

PRESENTATION
ON
LONG FORM AUDIT REPORT
(LFAR)



By

CA.T.G.Sukumaran B.Com.,FCA,CAIIB

Partner, T.G.Sukumaran & Co

II Floor,12/22, Thiruvangadam Street

R.A .Puram , CHENNAI- 600028

Ph 044 -24953422 Fax 044-42815898

Mob 9840038334, 9566125381

E mail : tgsmaran@hotmail.com , casukumarantg@gmail.com

IMPORTANCE OF LFAR

- Long Form audit Report is a **questionnaire designed** by RBI with the purpose of bringing out the shortcomings / **deficiencies observed in respect of internal controls in Banks**, major part of it is about **advances portfolio**
- Banks **and RBI** attach more importance to LFAR and compliance of all deficiencies pointed out therein , normally before June of that year
- It is mainly used for framing LFAR by Bank's **SCA (Statutory Central Auditors)**, They will **review** the major accounts and can consider reclassification , if warranted in consultation with Branch statutory auditors
- Reserve Bank of India (RBI) inspectors check bank books every year as part of its **Annual Financial Inspection (AFI)** process. In addition to AFI , a special inspection named as **Asset Quality Review (AQR)**. was conducted in 2015-16 , in which they check asset classification , selecting accounts on a random basis
- In planning audit program , consider requirements in LFAR questionnaire, so as to cover all areas in short duration
- For each type of irregularity pointed out, **list out all instances specific with out exception** . Then only branch can correct and give compliance
- Position of **Large borrowal accounts** (Exposure above Rs. 2 Cr or 5 % of aggregate of advances of the branch , which ever is less) with irregularities pending in those accounts have to be made as annexures
- **Point wise LFAR Questionnaire and related audit checks** are explained hereafter

AUDIT PLANNING

- Visit Branch and start audit well in advance **before annual closing date.** Obtain due permission from concerned zonal Office of the Bank , if it is outstation branch.
- First go through **Closing instruction circulars** and other important circulars such as discretionary powers , service charges , ROI circulars , important schemes launched etc
- Analyze the Branch **advances portfolio**, for type and nature of major portion of advances i.e., whether it is Agriculture , SME, Retail or Commercial advances oriented
- Study the previous reports viz. Branch Statutory Audit , **LFAR ,MOC, Internal inspection , Concurrent audit, RBI inspection reports etc.,**
- Inform the branch to compile Large advances data (Exposure above Rs. 2 Cr or 5 % of aggregate of advances of the branch , which ever is less) in prescribed formats early to enable verification
- Study the **files maintained for large borrower accounts** , verify the documents and EM ,MOD,CERSAI Registration etc.,
- One year **sanction list to be generated from system** and documents for all major advances there in , to be verified
- Get familiarized with the **software used and access reports server / menu** to take reports on your own

KEY AUDIT POINTS FOR LFAR (OTHER THAN ADVANCES)

Areas / Heads	Audit Checks
CASH	Physical verification of cash by auditors Exceeding of daily Cash holding ,over retention Limit Mention average cash balance during the year Effective joint custody ,Periodical verifications
Stationery and Stamps, Fixed Assets	Physical verification Maintenance of registers / records
Security Items	Random checking of numbered stationeries like cheque books Fixed deposits/DD ,Payorders , etc Any missing reported , Proper Custody of Debit Card , PIN Mailer , Net Banking PIN custody and proper accounting of Returned undelivered
Suspense entries / Sundry creditors	Reconciliation ,Year wise break up Long out standing entries as it requires provision as per policy of the Bank, Proper authorization of entries
Deposits	Matured deposits, interest payments Window dressing (large variations before and after closing)
Profit and Loss	Income Leakages , Test Checking of interest application Interest reversals due to change in classification of advances Comparative study of P&L accounts with previous years

LFAR (OTHER THAN ADVANCES--CONTD)

Areas / Heads	Audit points to be commented
Accounts with other banks	BRS Un reconciled entries Long outstanding entries remaining un responded
Computerisation	Data Security Report Generation , checking Exception reports IS audit compliance
Audit and Inspection	Compliance to Internal inspection , Concurrent audit , RBI audit , Statutory audit , Stock , Credit audits Persisting irregularities
Any other matters	Auditors may comment on lapses / deficiencies in other important areas of Branch operations , not covered in Questionnaire such as KYC / AML compliance Complaints pending Irregularities in Deposit of demonetised SBN

ADVANCES – CREDIT APPRAISAL

Question

- In your opinion, has the branch generally complied with the procedures/instructions of the controlling authorities of the Bank regarding loan applications, preparation of proposals for grant/renewal of advances, enhancement of limits, etc., including adequate appraisal /documentation in respect thereof.

Audit Points

- Sanctions during the one year audit period and review of existing CC/OD/TL/NFB facilities:
- Whether latest **Audited financial statements** are obtained and analysed before taking the credit decisions, wherever applicable :
- Whether Branch ensured that the applicant / Co- obligant / guarantors names do not figure in latest **RBI Defaulters List** / Caution List / **CIBIL** and in case of export accounts whether appear in SAL (Specific Approval List) of ECGC.
- Whether CIR (Credit Investigation Report) from CIBIL is obtained in case of retail credit advances. In case the customer's CIR is not available in CIBIL website, the report may be obtained from the other three approved agencies of the Bank,
1) **Equifax** Credit Information Systems, 2) **Experian** Credit Information company of India Pvt Ltd, 3). **High Mark** credit Information Services Pvt Ltd.
- Whether assessment of **repayment capacity** / viability is properly checked
- Whether **Due diligence report** is prepared

ADVANCES – CREDIT APPRAISAL --CONTD

- Whether **Opinion Report, No due certificate** is taken in case of advances taken over from other Banks
- Whether **Credit rating** is done as per guidelines and applicable ROI Spread is applied
- Whether **Legal opinion and valuation reports** from Bank's approved Advocate / Engineer is taken as per Bank's guidelines inclusive of NPA accounts .
- **Misutilization/overstepping of lending/discretionary powers**, non-observance of prescribed norms/ procedures in credit dispensation
- **Escalation in working capital assessment**
- Verify Filed visit reports and **physical verification of assets**. If inspection report is not available it is to be pointed out , in case of leaving it silent , it will be construed that as if inspection is done
- **Jot down advance accounts sanctioned** during the period , **including closed prematurely**, wherein the reason should be analyzed with regard to genuineness of closure
- Even if certain accounts are **processed at a specialized cell** , we have to audit the accounts for certain aspects , as long as they are in branch portfolio
- Verify for **sanction to clients of other areas** , **indiscriminate lending** for achieving targets during “Loan Melas “
- Loans sanctioned for parties of the previous branch of the branch Head

ADVANCES – DISBURSEMENT

Question

- 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.

Audit Points

- At the time of initial disbursement, is **end use** ensured by properly disbursing the loan by way of DDs / PO after collecting borrower's margin ?
- Is disbursement made in **stages** commensurate with actual need ?
- In the event of **Cash Disbursements**, have adequate precautions been taken to ensure end use
- Are Bills / Invoices / **Engineers Valuation Report** available on record for assets created out of Term Loans / DPG ?
- Are **processing charges**, Upfront Fee, commission, Exchange properly collected.
- In case of **reimbursement** to the customer, are the bills / receipts submitted are **less than 12 months old** ?
- Whether **Disbursement authority** is taken in cases ,where sanctioned facility is not availed within prescribed period (six or twelve months) ?
- Whether oral sanctions by higher authorities are followed up for written confirmations.
- Whether Adhoc limits granted to borrowers for temporary/seasonal/peak level periods are periodically reported to controlling authorities and whether the same is liquidated within the stipulated time.

ADVANCES – DOCUMENTATION

Question

- In the cases examined by you, have you come across instances of credit facilities released by the branch without execution of all the necessary documents? If so, give details of such cases
- 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.

AUDIT POINTS

- Whether branch addressed **letters to legal adviser, valuer and auditor** to know the genuineness of the certificates issued by them.
- Has the Law Officer at Zonal Office / approved Advocate (other than the Advocate who has given legal opinion on Primary/Collateral Securities) verified and certified that the documents are in order within one month from the date of disbursement wherever the loan amount exceeds prescribed Limit (**Legal Audit**)
- EM creation and Registration with SRO for immovable properties in time to be verified as also receipt of **MOD** registered (wherever Registration is mandatory) with a subsequent EC
- If the branch is not a notified centre , Title deeds deposited with other designated branch should be verified (confirmation letter stating that the title deeds are held on behalf of that branch)
- Registration with **CERSAI** (Central Registry of Securitisation Asset Reconstruction and Security Interest of India) in time to be verified and CERSAI Registration ID to be obtained
- Filing of Charges with **ROC** in case of Corporate Borrowers in time, Modifications for any change/increase or decrease
- Whether **proper resolution** is obtained to execute documents , in case of Corporate Borrowers

ADVANCES – REVIEW

Question

- Is the procedure laid down by the controlling authorities of the bank, for periodic review of advances including periodic balance confirmation/acknowledgement of debts, followed by the Branch?

Audit Points

- **Review pending age wise** in case of CC/OD facilities to be obtained and Reported
- Review for Large value Term Loans also required to be done every year
- **Review by appropriate authority** to be scrutinized along with the process note
- Whether **Balance confirmation for CC/OD borrowers** is received
- AOD (acknowledgement of Debt) is to be taken in 24-36 months from date of documents to keep validity and enforceability . **List of time barred debts to be obtained and reported**
- **Short Term review** done only in System with out proper authority / process note to be verified

ADVANCES – MONITORING

Question

- Are the stock/book debt statements and other periodic operational data and financial statements etc., received regularly from the borrowers and duly scrutinised
- In respect of advances examined by you, have you come across cases of deficiencies in value of securities and inspection thereof or any other adverse features such as frequent/unauthorised overdrawing beyond limits, inadequate insurance coverage,

Audit Points

- Whether stock/book debt statements are being **received regularly**? If not, report
- Whether the same are being critically scrutinized for **unpaid / non-moving/ obsolete /damaged stock** and action taken thereon?
- Whether the **stock/book debts for more than three months** considered for DP and for classifying the loans (secured/unsecured)?
- **Stock audit reports** to be seen and verified for compliance if irregularities pointed out
- Ageing of Book Debts certified by statutory auditor of the borrower , to be received quarterly
- Check insurance for full value of security (primary or collateral) , Bank clause incorporation , validity including NPA accounts
- Re Valuation of mortgaged Properties after three years (including NPA accounts)

ADVANCES – ASSET CLASSIFICATION

Question

- Has the branch identified and classified advances into standard/sub-standard/doubtful/loss assets in line with the norms prescribed by the Reserve Bank of India?

Identification of account as NPA

- **Continuous excess for 90 days in CC/OD limits** ,CC / OD Interest debited in the account is not serviced within 90 days ,Credits in the account is not sufficient to cover the interest debits
- **Limits not reviewed for six months** from the due date
- **Technical / Short reviews** made more than two times
- **Stock statements** not submitted for six months
- Interest and instalments remaining overdue for 90days
- Agricultural **Crop loans** remaining overdue (due after one crop season for long Term crops and two season for short term crops), Agri Term Loans overdue calculated as per repayment schedule and moratorium fixed ,depending upon crop The **crop season** for each crop, which means the period up to harvesting of the crops raised,would be **as determined by the State Level Bankers' Committee** in each State.
- Jewel Loans not recovered for 6 months from due date , (Due date depends on whether it is for Agricultural or Non Agricultural purpose)
- TOD not adjusted for 90 days
- BG invoked , ILC / FLC devolved not recovered for 90 days
- Cheque purchased , returned unpaid not recovered for 90 days
- Continuous deficit in Drawing power tantamount to continuous excess

LATEST UPDATES IN NPA NORMS

- RBI relaxed the NPA norms to fight Cash Crunch on account of **demonetisation of Specified Bank Notes (SBN)**
- **Additional 60 days period** in addition to existing 90 days norms is allowed for the **dues recoverable during Nov & Dec 2016**, to classify the account as NPA
- This is applicable to Borrower's enjoying working capital limits or Loans including Term Loans and Crop Loans with sanctioned **Limits upto Rs one Crore only**
- For example If instalments / interest due from 30.11.16 is not recovered ,the account will become NPA only on 30.04.17.
- But this relaxation is **not applicable for dues recoverable during Sep and Oct 2016** for which 90 days norms continue
- In the recent Budget , **Permissible Total NPA level** of a Bank has been raised from 7.5 % of the total advances to 8.5 % of the total advances, so as to enable thee Banks to clean up their balance sheets and show the correct the classification of all Bad Loans from 01.04.2017
- If State Govt declares certain area as drought hit , Bank should be guided by the SLBC minutes and apply the guidelines in deciding the classification

ADVANCES – RECOVERY

Question

- Have you come across cases where the relevant Controlling Authority of the bank has authorised legal action for recovery of advances or recalling of advances but no such action was taken by the branch? If so, give details of such cases..
- Also state whether any rehabilitation programme in respect of such advances has been undertaken, and if so, the status of such programme

Audit Points

- Recalled advances , Suit filing , Obtaining Court decree , EP execution
- **Suit filed cases – follow up. SERFAESI** (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest) proceedings
- Recovery in accordance with Compromise package .
- Restructuring of Accounts.(whether terms &conditions of CDR and SDR package are complied with)
- Recovery in Written off accounts
- Recovery in SMA (Special Mentioned accounts) with overdues of more than 30/60days to be verified
- Recovery in upgraded accounts also to be scrutinised
- Have appropriate claims for DICGC / CGTMSE and export credit guarantees/insurance and subsidies, if any, been duly lodged and settled?
- Whether Premium at correct rate is paid In case of CGTMSE accounts (now the rate is related to Total NPA level of the Bank)

LARGE BORROWAL ACCOUNTS -ANNEXURE TO LFAR

- 100 % audit is required for all advance accounts with **Limit above above Rs. 2 Cr** ,
Limit is inclusive of Non fund based facilities also
- Study files for **process note** , **sanction letter** , **review** , and correspondence with CO /RO in connection with these accounts
- Irregularities pointed out in **Internal inspection** , **Stock audit** , **credit audit reports** if any for these accounts and ascertain their present position
- **Document perfection** to be ascertained and charge creation particularly for immovable properties --EM , SRO Regn , CERSAI (Central Registry of Securitisation Asset Reconstruction and Security Interest of India) registraion to be verified
- **Filing of charge with ROC** in time to be verified , in case of Company Borrowers
- Go through the Monthly Stock statements , QIS , Balance sheets submitted
- Operations in the account to be verified so as to confirm that transactions are related to business and in tune with projections
- Whether Credit rating internal and External are done as per sanction
- Pending in compliance of **Sanction terms** to be verified
- If you are not satisfied with the quality of security from the information available , better **go for a unit visit**
- Insurance of Primary as well as collateral security to be with full value and validity

NON FUND BASED LIMITS

- Get the Non fund based limits such as **BG, LC** , etc listed out from system partywise
- Check for proper recovery of processing charges in these limits for sanction and renewal
- Check whether **margin requirements** are met and lien is marked in case of deposit margins
- BG commission to be checked thoroughly . It should be for full period including claim period . Sometimes if it is recovered on annual basis there may be omissions
- If **Commission is recovered for future years** it should not be taken fully to PL of current year
- Check **supply bills for genuineness** and ensure that they are not accommodation
- **LC devolvement and invoking of guarantee** to be verified
- **Expired guarantee should be listed out** and also verify whether guarantee entries are just reversed in system with out getting back original guarantee
- Overdue bills and bill **crystallisation** should be scrutinised
- Verify whether **proper hedging** is there for foreign currency liabilities in import finance

AUDIT POINTS IN DEPOSIT OF DEMONETISED SPECIFIED BANK NOTES (SBN)

- Any irregularities , deviations to RBI guidelines regarding **deposit of demonetized SBN** may be pointed out in “Any other matters” column in LFAR
- Go through the Concurrent auditor or CO Inspection Report in this matter and check for any malpractices are reported
- Ascertain whether any investigation from IT authorities are going on about the transactions in any account in this regard
- **Verify the Cash Transactions in SBN during 08.11.16 to 31.12.16 with the following audit checks**
- Whether accounts are with PAN no , in cases where Cash Related Transactions in SBN of amounts above Rs. 50,000/- are permitted
- Whether any abnormal remittance was there in Minor Accounts/PMJDY/SHG and Inoperative account/Sr. Citizen/Pension / staff accounts
- Any transactions routed through GL or parking accounts
- Whether value of Transactions commensurate with the means of the Customer or regular level of transactions in case of Traders accounts
- Any KYC lapses in the account opened during the demonetization period
- All high value Transactions from CTR & STR reports

MEMORANDUM OF CHANGES

- Prepare MOC carefully for change in **asset classification** , **taking into account provision change and also to effect change in P & L due to interest reversal**
- If number of accounts are more in MOC , prepare MOC with the annexures and **discuss with the Branch Head** before finalising changes in classification
- If **security value of advance is changed** , **it may affect provisioning rate** (For example if security for composite limits is marked in system for a single Limit , then the provision rate will be wrong for other Limits)and some times category of NPA also and accordingly MOC to be prepared
- **NPA date change also may require reclassification and provision change** and they should be properly incorporated in MOC
- MOC in case of changes in GL Head Balances in **Balance sheet** and P& L Head balances in **Profit & Loss Statement** are to be incorporated in relevant MOC
- These may arise due to wrong postings in GL accounts , erroneous income recognition for the previous or future periods , interest reversals in NPA identified accounts
- “MOC not required up to Rs. 10000/- change” This clause is to be considered only for aggregate change in specific heads (For ex , if interest is to charged / reversed in 2 or 3 accounts , aggregating to more than 10000 , MOC will arise)

DO S AND DON'T S

- As time duration is normally short , Be **objective and Focused**
- Effective and speedy audit is necessary to complete proper audit in time
- Employ **experienced assistants** who are familiar with computerised banking software , credit department in Banks
- **DATA ANALYSIS** assumes greater significance in todays Hi Tech banking as the audit is to be completed in a few days time
- Concentrate more on **Asset classification verification** and **major / critical borrowal accounts** to report their correct position
- Follow checklist for sample testing of various types of advances
- **Avoid giving general comments** as to the irregularities found . **List out the instances** / specific accounts where irregularities are to be pointed out
- Frauds if any detected during the year , verify reporting to higher authorities and follow up as per their direction. Take a certificate , if there are no frauds
- In case Branch **officials unable to explain / clarify issues** to our satisfaction , Contact controlling authorities to complete audit in time
- Documents related to advances said to be **available with Central Processing cell** – we have to check authenticated copies available and authenticity of the records in files / sanctions if not satisfactory , call for originals , as the advance appears in branch balance sheet .

THANK YOU