



**Bank Branch Audit
- LFAR, Tax Audit Report
and
Statutory Certificates
(Baroda Branch of WIRC of ICAI)**

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Introduction- Bank Audit & Types of Audit Reports

- ★ Special Features of Bank Audit
- ★ Audit of Advances – Important Part of Bank Audit
- * Audit Reports/ Certificates to be signed:
 - ★ Statutory Audit Report under the BR Act, 1949.
 - ★ Memorandum of Changes (MOC)
 - ★ Long Form Audit Report (LFAR)
 - ★ Tax Audit Report u/s 44AB of the I. Tax Act.
 - ★ Branch Returns
 - ★ Misc. Certificates
 - ★ Ghosh & Jilani Committee Recommendations

Statutory Audit Report under Banking Regulations Act, 1949.

- ❖ Audit Report Format (as prescribed under the Banking Regulation Act, 1949).
- ❖ Generally, the specimen format of the Audit Report provided by the Bank.
- ❖ All Standards on Auditing (SA) for the conduct of the Audit and Issue of Audit Report equally applicable to Bank Audit.
- ❖ Statutory Audit Report and LFAR are two independent and different Audit Reports and cross-referencing for any comments or qualifications should not be done.

Long Form Audit Report (LFAR) as prescribed by RBI.

- ❖ LFAR is a separate Audit Report to be submitted to the Management the prescribed format.
- ❖ LFAR format first prescribed by RBI in 1985 and then latest revised in 2003.
- ❖ Generally, the specimen format provided by the Bank.
- ❖ In LFAR, the main focus is on identification of the lacunae in the operations and internal control system of the Bank. Statutory Audit Report may not communicate this aspect.
- ❖ Statutory Audit Report and LFAR are two independent and different Audit Reports and cross-referencing for any comments or qualifications should not be done.

Important Features of LFAR:

- ❖ RBI has prescribed two formats of LFAR viz. LFAR for the Bank as a whole and LFAR for the Branches of the Bank.
- ❖ Format of LFAR is in a Questionnaire Form. These Questions should be answered clearly. Questions are only indicative and not exhaustive. Auditor should not limit the report to only answering the questions, he may provide additional information relevant to the Question.
- ❖ LFAR is not a substitute of Statutory Audit Report nor it is deemed to be a part of the Main Audit Report.
- ❖ Any Adverse Comment in the LFAR may not necessarily result into a Qualification for the Main Audit Report.

Major Clauses in LFAR:

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

Major Clauses in LFAR:

C. Profit and Loss Account.

D. General:

1. Books & Records
2. Reconciliation of Control & Subsidiary Records.
3. Inter Branch Accounts
4. Audits/ Inspections
5. Frauds
6. Other Miscellaneous Matters

E. Annexure attached to the LFAR – For Large Advances having exposure with more than 5% of Total Advances or Rs.2.00 Crores whichever is less.

Major Clauses in LFAR:

- ★ Questionnaires applicable to Specialized Branches like –
 - Branches dealing in Foreign Exchange Transactions.
 - Branches dealing in Very Large Advances in excess of Rs.100 Crores.
 - Branches dealing in NPA Recovery (Asset Recovery Management Branch)
 - Branches dealing in Clearing House Operations (Service Branches)

LFAR – Clause to Clause Reporting Requirements

☀ Cash Balance:

- Physical Verification by Auditor.
- Whether Cash Balance is within the limits prescribed by Controlling Authorities.
- Regular reporting of Excess Cash Balance
- Insurance for Cash-in-custody and Cash-in-Transit (Generally at H.O. level)
- Cash Balance to be held in joint custody
- Periodic verification of Cash Bal. By Manager/ other authorities.
- System for Disposal of Soiled Notes, Missing Tokens, Stapling of Notes etc.

LFAR – Clause to Clause Reporting Requirements

- ★ Balances with RBI, SBI and Other Banks:
 - Verify Balance Confirmation Certificates and Reconciliation Statements, in case of difference.
 - Analyze Pending/ Outstanding entries in Reconciliation and Explanation to be obtained from the Branch.
 - If there are any revenue entries pending in Reconciliation which require Write Off – the same should be reported in LFAR.
 - If there are pending entries in Reconciliation Statement outstanding for a period of more than 6 months, specific details of such pending entries should be given in LFAR.

LFAR – Clause to Clause Reporting Requirements

☀ Money at Call and Short Notice:

- Normally, these items are accounted at Treasury Dept. of H.O.
- If there are any such transactions at Branch, the Auditor should examine due compliance of instructions/guidelines of Controlling Authorities in this regard.

☀ Investments:

- Normally, Investments of Bank are accounted at H.O. Level.
- If there are any such transactions at Branch, the Auditor should physically verify such Investment Certificates and should obtain a certificate from the Branch regarding the Investments of Head Office held at the Branch.
- Examine that income from Investments is regularly received and matured Investments are encashed on time.
- Examine due compliance of instructions/guidelines of Controlling Authorities for valuation of Investments and other related matters.

LFAR – Clause to Clause Reporting Requirements

☀ Advances - Reporting on four areas:

- (a) Credit Appraisal – At the time of application and sanction. – And also on Review/Renewal
- (b) Sanction / Disbursement – Authority to Sanction, Compliance of Sanction Terms before Disbursement.
- (c) Documentation- Execution & Renewal of Documents - Vetting of Documents by Legal Dept.- Disbursement without Documentation??
- (d) Review / Monitoring / Supervision of Advances.

Advances - Credit Appraisal

- ★ Whether Application from borrower in prescribed form?
- ★ Whether KYC Compliance as Per RBI Requirements?
- ★ Whether Evaluation of Financial Data, Project Report-CMA data, Projected P&L, BS & Cash Flow etc. done?
- ★ Board Resolution for the availment of the facility
- ★ Latest I. Tax Records & Net Worth of Borrower/Guarantor
- ★ Confidential report and NOC from the existing banker
- ★ CIBIL Report, Title clearance report & valuation report
- ★ Whether Analysis of important Financial ratios done?
- ★ Whether Security Valuation & Title Verified?
- ★ Whether Appraisal done by Competent person?

Advances - Sanction & Disbursement

- ✦ Examine the sanction procedure and powers.
- ✦ Check that the Limits sanctioned are within the powers of the sanctioning authority
- ✦ Any change in the terms of sanction whether ratified by proper authority?
- ✦ Examine the system of Pre & Post-Disbursement unit inspection and reports.
- ✦ Whether Acceptance of the terms & conditions of sanction obtained from Borrower?
- ✦ Verify that Disbursement done only after compliance of all the Sanction terms and conditions

Advances - Loan Documentation

- ★ Whether All loan documents, as required by the sanction letter and loan policy have been executed?
- ★ Whether Loan documents are properly executed and approved by legal department or legal expert?
- ★ Fresh loan documents obtained on change in limit, change in the constitution of the borrower?
- ★ Whether Original title deeds, title clearance certificate valuation report are held on record?
- ★ Whether Charge on securities registered with ROC/ RTO/ LIC/ other appropriate authority
- ★ Lien marking/ NOC of housing society

Advances - Monitoring/ Supervision

- ✦ Verify that Regular QIS, Stock & Debtors statements are submitted and scrutinized - Examine Stock Inspection reports
- ✦ Whether Periodic Review of Overdue/ NPA accounts is done by Bank?
- ✦ Adequacy and Validity of Insurance Cover.
- ✦ Review/ Renewal of facilities carried out as per Bank policy
- ✦ End use of Funds – Ensure that No Diversion of Funds
- ✦ Penal interest charged for breach of DP limits/ non-submission of Stock Statements?
- ✦ Stock statements older than 3 months - Account will be NPA.
- ✦ Non-renewal/ Non-regularization of regular/ ad-hoc limit within 180 days from the due date will make the account NPA.
- ✦ Verify Stock audit report (once in 12 months) and Valuation Report (once in 3 yrs) for Accounts with limits > Rs.5.00 Crores

Advances - Asset Classification & Provisioning Norms

- ✦ Whether Advances have been classified properly into Standard, Sub-Standard, Doubtful and Loss Assets as per Asset Classification Norms as per RBI Master Circular?
(Refer RBI Master Circular No.DBOD/BP.BC.9/ 21.04.048/ 2012-13 dtd.02.07.2012).
- ✦ Whether Prudential Norms for Income Recognition and Provisioning have been complied by the Branch as per Master Circular?
 - Income Recognition - For NPA accounts income should be recognized on realization basis.
 - When an account becomes non-performing, unrealized interest of the previous *periods* should be reversed or provided for.

NPA Classification Example

Classification	NPA Date between	
Sub-Standard	01.04.2012	31.03.2013
Doubtful up to 1 Year (D1)	01.04.2011	31.03.2012
Doubtful 1 to 3 Years (D2)	01.04.2009	31.03.2011
Doubtful more than 3 Years (D3)	Before 31.03.2009	

LFAR – Clause to Clause Reporting Requirements

★ Other Assets:

➤ Stationery & Stamp Items:

- Examine the control on custody and issue of Stationery Items like Drafts, Pay Orders, TDRs, Cheque Books, Traveller Cheques etc.

➤ Sundries & Suspense Debit Items:

- Obtain details of age-wise analysis of Pending Entries in Sundries and Suspense Debit Account.
- Examine the reasons for Long Outstanding / Pending Entries and its Recoverability.
- Suggest Write Off / Provisioning for Irrecoverable Items.

LFAR – Clause to Clause Reporting Requirements

★ Liabilities – Deposits:

- Verify Compliance of KYC Norms in case of Deposit Accounts.
- Compliance of H.O. Guidelines for operations in Dormant/ Inoperative Deposit Accounts.
- Inoperative Accounts – Possible Fraud Area.
- Examine Unusual Large Movements in Deposit Accounts at the year end.
- Obtain and Examine the list of Overdue/ Matured Deposits (Figure to be reported in LFAR)
- Whether Bank has a system of providing for Interest on Overdue / Matured Deposits?

LFAR – Clause to Clause Reporting Requirements

★ Other Liabilities – Bills Payable, Sundry Deposits etc :

- Obtain and Examine the list of age-wise pending entries in Bills Payable and Sundry Deposit Accounts.
- Identify Unusual Items if any in these accounts.
- Also Examine How these items have been disposed off (e.g. Deposit of Money without Account Number in Sundry Deposits A/c.) – Possible Fraud Area.
- Also suggest Disposal of Long Outstanding Entries.

LFAR – Clause to Clause Reporting Requirements

★ Contingent Liabilities :

- Examine the List of Contingent Liabilities (Other than Constituent Liabilities such as Guarantees, LC etc.).
- Discuss with Branch about any legal matters pending against the Branch and possibility of any loss in respect of any such items – Whether such items have been disclosed as Contingent Liability or whether Provision made for the probable Loss?

LFAR – Clause to Clause Reporting Requirements

☀ Profit and Loss Account:

- Interest and Commission income to be verified on Test Check basis.
- Examine the system of changing the rate of interest on deposits/ advances from time to time as per Head Office Circulars.
- Examine the implementation of Income Recognition Norms with respect to Income from NPA Accounts.
- Whether there are any Divergent Trends in respect of major items of Income or Expenditure? – Comparison and Ratio Analysis are Important Tools for finding out such Divergent Trends in Revenue Items.

LFAR – Clause to Clause Reporting Requirements

☀ Books and Records:

- Now Generally, Books are maintained in Computerized Environment.
- Examine the extent of Computerization and Adequacy of Access and Data Security Measures and other Internal Controls relating to Computerized Environment.
- Examine the Process of Creation of new Logins, Change of Password, Access Restrictions for certain files/ menus in the Computer System. E.g. Cashier should not have access to Ledger Menu.
- Examine the System of Creation and Modification of Master Data.
- Examine the System of Timely Backups, Offsite Backups, Contingency and Disaster Data Recovery Plan for Computer System.

LFAR – Clause to Clause Reporting Requirements

☀ Reconciliation of Control & Subsidiary Records:

- Now, Books are maintained in Computerized Environment and generally, there is no mismatch in Control & Subsidiary Records.
- Discuss with the Branch and Examine the date up to which Control and Subsidiary Records are Balanced.

☀ Inter Branch Accounts:

- Normally, Inter Branch Transactions are passed through Head Office Account.
- Examine that the Balance in Head Office Account as per HO Statement is in agreement with the HO Balance in GL, In case of Difference, examine Reconciliation Entries (like DPWA).
- In computerized and CBS environment now, generally there is no mismatch in Inter Branch Accounts and Head Office balance.

LFAR – Clause to Clause Reporting Requirements

☀ Audits/ Inspections:

- Examine the observations/qualifications in Previous Audit Report and Reports of Concurrent Audit, Internal Audit, RBI Inspection, Stock Audit, Credit Audit, Revenue Audit etc. and find out that whether they have been complied with in time?
- Consider the major adverse comments and non-compliances of such reports while finalizing your Audit Report.

☀ Frauds:

- Examine the Fraud Register maintained by the Branch and report the frauds discovered during the year under Audit.
- Examine the corrective steps taken by the Branch to minimize the occurrence of such frauds in future.
- Auditor may give useful suggestions to minimize the possibility of Occurrence of Frauds with respect to various aspects.

LFAR – Clause to Clause Reporting Requirements

☀ Miscellaneous:

- Examine proper maintenance of Fixed Asset Records and Calculation of Depreciation.
- Examine the Possibility of Window Dressing by the Branch.
- Any other matter to be brought to the notice of the Management or Central Statutory Auditors.

☀ Annexure to LFAR: (to be obtained from Branch Management)

- For Branches dealing in Large Advances/Asset Recovery Branches – for all advances with outstanding balance of Rs.2 Crores and above
- For Advances upgraded or downgraded during the year with with outstanding balance of Rs.1 Crores and above.
- For All other Branches – in respect of advances with outstanding balance of Rs.10 Crores and above.

Tax Audit u/s 44 AB of I.Tax Act:

- ✦ Audit Report in Form No.3CA.
- ✦ Statement of Particulars in Form No.3CD.
- ✦ Generally, most of the clauses – filled in by the Bank in printed form – Some of the Items applicable only at the HO Level.
- ✦ Only few clauses to be answered by the Branch Auditor.

Tax Audit – Relevant Clauses:

- ☀ Clause 9 (b) and (c) - Books of Accounts Maintained and Examined – Generally printed list.
- ☀ Clause 14 - Particulars of Depreciation allowable – Details of Purchase, Sale, Transfer and Disposal/ Write-off of Fixed Assets to be verified by Branch Auditor.- Depreciation calculation – generally at HO.
- ☀ Clause 17(a) – Any amount of Capital Expenditure debited to Profit and Loss A/c.
- ☀ Clause 17(e) – Expenditure by way of Penalty or Fine for violation of any law debited to Profit and Loss A/c.

Tax Audit – Relevant Clauses:

- ★ Clause 17(f) – Any amount inadmissible u/s 40(a):
 - (a) Amount inadmissible u/s 40(a)(i):
 - Any interest paid to a Non-Resident person or to a Foreign Company without TDS.
 - (b) Amount inadmissible u/s 40(a)(i)(a):
 - Any interest, commission, brokerage, fees for Professional/ Technical Services or Contract Amount paid to a Resident person without TDS.
 - (c) Amount inadmissible u/s 40(a)(i)(a):
 - Any tax, interest or penalty under Income Tax Act or Wealth Tax Act debited to P&L A/c.

Tax Audit – Relevant Clauses:

- ★ Clause 17(h) – Section 40A(3) read with Rule 6DD:
 - Whether any amount is inadmissible u/s 40A (3) read with Rule 6DD – relating to disallowance of any expenditure paid otherwise than by A/c. Payee Cheque?
 - Obtain a Certificate from the Branch Management relating to payments covered u/s 40A(3).
- ★ Clause 21 - Bank's Contribution and Employees' Contribution to Provident Fund- Annexure details to be verified.
- ★ Particulars of Income/ Expenditure of Prior Period credited or Debited to the Profit and Loss A/c. of the Current Year

Tax Audit – Relevant Clauses:

☀ Clause 27 - Compliance of TDS provisions:

- Verify TDS compliance under all relevant sections like Salary, Interest, Interest to NRI, Contract Payments, Technical & Professional Fees etc.
- Provide Details of :
 - (a) Tax Deductible but not deducted at all.
 - (b) Shortfall on account of lesser TDS than required.
 - (c) Tax Deducted late
 - (d) Tax Deducted but not paid to Central Govt.

Other Certificates:

- ★ Certificate for Compliance of MOC-1 and MOC-2 as suggested by previous auditors.
- ★ Certificate for Cash and Bank Balances on reporting Fridays (One Friday in each month).
- ★ Certificate for Investments held by the Branch on behalf of Central Office.
- ★ Certificate for subsidy claim under PMRY Scheme.
- ★ Certificate for remittance of recovery in claim paid accounts to DICGC.
- ★ Certificate for Advances granted to Corporate/Wholesale Banking Segment (Verification of Quarterly Returns on Segment Reporting)

Report on Implementation of Ghosh Committee Recommendations:

- ✦ Banking Sector always faces the threat of Frauds.
- ✦ Committee under Chairmanship of Mr.A. Ghosh, Dy. Governor, RBI.
- ✦ Ghosh Committee inquired into various aspects of Frauds and mal-practices in Banks and gave recommendations to minimize the occurrence of frauds in Banks.
- ✦ The Branch Management is required to prepare this report on implementation of Ghosh Committee Recommendations (in “YES” or “NO” Format) and The Auditor is supposed to verify the answers given by the Branch.

Report on Implementation of Ghosh Committee Recommendations:

- ★ The main objective of this report is to ensure Existence of Proper Systems in Banks to ensure –
 - (a) Safety of assets,
 - (b) Compliance of laid down procedures,
 - (c) Accuracy and completeness of accounting and other records.
 - (d) Proper segregation and rotation of duties and responsibilities of staff and,
 - (e) Measures for the prevention of frauds.
 - (f) Timely detection of frauds and malpractices and taking corrective actions.

Report on Implementation of Jilani Committee Recommendations:

- ✦ Effective Internal Check and Control System is key to the success of Banking Sector.
- ✦ Committee under Chairmanship of Mr. Rashid Jilani, former CMD of PNB was asked to review the effectiveness of Internal Control, Inspection and Audit System in Banks.
- ✦ Jilani Committee made various recommendations for strengthening Internal Control, Inspection and Audit System in Banks under three broad categories based on areas of operations in Banks:
 - (a) EDP Environment in Banks.
 - (b) Inspection/ Internal Audit in Banks.
 - (c) Other Miscellaneous matters.

Report on Implementation of Jilani Committee Recommendations:

- ✦ The Branch Management is required to prepare this report on implementation of Jilani Committee Recommendations (25 Questions to be answered in Implemented/ Not implemented Format) and The Auditor is supposed to verify the answers given by the Branch.
- ✦ Some of the Recommendations of Jilani Committee are to be implemented at Branch Level and some of them at RO/ZO Level.
- ✦ Central Statutory Auditors have reported in past that the reports received from branches on Ghosh and Jilani Committee are not properly verified by the auditors and they are replica of previous reports. - The Auditor is supposed to verify the correctness of the reports prepared by the Branch – In case of negligence, the auditor may be held accountable.



THANK YOU