

## ANNEXURE - VII

### LFAR REQUIREMENTS DESERVING SPECIAL ATTENTION

- a) Balance confirmation certificates and reconciliation statements with banks indicating reasons for unadjusted old entries outstanding between 6 months and 1 year, and those over 1 year old.
- b) Responses to Para I.4 of the questionnaire, if and to the extent applicable to the branch.
- c) Status of “large advances” in the light of the reporting requirements as per Item I.5 of the questionnaire.

(Large Advances, for this purpose, are defined to be those in respect of which the outstanding amount is in excess of 5% of the aggregate advances of the branch or Rs. 2 Crores, whichever is less).

- d) Data as per the format in Item I.5 (d) (xii) of the questionnaire, relating to (i) credit guarantee claims, and (ii) subsidies.
- e) Particulars of cases of compromise/settlement and write off involving write offs/ waivers in excess of Rs.50 lakhs.
- f) Information [as per item I.5 ( e) of the questionnaire], in a tabulated form as regards guarantees invoked, letters of guarantee and Co-acceptances.
- g) Information as per Item I.6 (b) of the questionnaire
- h) Details as per the format [ II.2(i) of the questionnaire]
- i) List of contingent liabilities not acknowledged as debts in response to item II.3 of the questionnaire.
- j) Statement of divergent trends in major items of income/ expenditure as compared to the previous year with explanation thereof. Items comprising interest earned on advances and that paid on deposits may preferably be computed on the basis of monthly average advances/ deposits for the branch and the current and previous year for comparison.
- k) Note on areas of computerisation and Bank’s instructions/guidelines covering matters in Item IV. (1)(b) of the questionnaire.
- l) Statement in response to Item IV. 2 of the questionnaire.
- m) List of outstanding debits, if any, in H.O. Account in respect of Inter-branch transactions.
- n) Inter-branch Adjustments

Particulars/status of unresponded/ pending/ uncomplied queries or communications from the designated offices as regards unmatched items in Inter-branch Adjustments.

List/status of outstanding old/ large entries at debit comprising Inter- branch Items.

- o) Statement of particulars of frauds discovered during the year, as per the prescribed format.
- p) Evidence of reconciliation of records of fixed assets, (with a confirmation as to their updation) with physical inventories last taken.
- q) Documents of title of the branch premises, if maintained at the Branch, for production to auditors.
- r) Information/ responses to the questionnaire, if a specialized branch (Refer Appendix – Item A.3 in particular).
- s) Information in the structured format in response to Item B of the Appendix covering advances, each in excess of Rs. 2 crore. (Refer Annexure III)
- t) Information in respect of borrowers pursuant to Item C of Appendix.
- u) Details of Inward/outward clearing as per the prescribed format (**per D2 of the Appendix**).

**(The above is besides the information on systems/ procedures followed and instructions of the Controlling Authority in relation to various items as per the questionnaire, which need to be made available by the Branch, well in advance to enable the auditors to verify the responses to the questionnaire).**



**Text of letter recommended for being addressed to the Branch**

BY HAND

March 30, 2008

The Branch Manager,  
\_\_\_\_\_ Bank,

Dear Sir,

**Re: Audit of Accounts for 2007-2008.**

We are deputing our team headed by Mr. \_\_\_\_\_ in connection with the verification of the following, at the close of business on 31.3.2008 :

**A. Cash balances etc.**

- (a) Cash in hand (including with tellers);
- (b) Cash at sub offices
- (c) Cash in ATM(s), if operated/controlled; and if any with authorized agencies for stuffing;
- (d) Petty Cash/imprest balances;
- (e) 5. Postage in hand;
- (f) Tokens, if any
- (g) Foreign Currency, if any.

In connection with the above, please ensure that you will be getting the verification done simultaneously, and at all locations, of the balances for the aforesaid items and produce for our verification the following:

- (a) Foreign Currency parcels, if any, lying at the Branch.
- (b) Sealed covers containing cash, if any.
- (c) Petty Cash and imprest balances held with various officers.

**B. Security Paper Stationery/ Forms (Unused/ blank) and those issued, but in hand**

- 1. We would be undertaking the physical verification of *the unused/blank security paper stationery/ forms* lying at the branch, including for the following:
  - a) Time/Term Deposits; b) Deposits under various schemes; c) Travellers' Cheques; d) Drafts; e) Pay Orders/Banker's Cheques, Gift cheques, etc; and f) Cheque Books/ Withdrawal Slips We would request you to keep ready, a list of stock of all stationery in hand of the nature and type referred to above, so that verification thereof is expedited; and further ensure that the relevant registers are upto date to enable us to examine the balances therein.
- 2. Instruments of the above nature issued but lying in physical custody of the Branch may be listed and got verified

**C. Bills for Collection/Purchased**

All bills in hand (for collection as well as purchased) may be listed out and got physically verified.

**D. Fixed Deposit Receipts in physical custody of the Branch, in respect of Deposits received or renewed (refer Para 6 of Annexure I Section A of our earlier letter):**

Such undespached Receipts in the physical custody at the Branch may be produced.

**E. Your formal confirmations for our record**

Upon completion of the exercise involving physical verification as aforesaid, we would request you to let us have a confirmation of the balances as at the close of the business as at the year-end duly signed by the authorised signatories.

**F. External Confirmations**

May we request you obtain and to let us have, balance confirmation certificates in respect of:

- a) balances with other banks as at the year-end along with reconciliation statements, in evidence of outstandings with such banks (including, if any, with the Reserve Bank of India);
- b) borrowings, if any, recorded at the Branch (banks/ institutions)

We expect these certificates/ reconciliation statements, duly authenticated, to be handed over along with the Branch returns.

We shall be thankful for your co-operation.

Yours faithfully,

**CHARTERED ACCOUNTANTS**

**BANK BRANCH AUDIT PROGRAMME (2007-08)**

1. Name of the Bank : \_\_\_\_\_ Branch: \_\_\_\_\_
  2. Year Ended : 31st March, 2008
  3. Audit In-charge : \_\_\_\_\_
  4. Audit Assistants:
 

	Name	Signature
a)	_____	_____
b)	_____	_____
c)	_____	_____
  5. Audit commenced on: \_\_\_\_\_ Completed on \_\_\_\_\_  
 \_\_\_\_\_
  6. Submission of Reports
 

	Date of Submission
a) Statutory Audit Report	_____
b) LFAR	_____
c) Tax Audit Report	_____

    - d) Certificates:
      - i) DICGC Claims
      - ii) Subsidy claims under Prime Minister's Rojgar Yojna for Unemployed Youth (PMRY)
      - iii) Data on 12 odd dates for verification of SLR
      - iv) Exposure to Sensitive Sectors
      - v) Implementation of the recommendations of the Ghosh Committee
      - vi) Implementation of the recommendations of the Jilani Committee
      - vii) Movement chart of NPAs and provisions
      - viii) Information on restructuring of Advances
      - ix) Investments held on behalf of Head Office.
      - x) Other Certificates required by bank
  7. Remarks:
1. **To effectively carry out the audit at the Branch level, the audit staff is expected to be familiar with:**
    - a) Legal requirements, particularly as regards financial disclosures and audit reporting,
    - b) Important circulars of RBI, to be available for ready reference(Refer **Section J**)
    - c) Prudential guidelines issued by Reserve Bank of India (RBI) for classification of advances, provisioning and Income recognition. (Please to Refer in particular to RBI Master Circular).
    - d) Circular(s) from Head Office relating to closing of accounts (which are expected to be in line with the statutory and regulatory requirements),
    - e) Terminologies used by the bank to describe transactions / balances,

- f) Publications of the Institute of Chartered Accountants of India, particularly the:
  - (i) Guidance Notes on:
    - Audit of Banks (latest edition - March 2008)
    - Tax Audit under section 44 AB of the Income tax Act.
  - (ii) Statement on Qualifications in Auditors' Reports
- g) Questionnaire prescribed by RBI for Long Form Audit Report in respect of bank branches (**Section F**). Matters deserving special attention are listed in the Management letter (**Section A - Annexure VII**).
- h) Significant Accounting Policies of the Bank, particularly those relevant to the branch,
- i) Accounting and Auditing and Assurance Standards (Refer **Section G**),
- j) Internal controls (refer also **Section H**),
- k) Basic Analytical procedures that may be adopted (Refer **Section I**)
- j) Previous branch auditor's main report, LFAR and the latest available reports of inspection/ internal/concurrent audit, special/credit /systems audit (**See Section A - Annexure I, Para 1**),
- k) Auditor's responsibilities in relation to frauds/ fraudulent activities (**Section K**)
- l) Familiarization with requirements of law having effect on the financials of the Bank, {including Fringe Benefits Tax (**Section L**)}; and
- m) Banking Cash Transaction Tax (BCTT- **Section M** – also Refer Chapter VII of the Finance Act 2005 which introduced BCTT).

**2. Audit engagement and representation Letters, seeking information:**

Communications, including seeking information from the Branch Management must be sent: – **upon receipt of appointment** ( **Section A** – together with requisitions as per **Annexures I, II, III, IV, V, VI and VII** thereto), and – **for year-end procedures** (**Section B**),

These communications are self explanatory for the minimum requirements, to which further requirements may be added, based on specific knowledge on matters related to the branch.

**3. Signing of annual financial statements:**

- a) It is important to note that the financial statements (returns) of the bank branches, once prepared (based on books as closed as at the year-end), leave no scope for any changes therein at the branch level, and no further entries/adjustments as at the year-end can be made at that level. Based on subsequent review/audit observations, errors/ omissions are sought to be remedied through a **Memorandum of Changes** (MOCs), which is given effect to by the Bank management while finalizing the financial statements of the Bank– and this function is centralized at Head Office or through the designated offices (Circle/ Zonal/Regional/Divisional).

It is recommended that, as the first part of the audit exercise, the audit staff must ensure that the figures in the branch annual financial statements, which are frozen (as stated above), tally with those as per books. This must be attempted at the very beginning of the audit at the branch level, and the returns as finalised and authenticated by the branch management can, after such exercise is done, be countersigned by the audit firm with the remarks “SUBJECT TO AUDIT REPORT”.

**In the process of tallying the figures as aforesaid, Head-wise notes need to be taken to report the differences, if any, between the balances in the control accounts and the subsidiary records, indicating the arrears of balancing.**

- b) It is, therefore, imperative that the Branch Management makes available for audit verification, **all** the Branch returns/ statements/schedules and not merely the Balance Sheet and Profit and Loss Account.

**These must be stamped and signed by the authorised officials and dated.**

While receiving any statements/details, it must be ensured by the audit staff that they record under their signature (on the inverse side of each statement/detail), **the date on which each statement is actually received.**

The date of delivery of each statement to auditors should be countersigned by the Bank officials notwithstanding that on the face of the statement, the date is different (usually the year-end date).

#### 4. **Audit Programme:**

Considering that transactions in a bank branch are voluminous but repetitive, it is appropriate to carry out the procedures head-wise; and it is for this reason that the Audit Programme is so drawn up.

**Not all heads of accounts are relevant for many branches, yet these have been given in the Audit Programme for examination, in case some figures appear in the branch statements.**

In confirmation of the work completed, the audit assistant must sign against the relevant item of the programme **immediately upon conclusion of each part of the assignment**; and if any part is not applicable, it may be so indicated by stating "NA."

**Accounts maintained in EDP environment:**

The staff must enquire as to whether the Branch accounts/records are maintained in the EDP environment so that they are familiar with the systems and procedures adopted by the Bank and determine the extent to which computerization/mechanization has been made; as also to incorporate additional procedures, if any, in the Audit Programme..

It needs to be ascertained as to **whether the branch is fully/ partially automated** and the platforms on which the operations and accounts are based, and as to whether there are various packages covering different sets of transactions, and as to the identification of vendors dealing with the same so that the verification procedures are appropriately adopted.

Special care needs to be taken to determine on how the transfer of balances from manually maintained ledgers to the computerised accounts initially took place in respect of heads/sub-heads, where there were arrears of reconciliation or where there are any old /large/ unexplained outstanding entries, particularly in nominal heads of accounts.

**Examination of the daily exception reports, both as regards systems and transactions assumes significance and can be a source of critical inputs into the reports.**

Clarifications, if required, may be resolved with a partner or a senior assistant in-charge of audit. Audit procedures recommended may be strengthened in areas of weakness, and based on matters that come to light as the audit progresses; and **such additional procedures necessary must be adopted and documented/ incorporated in the audit programme.**

#### 5. **Documentation/ Management Representations:**

The work done by the audit staff needs to be evidenced on record.

As part of audit evidence/documentation, **Para-wise reply** in writing in response to the audit requirements as per the firm's letters [**suggested in Sections A and B**] **must be** received from the Branch **simultaneously** with receipt of the initial statements; otherwise a reminder must be given in writing seeking compliance of the queries before the Audit Report is finalised.

A general reply from the Branch Management that “all information is already given”, would not be a reasonable/adequate response to the letters.

If there is no Response, a letter should be addressed to the Branch Management binding them on the information furnished during the audit, covering all matters in the letters not replied.

In preparing his report, the Auditor needs to take a view on any wrong management representations or reply contrary to facts in case the Bank proclaims having given information which is actually not furnished, or is inappropriate/incorrect.

**6. For an overview of the financial statements, the audit staff must:**

- a) jot down (in their own copy of the statements received ), against each head/sub-head, the comparative figures for the previous year (preferably in pencil)– both for the Balance Sheet as well as Profit and Loss Account items.

A comparison will help in looking into any unusual or large variations, to be enquired into.

- b) see whether there are any divergent trends since last year between:
- advances and interest income; and
  - deposits and interest expended.

**7. Internal controls:**

The audit staff needs to be familiar with internal control procedures **and must keep in view the inherent audit risks** arising from and focus sharply on effect, if any, of:

- **absence** of internal control procedures/systems,
- **inadequacy** of such procedures/systems, and
- **breach** thereof.

and particularly also in view of what is stated hereunder in Para 7. The effect of the above must be considered for incorporation in the report(s).

[Reference may be made to **Section H** more relevant at Branch level]

**8. Frauds/fraudulent activity etc.**

The scope of the audit assignment also now includes issuance of a confirmation to the Chairman of the Bank and in case of frauds involving Rs. 100 lakhs or more, to the Reserve Bank of India, and report **on any matter susceptible to fraud, or fraudulent activity or any foul play in any transaction**. This has extended the scope of work of the auditors and cast a responsibility well beyond normal audit procedures. The audit team would be well advised to look into aberrations in the internal control systems/procedures, and get response to the specific query made in writing to the Branch. Audit procedures must include looking into the exceptional reports generated daily, with regard to accounts maintained in the EDP environment.

Special attention must be paid to extensive use of nominal heads of accounts (like SUSPENSE, SUNDRIES), custody and control over critical stationery, large cash transactions, unrecorded contingencies and letters of comfort, originating debits in inter branch (Head Office) Account, unlinked debits in Bills Payable (DDs, TTs, MTs, Banker’s Cheques, Pay Orders etc.), loss of control over credits in overdue Deposits renewed, operations in inoperative accounts etc.

**9. Auditing and Assurance Standards:**

In performing his duties, the auditor must be fully conversant with the Auditing and Assurance Standards, particularly as to AAS 20 (as regards knowledge of banking business) and AAS 21 (Consideration of Laws and Regulations in an Audit of Financial Statements) and for the latter he must enquire and be satisfied that the Branch maintains a record/register of the applicable statutes/regulations and has updated them for compliance, as a system.

**10. Observations/ Reporting:**

To enable the auditor to furnish his report expeditiously, his audit observations/work papers and evidence of work done should be kept in the audit note file preferably **in the same sequential order** as that of the programme, in support of the reports.

**The Main Audit Report** must be in conformity with the reporting requirements of law and as per the mandate of the ICAI, rather than following the format suggested by the Bank, if not in conformity with such requirements.

The Auditor's Main Report has two essential ingredients, in that these contain statements of fact as well as his opinion on the true and fair view of the state of affairs and of the operating results.

A clean or unqualified report does not pose a problem as generally the verbiage is in line with that in the statute. The auditor's audit exercise may however result in notes/observations resulting in a qualified opinion, including disclaimer.

**A distinction, therefore, needs to be made between adverse comments and remarks of a - qualificatory nature; and**

**- qualificatory nature not having a bearing on the statutory reporting responsibilities.** While keeping in mind the concept of materiality, items of a qualificatory nature must be incorporated (in bold/italics) in the main (statutory) report, with the use of the words "Subject to" or "Except for"; **with the financial impact of such qualifications being quantified individually** (to the extent capable of ascertainment) and giving the total composite impact thereof on the state of affairs and on the operating results in the Profit and Loss Account. Qualifications must state the nature of the items, if not capable of being quantified, or where the auditor disclaims his opinion.

In respect of other notes/observations of a clarificatory nature, including those by management, the auditor should draw attention to the same or use the words "read with" (without qualifying his report in respect of such items).

**LFAR is not to be reckoned as a substitute for the main report and the Auditor may elaborate his qualifications therein and while reviewing the responses to the Questionnaire, should include his other observations/suggestions/clarifications etc. that deserve the attention of the management. For suggested form of reporting, refer:**

- **Section D** for Nationalised Banks,
- **Section DD** for Banking Companies .
- **Section D.Q** for illustrative audit observations.