generated data.
 - d) audit trail of manual intervention has been obtained.
- ❖ Inter Branch Accounts.

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.

➤ suspected or likely fraud cases are reported by branch to higher office during the year.

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

- ❖ Implementation of KYC AML Guidelines
- ❖ Management Information Systems
- ❖ 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;

Coverage

- iv. Stock audit Report;
 - v. RBI Inspection Report, if such inspection took place;
 - vi. Income and Expenditure (Revenue) Audit;
 - vii. IS/IT/Computer/Systems Audit; and
 - viii. Any special inspection / investigation report?
- Notice of the management or the Statutory Central Auditors?

THANK YOU