

Long Form Audit Report



The statutory Auditor of the Bank is required to submit Audit Report as per the requirements of the Banking Regulation Act, 1949. It is called as Statutory Audit Report. This audit report broadly gives a true and fair view on the financial statements. However, this report does not necessarily communicate the lacunae in the operations and internal control system at the bank. Hence, the RBI advised the Public Sector Banks to obtain the Long Form Audit Report (LFAR) from the auditor since 1985. LFAR is a separate report to be submitted to the Management in the format prescribed by the RBI. The format of LFAR was initially prescribed in 1985, was revised in 1992 and subsequently in the year 2003. The present format is effective from 31st March, 2003.

Over the period, there have been many changes in the operations in the Banking industry, viz. CBS environment, internet banking, SMS alerts, spread of ATM centres, etc. Considering the changes in the operations in the Banking industry, the format of LFAR is under review. However, till the new format is notified, the existing format is in use. Therefore, the statutory auditor is expected to report in the existing format given by RBI.

1. Format of LFAR

The Reserve Bank of India has prescribed two formats for LFAR viz. LFAR for Bank as a whole to be given by the Statutory Central Auditors (SCA) and LFAR for branches of the Bank which are to be given by the Branch Auditors in relation to the respective branch and its operations. The Central

Statutory Auditor is expected to review the LFARs submitted by the branch auditors and draft his LFAR in the format prescribed for the bank as a whole. Therefore, it is necessary for the branch auditors to draft the LFAR carefully and with clarity so that a relevant point if any, at the branch is not missed by the Central Statutory Auditor, while forming its opinion or giving his observations about the internal control and operations.

The format of LFAR is in a questionnaire form. These questions are to be answered clearly. These questions are only indicative and not exhaustive. Therefore, the auditor should not limit the report to only answering the questions. But, he may mention any relevant point which the auditor feels necessary



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to mention, in the same in the LFAR. The auditor should be clear, precise and relevant while finalising the LFAR of the branch.

While drafting the LFAR the following aspects need to be considered.

- The LFAR is not a substitute for Statutory Audit Report. Nor is it deemed to be a part of Statutory Audit Report.
- The Statutory Audit Report is a self contained document and the auditor should not make any cross reference to the observation in the LFAR. In case of any matter of emphasis, the auditor should mention the same in the report clearly.
- The matters in the main report may be elaborated in the LFAR.
- Any adverse comment made by the auditor in the LFAR, the auditor should consider whether qualification in the main report is required.
- It is not necessary that every adverse comment in the LFAR will result into a qualification in the main report. Therefore, the auditor should use his judgment in the facts and circumstances in each case. However, every qualification in the auditors report should be elaborated in the LFAR.
- The details given in the LFAR should be clear on facts and the opinion of the auditor is also to be mentioned so that the SCA can take up the point appropriately
- Though the format of LFAR is in a questionnaire form, the auditor should not necessarily limit the answer to YES or NO. He should mention his opinion, if any, over there as well.

2. Broad Structure of LFAR

In this article, the discussion is mainly on the LFAR applicable to the branch audit. Hence, the prescribed format of bank branch LFAR is discussed here.

The format of the LFAR consists of the questions on four major areas. Such as:

A. Assets

1. Cash
2. Balances with RBI, SBI and other Banks.
3. Money at call and Short Notice
4. Investments
5. Advances
6. Other Assets

B. Liabilities

1. Deposits
2. Other Liabilities
3. Contingent Liabilities

C. Profit and Loss Account

D. General

1. Books and Records
2. Reconciliation of Control and Subsidiary records
3. Inter branch Accounts
4. Audits/Inspections
5. Frauds
6. Miscellaneous

In addition to these questions, are also given questionnaires applicable to specialised branches

- Dealing in Foreign Exchange Transactions
- Dealing in very large advances in excess of ₹100 crore.
- Dealing in NPAs such as Asset Recovery Management Branches.
- Dealing in clearing house operations, normally referred to as service Branches.

In addition to these questionnaires, there is a format for Annexure for Large/Irregular/Critical Advances. Normally, this annexure is to be filled up by the branch management and the auditor should verify the details mentioned in the Annexure. The details will be pertaining to the advance granted in excess of ₹100 crore.

Some of the matters mentioned in the LFAR needs compilation of information at the branch. It is the responsibility of the concerned branch to compile the information and hand it over to the auditor for verification. The auditor should verify the correctness of information and include the same in his LFAR. In case, auditor faces any problem in getting such information or has a doubt about the correctness of information, he should report the same in his LFAR.

3. Reporting Under Specific Clauses

The following are the broad guidelines for verification and reporting under specific clauses

Cash

- The branch is expected to maintain the cash balance within the limit prescribed by the controlling authority. This is called the retention limit for the cash. In case the branch holds cash in excess of the retention limit, the auditor should report the same.
- The auditor should count the cash including the cash in ATM and see whether it tallies with the books.
- The excess balance should also be reported to the controlling authority within the prescribed time

frame. The reasons for such excess cash balance should be inquired into.

- Normally, the global Insurance Policy for cash-in-custody or cash-in-transit is taken at the head office level. The head office of the bank normally sends confirmation to that effect to the branches.
- The branch should hold cash in joint custody of the cashier and the Branch Manager. The Branch Manager is also expected to verify the cash periodically and put his signature to that effect. The auditor should report whether these directions are followed properly or not.
- Apart from answering the questions in the LFAR format the auditor should comment on identification and disposal of soiled notes, counterfeit notes, stapling of notes, use of ultra violet lamps, Note counting machines, etc.

Balances with RBI, SBI and Other Banks

- In case the branch maintains the account with RBI, SBI or any other bank, the auditor should see whether the reconciliation statement for the year-end balances is prepared or not.
- He should peruse the reconciliation statement and find out the long outstanding entries in the statement. An explanation from the branch for pending entries should be obtained. In case any revenue item is required to be adjusted or written off in the accounts, the same should be reported in the LFAR.
- The auditor should give the details of entries outstanding in the Reconciliation statement which are outstanding for more than six months, with specific details of outstanding entries for more than one year. The auditor may ask the bank to compile such information and verify the same before giving it in the LFAR.
- The continuous failure of the branch to obtain the balance confirmation certificates and/or preparing reconciliation statements should also be reported in the LFAR.

Money at call and short Notice

- Normally, money at call and short Notice are accounted for at the treasury department, Head

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office. However, in case such transactions are located at the branch, the auditor should examine the balances held at the branch with reference to the general or specific authority and instructions/guidelines from the controlling authority. The cases of non-compliance of relevant instructions should be reported, including unauthorised deposits or deposits in excess of authorised limit.

- It is also important to see whether the income has been booked properly or not.
- The yearend balance should be confirmed with the third party confirmation.

Investments

- There are separate questionnaires for the branches in India and for branches outside India. Though the reporting is to be done separately, the points to report are more or less the same.
- The auditor should obtain a certificate from the branch regarding investments held by the branch on behalf of the head office. The auditor should verify the security physically. In case the security is not available physically, the holding certificate/confirmation to that effect should be obtained. The income on investment should be reported to the head office. The auditor should see that accounting of such income is done properly.
- The matured investments should be encashed and the RBI guidelines for valuation should be followed properly. In case of any deviation, the auditor should report the same. For valuation of investment, the auditor should refer to the master circular on "*Prudential Norms for Classification, Valuation and Operation of Investment portfolio by banks*" issued by the RBI.
- The auditor should find out the unserviced investment and report the same, whether it could be considered as non performing investment (NPI).

Advances

The reporting under advances is to be done under four broad categories viz. Credit Appraisal, Sanctioning and Disbursement, Documentation, Review/Monitoring and Supervision. Since this topic is dealt separately, the aspects of verification and reporting on Advances are not elaborated in this article.

Other assets

- The Balance Sheet of the bank contains residual items about the assets which are not specified above, such as Stationery and Stamp, Sundries, Suspense A/c etc.

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- In case of stationery and stamps the auditor should check the control on custody and issue of stationery items, stamps *etc.* The auditor should review the process and registers for the same. Stationery items will also include Term deposit receipts drafts, pay orders, cheque books, traveler cheques, Gift Cheques *etc.*
- The auditor should offer the suggestions for better control in maintenance and use of stationery.
- The instances of lost or missing stationery should also be mentioned in the report.
- In case of **Sundries and Suspense Accounts**, the auditor should obtain the details of agewise analysis of pending entries in the account, inquire about reason for entry being pending for unreasonable period and assess the position of recoverability of the amount. The auditor should exercise his judgment about making necessary provision against such amounts.
- In case any unusual items are notices while perusing the account, the auditor should report the same.
- The auditor should not restrict his checking only to the pending entries, but he should also look into the entries which are squared off during the audit period.

Liabilities – Deposits

- A deposit accepted from the public is a liability for the bank. Inoperative deposit accounts could be viewed as one of the fraud prone areas. Therefore, there are certain guidelines for operations in inoperative accounts. The auditor should see whether operations in inoperative accounts are carried out as per the guidelines issued. In case the guidelines are not followed, the details of deposits should be given *viz.* name of the party, the amount due, the due date, the nature of the deposits *etc.*
- The auditor should also review the deposit accounts both operative and inoperative to find out whether there are any unusual large movements (whether increase or decrease) in the aggregate deposits held at the year end. In such situation, the explanation from the branch management should be obtained. The movements without proper explanation should be reported in LFAR.
- The auditor should obtain a list of overdue/matured deposits at the end of the year. The amount of overdue/matured deposits should be mentioned in LFAR.

Other Liabilities – Bills payable, Sundry Deposits *etc.*

- The auditors should obtain age wise details of pending entries in bills payable, sundry Deposits Accounts from the branch management.
- The details obtained should be scrutinised to find out whether there exists any unusual items or material withdrawal/debits; The auditor should take appropriate view on such items.

Contingent Liabilities

- The auditor should see that there exists a system which gives a reasonable assurance that all contingent liabilities are identified and properly disclosed.
- The auditor should mention the list of major items of contingent liabilities (Other than constituent's liabilities such as guarantees, Letters of Credit, acceptances, endorsements, *etc.*) not acknowledged by the branch.
- The auditor should also obtain representation from branch management that all contingent liabilities have been disclosed and that the disclosed contingent liabilities do not include any contingencies which are likely to result in a loss and which therefore, require consequent adjustments of assets and liabilities.

Profit and Loss Account

- The auditor should review the system at the branch to compute the discrepancy in interest, discounts or commission and for timely adjustment thereof. The Auditor should see the guidelines of controlling office in this regard.
- The interest and commission should be checked on test check basis to find out whether there exists proper system to compute them correctly.
- The income recognition Norms issued by the RBI should be followed at the branch. The auditor should report any deviation in that regard.
- The report should also mention whether there is a system to estimate and provide interest accrued on the overdue/matured deposits.
- The auditor should carry out the analytical procedure to find out whether there are any divergent trends in major items of income or expenditure. A suitable explanation should be asked for any divergent trend from the branch management. In case the auditor is not satisfied with the explanation he should mention the same in his report with proper details for the said divergent trend.

Books and Records

- In most of the situations, nowadays, the books are maintained in the computerised environment.
- If the books are maintained manually, the auditor should peruse them to find out whether they are maintained properly. The balancing is done and it is properly inked out. The books are to be authenticated by proper signatory at the branch.
- In respect of computerised environment, the hard copies of certain accounts should be printed regularly.
- The auditor should also mention the extent of computerisation and adequacy of the access and data security measures and other internal controls.
- The auditor may review the process of creation of new logins, change of password the administrative control to access different files or reports through computerised system. There should be maker checker system.
- Updating of the master data should be under supervisory control. The modification in the master data should be registered to Branch Manager only.
- The auditor should also review the contingency

and disaster recovery plan for the computer system. Timely backups, offsite backups, *etc.* should be reviewed to understand the backup procedure.

- The auditor should also mention any suggestion for efficient operation of the computer system.

Reconciliation of control and subsidiary Records

- The auditor should see whether the subsidiary records are tallied with the control accounts. In case there are differences the same should be reported. He should also mention the date upto which the control and subsidiary records are balanced.

Inter branch Accounts

- Normally, the inter branch transactions are passed through Head office account. The balance in Head Office Accounts as shown in the statement should be in agreement with the Head office Account in General Ledger. In case of any difference, the reconciliation statement should be obtained. The pending entries should be scrutinised to report whether there is a system of responding the entry promptly.
- The outstanding debit entries in the Head office

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Account should be mentioned. The items of double response in Head office Account should also be reported.

- The report will also give old/large outstanding debit entries as at the year end which remains unexplained.

Audits/Inspections

- The auditor should review the audit reports for concurrent audit, RBI inspection special audit, internal audit, credit audit, *etc.* and find out whether they are complied properly. While finalising the report the auditor should consider the major adverse comments arising out of these reports.

Frauds

- The auditor should peruse the fraud Register and report particulars of Frauds discovered during the year under audit at the branch.
- The auditor can also give suggestions to minimise the possibility of their occurrence.

Miscellaneous

- The auditor should mention about the adequacy of control and maintenance of records in relation to the Fixed Assets at the branch. The Fixed Asset Register should be updated.
- The calculation of depreciation should be checked properly and any deviation should be reported.
- The auditor should also check on the impairment of the assets.
- The auditor should report whether examination of accounts indicate possible window dressing. The auditor should review the transactions near to the balance sheet date to look into the possibility of window dressing in the account.
- The auditor can also mention any other matter which he would like to bring to the notice of the management or Central Statutory Auditors.

Questionnaire Applicable to specialised branch

- Now a day the banks prefer to have branches on the basis of specialised functions such as branches having foreign exchange transactions, branches for large advances Asset Recovery, Management Branches, Service Branches, *etc.* The LFAR also provides separate questionnaire for audit of such specialised branches. The auditor is supposed to report additionally as per applicable questionnaire.
- While answering these questionnaires, the auditor should understand the functions and

working of these branches properly and use his audit checks.

4. Finalisation of the LFAR

The following are certain points which should be borne in the mind while finalising the LFAR:

- The auditor should plan for preparation of his LFAR of the branch after studying the contents of LFAR questionnaires thoroughly.
- The information required from the branch should be asked for at the beginning of the audit and should be obtained from the branch management.
- Though the branch management is responsible to give the required information, the auditors should verify the correctness of the information. Once he is satisfied about the correctness of the information, only then should he reproduce the same in the the LFAR.
- Though the Statutory Audit Report and LFAR are two separate reports, it will be advisable to finalise the Audit Report and LFAR simultaneously.
- It is advisable to discuss the contents of LFAR with the branch head and get his responses before finalising the same. The objective is to ensure correct presentation so as to state facts which have been verified during the course of audit.
- The LFAR is a descriptive report, which will communicate the observations to the Central Statutory Auditors to finalise his final report. Hence the comments in Bank Branch LFAR should not be vague and they should be properly supported by the incidences/observations.

5. Conclusion

The LFAR is not only a questionnaire that the auditor is supposed to answer. As its name indicates, LFAR is an elaborate reporting on the operations and controls in the branch which is based on the audit observations made by the auditor during the course of the audit. The whole bank LFAR is drafted by the Central Statutory Auditors based on the LFAR received from the Branch Auditors. The overall operations at the branch/bank are changing with the changing technology. Therefore, the reporting in the LFAR should be clear, quantifiable and meaningful. The auditor need not restrict to the questions given, but he can also mention the relevant observation in the LFAR in the residual paragraphs. This will help the Central Statutory Auditors to form opinion and report more meaningfully. ■