



LFAR, MOC & Documentation

**National Conference on ‘Statutory Audit of Bank Branches’
hosted by the Pune Branch of WIRC of ICAI**

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Disclaimers

- These are my personal views and can not be construed to be the views of the ICAI, Regional Councils of ICAI, Branch of ICAI or M.P. Chitale & Co., Chartered Accountants.
- These views do not and shall not be considered as professional advice.



Long form Audit Report ('LFAR')

An Overview – LFAR

- LFAR is a report in the form of questionnaire prepared by RBI which an auditor has to report on as part of the branch audit deliverables
- Introduced by RBI in 1985 and since revised in 1992-93, 2003 and 2020.
- Appendix to LFAR also contains additional questionnaire for:
 - Specialized branches dealing in foreign exchange transactions
 - Branches having very large advances
 - Recovery of NPAs
 - Branches dealing in clearing house operations

Guiding Principles: Objective, Strategy, Scope and coverage

■ *Overall Objective:*

- Transaction testing
- Inputs to Statutory Central Auditors – (Sr. No. 7b)
 - Implementation of policies and regulatory requirements
 - Risk management, compliance and internal audit
 - Efficacy of the system

■ *Review of transactions:*

- Above the threshold -> transactions detailing
- Below the threshold -> systems and processes to be verified

■ *Verification of Data Integrity and data related control systems:*

- Special thrust on data inputs used in MIS at corporate level & supervisory purposes

Do's & Don'ts – LFAR reporting

- The branch auditor ('auditor') should thoroughly study the questionnaire – Refer Technical guide issued by ICAI
- Each answer to the questionnaire should be precisely answered with reasoning for the same - avoid vague or general comments
- LFAR is not a substitute for the Statutory Audit Report and are two independent and different Audit Reports – avoid cross referencing
- Specific instances / shortcomings should be clearly mentioned at appropriate places
- The auditor should mention the Qualifications in the main report and not the LFAR.
- The LFAR report should not be handwritten; should be well articulated and quantification made at appropriate places to enable consolidation by the SCAs.
- Should not be the previous year report which is re-printed

LFAR – Reporting Parameters

I. Assets

- Cash
- Balances with other Banks (Branches with treasury operations)
- Money at Short / Call Notice
- Investments (for branches outside India)
- Advances

II. Liabilities

- Deposits
- Other Liabilities – Bills Payables, Sundry deposits etc

III. Profit And Loss Account

IV. General (Gold, other records, inter-branch, Frauds, KYC, MIS & Misc)

LFAR: Advances Major amendments

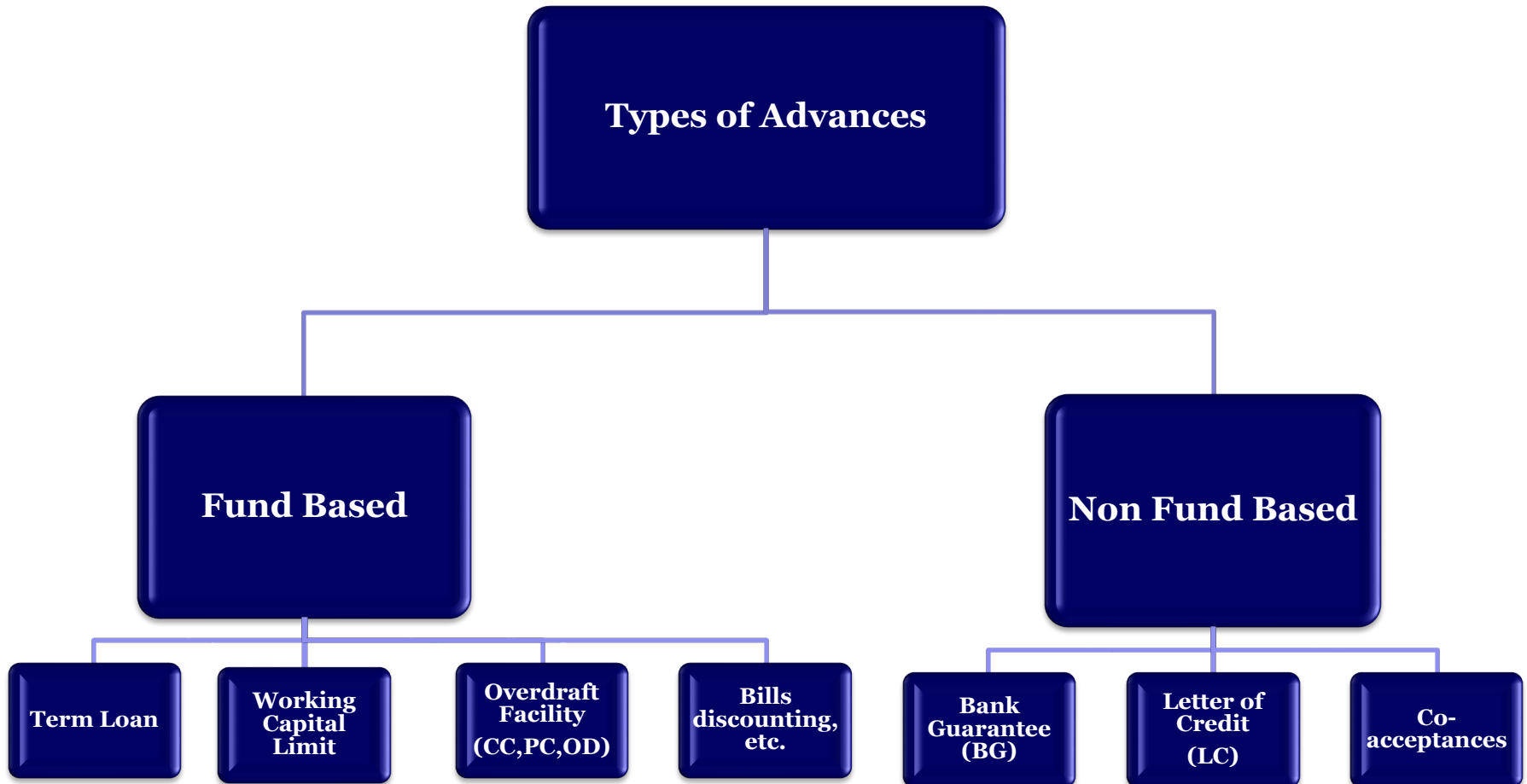
I. Threshold criteria

- Threshold Criteria: Excess of 10% of aggregate balance of fund based and non-fund based advances or Rs. 10 Cr whichever is lower

Account No.	Account Name	Balance at year end (O/S) (Funded) (Rs. In Crores)	Balance at year end (Non-Funded) (Rs. In Crores)	Total (Rs. In Crores)
Total		150	50	200
Total O/s		X	Y	$Z = X + Y$
% examined		A as % of X	B as % of Y	C as % of Z

- E.g. Advances in Branch A are Rs. 200 Crores (FB + NFB), all accounts in excess of Rs. 10 Crores (outstanding) need to be examined

Types of Advances



Note: When the BG is invoked or LC is devolved, such facility gets converted into forced loan which is part of funded limits

LFAR: Advances Audit Approach

- Report on all advances (*including NFB Limits*) which are above the threshold limits
 - If data is not readily available for NFB limits, request a system generated report wherein NFB limits are also included
- For Advances below the the threshold limits:
 - Process walkthrough – process manual, HO circulars
 - Data Analysis for voluminous branches
 - Delay in submission of stock statements – Concurrent audit
 - Overdue accounts regularized nearing BS date – SMA data
 - Frequently overdrawn accounts – MIS data
 - Sample selection – based on data analysis

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II. Quick Mortality Accounts

- Credit facility became non-performing within a period of 12 months from the date of first sanction - Account name, no. and O/s balance
 - Request for the list of NPA accounts – March 31, 20XX
 - Obtain a list of all advances accounts with Date of Sanction and disbursements
 - Review Accounts identified as NPA in the respective year under review
 - Thorough examination of all such accounts to be conducted and such accounts to be reported in the LFAR in the prescribed format

Common exclusions:

- Repayment holiday period (interest or installments) to be ignored and period of 12 months to commence post expiry of repayment holiday period
- Cash Credit accounts renewed with or without any credit enhancement

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III. Verification of interest rate – Borrowal accounts

- In borrowal accounts whether the applicable interest rate is correctly fed into the system?
 - Obtain a list of all advances accounts with Date of Sanction O/S balances – March 31, 20XX
 - Obtain interest parameters and interest change history information from CBS – alternatively, request can be made to the bank for such report
 - Understand the process of change of interest rates – Centrally performed or at branches; and for loans against FDs
 - Select samples basis the data received; more weightage can be given to accounts where changes in interest rates are present
 - Compare the interest rates as fed in the system vis-à-vis sanction letter

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IV. Review of interest rates – MCLR / EBLR

- Whether the interest rate is reviewed periodically as per the guidelines applicable to floating rate loans linked to MCLR / EBLR (External Benchmark Lending Rate)?
 - Obtain a list of all changes in MCLR / EBLR during the year which can be compiled in an excel sheet
 - The auditor can also generate Interest Report for review period and can review the different rate of Interest applied in the respective account
 - Review the Interest master details in the CBS as updated post the change in the MCLR / EBLR for the samples selected
 - Compare the interest rates as fed in the system vis-à-vis circulars issued for the change in the interest rate

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V. Frequent Renewal / rollover of short term loans

- Have you come across cases of frequent renewal / rollover of short-term loans? If yes, give the details of such accounts.
 - Working capital facilities have to be reviewed / renewed every year.
 - Account where the regular / ad-hoc limits have not been reviewed / renewed within 180 days to be classified as NPAs.
 - Each bank has different set of processes to review / renew loans and updation thereof in CBS
 - Obtain a report containing list of reviews and renewals carried out during the year; Also, obtain a report for ad-hoc limits issued during the year
 - The auditor is required to examine report cases where frequent renewal / rollover of accounts is made w/o obtaining requisite information from the borrower

LFAR: Advances Audit Approach

VI. Correctness and validity of Credit ratings

- Whether correct and valid credit rating, if available, of the credit facilities of bank's borrowers from RBI accredited Credit Rating Agencies has been fed into the system?
 - Credit ratings are based on the credit rating agency's assessment of creditworthiness of the borrowers which indicates credit risk associated
 - These credit ratings are valid for one year and are reviewed by the credit rating agencies each year
 - Obtain list of Accounts wherein External Credit Rating is mandatory and also verify if the credit ratings have been assigned by RBI accredited rating agencies
 - Refer RBI circular dated Jan 09, 2023 for accredited rating agencies – 6 nos.
 - Verify cases where the credit rating is poor or has been marked as unrated

LFAR: Advances Audit Approach

VII. Drawing Power Computation

- Is the DP properly computed?
 - Thoroughly review and understand the policy of the bank with regards computation of the drawing power
 - Computation of paid stock
 - Creditors amount reduced from Stock or reduced only to the extent of value in excess of creditors ascertained at the time of Credit assessment
 - Review the details of stock statements, book debts, creditors information and other financial information
 - The auditor needs to prepare a template for verification of DP computation and also part of documentation.
 - Verify in the CBS how the DP amount, margin % & security amount has been fed/updated in the system – Multiple ways
 - ‘D’ indicator or ‘E’ indicator in case of Cash Credit (Finacle ERP)

LFAR: Advances Audit Approach

VIII. Adverse features in Top 5 Standard Accounts

- Comment on adverse features considered significant in top 5 standard large advances and which need management's attention
 - Obtain a report containing details of all advances accounts (Fund based + Non fund based)
 - Apply filter for selecting top 5 standard accounts
 - The auditors may request for status of borrowers in the CRILC database
 - Report on the discrepancies noted in the LFAR

LFAR: Advances Audit Approach

IX. System based asset classification

- Has the branch identified and classified advances into standard / substandard / doubtful / loss assets through the computer system, **without manual intervention?**
 - RBI has been insisting and has also issued circulars for implementation of Straight Through Process (STP) of NPA identification and asset classification – Systemic risk
 - Each bank has different set of processes followed for identifying and marking of NPA
 - Understand the process of marking NPAs at branches; verify if any access rights given to branch officials regarding NPA identification process
 - Repeated restructuring
 - Non-commencement of projects as per DCCO – various dates
 - Percolation effect – One borrower one classification, Frauds
 - Significant erosion – Less than 50% of value assessed by Bank / RBI
 - Any such cases need to be thoroughly audited and reported wherever manual intervention is involved – Obtain MRL

LFAR: Advances Audit Approach

X. Classification of Special Mention Accounts ('SMA')

- Whether the branch is following the system of classifying the account into SMA-0, SMA-1, and SMA-2. Whether the auditor disagrees with the branch classification of advances into standard (Including SMA-0, SMA-1, SMA-2) / sub-standard / doubtful / loss assets, the details of such advances with reasons should be given
 - Obtain list of all Advance Accounts as at the end of the year and refer the overdue amount. Also, list for the immediately preceding month / quarter can be checked for the movement in accounts
 - Select the samples in case of each asset classification type (std, SMA and NPAs) and map the same against the overdue days
 - Report such accounts / advances in the LFAR by mentioning the reasons for discrepancy noted

LFAR: Advances Audit Approach

XI. Upgradations in NPAs

- Whether the upgradations in non-performing advances is in line with the norms of Reserve Bank of India
 - Obtain the list of NPA Accounts upgraded during the year
 - Compare the list of NPA accounts as at the end of Previous Year and as at the end of Current Year – Movement analysis & completeness check
 - Quarterly reporting of NPA accounts may be reviewed
 - Verify that the entire overdues have been repaid and the source of funds (genuine recovery) have also been verified by the branch before upgrading the account
 - In case of discrepancies noted, the same should be reported and the account may be downgraded by way of MOC

LFAR: Advances Audit Approach

XII. Valuation Reports - NPAs

- In respect of non-performing assets, has the branch obtained valuation reports from approved valuers for the immovables charged to the bank, once in three years, unless the circumstances warrant a shorter duration?
 - Review the valuation date from NPA report as at the end of each financial year
 - Review the valuation reports and verify that the valuation contains the parameters – Fair Market Value, Realisable Value and Distress value
 - Review the physical valuation report for correctness of information updated in CBS – realizable value should be updated

LFAR: Advances Audit Approach

XIII. Appropriation of recoveries

- Whether in the cases concluded the recoveries have been properly appropriated against the principal / interest as per the policy of the bank?
 - Obtain the accounting policy followed by bank for the appropriation of recovery in NPA Accounts (Ex. Charges -> Interest -> Principal)
 - In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner. (Para 3.3.2 – IRAC circular)
 - Review in CBS through EMI Recovery menu options and reversal of Memorandum Interest Transactions from Account Statement menu option for recovery sequence followed

LFAR: Liabilities & Others Audit Approach

I. Levy of charges – Minimum balance

- Is the branch complying with the regulations on minimum balance requirement and levy of charges on non- maintenance of minimum balance in individual savings accounts?
 - Obtain the bank policy for Minimum Balance requirement in different types of savings accounts
 - Select samples from different types of Savings Accounts – Product wise sampling
 - Understand the logic as implemented & methodology in the CBS for levying of such charges
 - Extract the account statement for the year and ascertain average monthly balance (e.g. If the charges are prescribed on Average Monthly Balance) and verify the same against those charged by the bank

LFAR: Liabilities & Others Audit Approach

II. Any other matters - Management / SCA

- Are there any other matters, which you, as a branch auditor, would like to bring to the notice of the management of the Statutory Central Auditors?
 - Matters observed by the branch auditor which may be of significance to the management / SCAs
 - The auditor may point out to any systemic risks, CBS issues, internal control issues which may be of relevance to the SCAs.



Memorandum Of Changes (MOC)

MOC – When & How to issue MOC

- **Memorandum of Changes (MOC) – When to issue**
 - MOC in effect is a rectification entry that needs to be passed in the books of branch accounts to rectify errors / omissions / classifications / provisions etc.
 - MOCs can be categorized into following heads:
 - Relating to modifications in Balance Sheet
 - Relating to modifications in Profit and Loss Account
 - Modifications to advances portfolio (Re-classifications)
 - Relating to outstanding balances of the advances
 - Revision in provisions (NPA or other)
 - Reversal of income on newly recognized NPAs.
 - Rectification required in relation to fixed assets

MOC – When & How to issue MOC

▪ Memorandum of Changes (MOC) – How to Issue

- The branch auditor should read the closing circular issued by the banks to branches, wherein the detailed methodology to be followed for preparing the MOC is elucidated.
- The branch auditor is expected to acquaint himself with the methodology of preparing MOC and particularly the correct account codes, corresponding effect of the debits and credits.
- Wherever the interest or other incomes are reversed on Non performing advances the MOC for provisioning should be net of such reversals
- The MOCs should be backed up by adequate documentation and should be correctly reflected in the statement of MOC with reasons provided thereof.
- Even in case there are no such issues observed by the Auditor, NIL MOC is required to be enclosed with the report. All the facts and figures given in the MOC are also given a reference in the Main Audit Report.

MOC – When & How to issue MOC

To
Finance & Accounts Department

Branch :
Br. Code :
Region :
Date :

Memorandum of changes - Journal Entries to be passed

Sl. No.	Particulars *	Code No.	Debit Rs.	Credit Rs.

* Full details along with code number in Balance Sheet / P & L Statement shall be furnished along with each entry.

Principal Officer
Name

Auditors' signature with seal

MOC – When & How to issue MOC

Memorandum of Changes (summary) – Audit Report				
	Increase		Decrease	
	(No. of items)	(Rs.)	(No. of items)	(Rs.)
In respect of :				
a. Income				
b. Expenditure				
c. Assets				
d. Liabilities				
e. Gross NPAs				
f. Classification of Advances				
g. Risk Weighted Assets				
f. Other items (if any)				

MOC – When & How to issue MOC

▪ Memorandum of Changes (MOC) – Precautions

- Justification for modifications suggested by auditor i.e. the nature of change as well as the quantification of suggested change and its impact.
- The format of MOC in most banks will have both sides like a trial balance. It should be ensured that total of changes suggested in balance sheet and profit and loss account is tallied on both accounts
- The total of reclassification of the advances suggested in secured, unsecured, guaranteed advance and sector wise advance should be correctly brought out in the MOC and total of both sides should tie up
- In case of change suggested as per prudential norms on income recognition, the impact, if any on the provisioning of the assets is also to be looked into
- It is to be ensured that a NIL MOC is invariably forwarded, even if there are no change in the report.
- MOC also to be signed by the branch in charge
- Disagreement between branch manager and auditor – Scenario
- If branch is not agreeable then it should say so, at least the impact is quantified in case CSA has to uphold the MOC



Questions ?



Thanks!!!

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