Technical Guide on Revised Formats of Long Form Audit Report

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Foreword

In September 2020, the Reserve Bank of India has issued the revised formats of Long Form Audit Report (LFAR) which would be applicable for audits of financial year 2020-21 and onwards. The revised formats of LFAR have made several significant changes including many new reporting requirements as compared to the earlier formats of LFAR. Therefore, a need was felt for providing appropriate guidance to auditors of banks on the revised formats of LFAR so that they can discharge their reporting obligation more efficiently and effectively.

I am happy that the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India has brought out this "Technical Guide on Revised Formats of Long Form Audit Report" for the benefit of the members. The Technical Guide provides detailed guidance on all the reporting requirements prescribed in the revised formats of LFAR. The Technical Guide has been written in easy to understand language and is quite comprehensive.

I compliment CA. G. Sekar, Chairman, CA. Shriniwas Y. Joshi, Vice-Chairman and all members of the Auditing and Assurance Standards Board for their efforts in bringing out this Technical Guide for the benefit of the members.

I am sure that the members would find this Technical Guide immensely useful in their professional assignments.

March 19, 2021 — **CA. Nihar N Jambusaria**
New Delhi — President, ICAI

Preface

The Reserve Bank of India has issued revised formats of Long Form Audit Report (LFAR) for banks and their branches vide its circular dated September 5, 2020 which are applicable for audits for financial year 2020-21 and onwards. Revised formats of LFAR contain several significant changes and several new reporting requirements vis-à-vis earlier formats of LFAR. The Auditing and Assurance Standards Board of ICAI undertook the task of developing a specific Technical Guide to provide appropriate guidance to the auditors of banks on revised formats of LFAR.

We feel immense pleasure in placing in hands of the members this "Technical Guide on Revised Formats of Long Form Audit Report" issued by the Board. The Technical Guide was initially developed by a study group constituted by the Board for this purpose and thereafter it was finalised with the contribution of the Board members. The Technical Guide has been written in easy to understand language and provides detailed guidance on various reporting requirements contained in revised formats of LFAR. We may caution the members that this Technical Guide is not a substitute for the publication "Guidance Note on Audit of Banks 2021 Edition" issued by the Board and this Technical Guide should be used in conjunction with the Guidance Note.

At this juncture, we wish to place on record our sincere gratitude to CA. Pramod Jain, Central Council Member and Co-convenor of the study group for sparing time out of his other preoccupations to develop this Technical Guide.

We express our sincere thanks to CA. Nihar N Jambusaria, Honourable President, ICAI, CA. (Dr.) Debashis Mitra, Honourable Vice-President, ICAI and CA. Atul Kumar Gupta, Honourable Immediate Past President, ICAI for their guidance and support to the activities of the Board.

We also express our sincere thanks to all the Board members for their suggestions, support and guidance in finalising this Technical Guide. We appreciate the contribution made by CA. Megha Saxena, Secretary, AASB, CA. Rajnish Aggarwal, Assistant Director and CA. Parul Gupta, Research Fellow in finalizing this Technical Guide.

We are confident that the members would find this Technical Guide immensely useful.

CA. Shriniwas Y. Joshi	**CA. G. Sekar**
Vice Chairman, AASB	Chairman, AASB

Acknowledgement

The Board acknowledges the contribution made by the following members of the study group constituted for the development of Technical Guide on Revised Formats of Long form Audit Report and we place on record our gratitude for their contribution in enrichment of knowledge of the members:

CA. Prasanna Kumar D, Central Council Member, ICAI, CA. Dhananjay J. Gokhale, CA. Sandeep D. Welling, CA. Niranjan Joshi, CA. Ashutosh Pednekar, CA. Gautam V. Shah, CA. Abhijit Sanzgiri, CA. Navdeep Gupta, CA. Pawan Lohia, CA. Purshotam Gaggar, CA. Prashant Panda, CA. Alpesh Waghela, CA. Heneel Patel, CA. Nilesh Joshi, CA. Prashant Tidke.

CA. Shriniwas Y Joshi
Vice Chairman, AASB

CA. G. Sekar
Chairman, AASB

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Section A –
Long Form Audit Report in Case of Banks

A. Guiding Principles on Objectives, Strategy, Scope and Coverage of LFAR

1. In the case of banks and bank branches, the auditors have to report on certain matters prescribed by the RBI. Such a report is termed as long form audit report (LFAR). In the year 1985, the RBI advised the public sector banks to obtain LFAR from the auditors. The main audit report is to be submitted as per the requirements of the Banking Regulation Act, 1949. LFAR is a separate report to be submitted to the bank management in the format prescribed by the RBI. The bank management in turn has to ensure compliance and place the same to its Board of Directors and submit it to RBI.

2. The RBI vide its circular No. RBI/2020-21/33/ Ref.No.DOS. CO.PPG./SEC.01/11.01.005/2020-21 dated 5th September 2020 on Long Form Audit Report (LFAR) - Review revised the LFAR formats for banks and bank branches. The matters to be reported by the SCAs and the SBAs in their LFAR are given in the said circular and the auditor is required to respond to the same. It may be noted that LFAR is not an annexure to the auditor's report but a separate and distinct reporting addressed to the bank's management. The LFAR format mainly focuses on systemic issues in banks, tries to address and seek independent opinion of the banks auditors.

3. The format of LFAR contains certain illustrative matters which need to be commented upon specifically by the auditors. It should be noted that due to paucity of time available for conduct of audit, the auditors may resort to test checks, obtain management representations, conduct process reviews and make inquiries. Whatever be the methodology adopted by auditors, they should ensure that they specifically state what they have verified, how they have verified and to what extent they have verified. Auditors should be aware of their responsibilities and the regulatory expectations in submission of LFAR which should highlight major discrepancies in the working of the bank.

4. In the abovementioned circular, RBI also laid down the guiding principles on objectives, strategy, scope and coverage of LFAR which are as follows:

> ***i. The overall objective of the Long Form Audit Report (LFAR) should be to identify and assess the gaps and vulnerable areas in the business operations, risk management, compliance and the efficacy of internal audit and provide an independent opinion on the same to the Board of the bank and provide their observations.***

5. Operational risk has been defined by the Basel Committee on Banking Supervision as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk generally includes frauds, employment practice and workplace safety, products and business practices, damage to physical assets, business disruption and system failure.

6. It is important for banks to maintain adequate internal control processes to prevent frauds and reduce errors in banking transactions.

7. The overall objective of LFAR is to assess the weakness and identify the gaps in the banking operations. This identification is required to be within the overall objectives of audit i.e., forming an opinion on the true and fair view of the financial statements. An audit report is on a set of general purpose financial statements of the bank whereas the LFAR is a specific purpose report addressed to the Board of Directors of a bank. Accordingly, this identification is not meant to be an independent wholesome exercise of gap and vulnerabilities evaluation.

8. The Board of the bank is responsible for ensuring effective management of the operational risks in banks. They are responsible for adequate and effective internal control system in banking operations. Internal audit independently reviews the operational risk and internal control system in banks. Comments of statutory auditor in LFAR provide independent opinion on the operational risk and internal audit of banks.

9. The auditor needs to incorporate his observations on governance, policy and implementation of business strategy and its adequacy vis-à-vis the risk appetite statement of the bank, effectiveness of assurance functions (risk management, compliance and internal audit). The auditor should seek

information from the bank on the data points that the bank can provide with regard to the business strategy and the risk appetite statement. This would be usually mentioned in the agenda deliberated in the meetings of the Risk Management Committee of the Board of Directors as well as in the meetings of the Board of Directors.

10. The auditor is required to report on the adequacy of risk-awareness, risk-taking and risk-management, risk and compliance culture *per se,* compliance testing, including the sustenance of the compliance, as also system of branch inspection, frequency, scope/coverage of inspection/internal audit; concurrent audit or revenue audit should also be examined along with the system of follow-up of these reports, position of compliance, corrective action taken by the bank among others.

ii. This may also involve commenting on various risks to which the banks are exposed to like credit, market, operational and liquidity risk and risk management efficacy, assessment of appropriateness of procedures for preparation of supervisory returns, KYC/AML/CFT issues, cyber security, business performance, business strategy including very high growth / high ROE accompanied with high risks, etc.

Risk Management in Banks

11. Risk management is the process of identifying risks, quantify exposures to those risks and ensuring effective capitalization in banks. Banks develop risk assessment techniques that are appropriate to the size and complexities of their business profile, their resources and data availability. Banks should categorize the risk in high frequency-high severity, high frequency-low severity, low frequency high severity, low frequency-low severity in the decreasing order of the risk exposure.

12. Risk assessment should also identify and evaluate the internal and external factors that could adversely affect the bank's performance, information and compliance by covering all risks faced by the bank that operate at all levels within the bank.

13. It is important that each type of major risk like credit risk, market risk and operational risk is to be managed as independent function. In banks, there is normally a Risk Management Committee which reports to the Board of Directors and there are sub-risk management committees like Credit Risk Management Committee, Market Risk Management Committee and Operational Risk Management Committee which report to the Risk Management Committee. These committees work independently to ensure adequate risk management in the bank.

14. Annex I of abovementioned circular has prescribed coverage of various matters like credit risk, market risk, liquidity, KYC/AML non-compliance risk, cyber security risk etc. and the procedures required to be performed by the Auditor are given in subsequent Chapters / Paragraphs of this Technical Guide. The Auditor is required to comment on each of the above aspects of risk and the management of risk within the Bank.

15. It is important for the Auditor to identify along with the bank the various data points and sources of information that will enable the Auditor to perform his procedures and form an independent opinion on the matters required to be commented upon, e.g. to comment upon high growth/high ROE accompanied with high risks, the Auditor needs to understand the business strategy of the bank and the manner in which it is implemented. For this purpose, the bank will need to provide documentation with regard to the basis of its business decisions and the documentation with regard to monitoring adherence to such decisions. A combined perusal of various agenda documents, minutes of the meetings of Board, its committees and committees of senior executive management, MIS, internal audit reports, ICAAP reviews, RBI-RBS tranche documents will aid the Auditor to arrive at the opinion to be given in the LFAR.

iii. Some of the matters to be dealt with by the SCA in their LFARs will be based on the LFARs received from the branches. In dealing with such matters, the SCA are expected to exercise their own judgement to make their observations on the basis of review of Branch Auditors' LFARs.

16. SCAs are expected to give their own judgement on some matters based on review of SBAs' LFARs. While the judgement cannot override the intent of the SBA, the SCAs would need to consider the frequency of the observations across branch audits as well as the materiality of that observation including the materiality of the element(s) of financial statements pertaining to that observation.

iv. While deciding their audit strategy, the auditors may factor-in all material issues which are considered critical by looking at the size and complexity of the business operation, business strategy/models, internal controls including the control culture of the bank, structure and complexity of the IT systems, etc.

17. The Auditor is expected to prepare his audit strategy and the audit plan based on size and complexity of business operations, internal control and culture of the bank and expected to review all the aspects like operations, business models, internal control system and even complex IT system.

v. The scope and coverage of Statutory Audit and LFAR will broadly be as per the given format. However, if the SCA feels a need of some material additions, etc. in the scope, this may be done by giving specific justification and with the prior intimation to the Audit Committee of the Board of the bank.

18. Any matter not listed in LFAR and noticed by the SCA which is material can be additionally reported. The scope is not restricted only to the matters listed in LFAR. However, the Auditors would need to intimate the Audit Committee of the Board before including such matter.

vi. SCA may resort to need based limited transaction testing as hitherto.

19. As in the earlier circulars on LFAR, the RBI has permitted Auditors to determine their reporting points and form their opinion based on verification of a sample of transactions. The auditor may

consider one or more of the following aspects as applicable for the respective areas that are to be understood, elaborated and commented upon by the auditor in the LFAR:

- Identify the RBI guidelines on the subject.
- Bank's policies & procedures to comply with the relevant RBI guidelines.
- Bank's mechanism to monitor the same on an ongoing basis – controls, internal/ concurrent audits etc.
- Assess/ enquire on design of the controls put in place by the bank including internal and concurrent audits.
- Effectiveness of the function based on Metrics stipulated by the bank to evaluate effectiveness of the function. Provide comments on appropriateness of metrics based on the auditor's knowledge & experience.
- Elaborate on the governance framework for the said function i.e. independent review by committee of the Board/ Management and comment based on review of analysis and minutes.

vii. In deciding whether a qualification in the main report is necessary, the auditors should use their judgement based on the available evidences / facts and circumstances of each case.

20. Where any of the comments made by the Auditor in his LFAR is adverse, the Auditor should consider whether a qualification in the main audit report is necessary. It should not, however, be assumed that every adverse comment in the LFAR would necessarily result in a qualification in the main audit report. In deciding whether a qualification in the main audit report is necessary, the Auditor should use his professional judgement having regard to the facts and circumstances of each case.

21. Where the Auditors have any reservation or adverse remarks with regard to any of the matters to be dealt with in their LFARs, they should give the reasons for the same.

I

Credit Risk Areas

The format of LFAR requires auditors to offer their comments on the following aspects of credit risk areas:

1. Loan Policy
2. Credit Assessment
3. Sanctioning / Disbursement
4. Documentation
5. Review / Monitoring / Post sanction follow-up/Supervision
6. Restructuring/Resolution of Stressed Accounts
7. Asset Quality
8. Recovery Policy
9. Large Advances
10. Audit Reports
11. Recovery Records
12. Wilful Defaulter

1. Loan Policy

The observations should broadly cover the sufficiency and effectiveness of the loan policy along with the compliance to instructions issued by RBI in areas like exposure norms, interest rates, statutory and other restrictions, among others. Other aspects relating to updation of the policy, system of monitoring and adherence thereto should also be commented upon. The observations should also comprise business model/business strategy as per the policy as against the actual business/income flow of the bank.

- LFAR requires the auditor to comment on the loan policy of the Bank. LFAR also requires the auditor to comment on the business model of the bank. The Auditor is required to comment on the sufficiency and effectiveness of the loan policy. The auditor needs to study in detail the loan policy *vis-a-vis* actual business model of the bank and comment on the effectiveness of the loan policy in comparison with actual business of the bank.

- Loans and advances given to borrowers involve number of risks. Credit risk or default risk involves inability or unwillingness of a customer or counterparty to meet commitments in full or in part on time as contracted. The credit risk of a bank's portfolio depends on both external and internal factors.

- The external factors are the state of the economy, wide swings in commodity/equity prices, foreign exchange rates and interest rates, trade restrictions, economic sanctions, Government policies, etc.

- The internal factors are deficiencies in loan policies/administration, absence of prudential credit concentration limits, inadequately defined lending limits for Loan Officers/Credit Committees, deficiencies in appraisal of borrowers' financial position, excessive dependence on collaterals and inadequate risk pricing, absence of loan review mechanism and post sanction surveillance, etc.

- Credit Risk Policy is generally articulated in the bank's loan policy. Loan policy of the bank should be duly approved by the Board.

- Each bank has a high-level Credit Policy Committee (CPC)/Credit Risk Management Committee or Credit Control Committee.

- This Committee lays down the policy and procedures on loans and advances. The Committee formulates clear policies on standards for presentation of credit proposals, financial covenants, rating standards and benchmarks, delegation of credit approving powers, prudential limits on large credit exposures, asset concentrations, standards for loan collateral, portfolio management, loan review mechanism, risk concentrations, risk monitoring and evaluation, pricing of loans, provisioning, regulatory/legal compliance, etc.

- Banks also set up Credit Risk Management Department (CRMD), independent of the Credit Administration Department.
- The CRMD enforces and monitors compliance of the risk parameters and prudential limits set by the CPC.
- The CRMD lays down the risk assessment systems, monitors quality of loan portfolio periodically, identifies problems and corrects deficiencies, develops MIS and undertakes loan review/audits.
- Large banks might have a separate set up for loan review/audit.
- The CRMD is accountable for protecting the quality of the entire loan portfolio.
- The CRMD also undertakes portfolio evaluations and conducts comprehensive studies on the environment to test the resilience of the loan portfolios.
- Loan policy of the bank must contain credit approving mechanism/authority (delegation of authority), prudential limits w.r.t. borrowers, risk rating, risk pricing, portfolio management, loan review mechanism etc.
- Loan policy of the bank must compliment the business model of the bank.

Sufficiency and effectiveness of the loan policy

Loan policy of the bank must contain the following:

i. Credit approving Mechanism/Authority - (Discussed in detail latter on in this Chapter- Please refer Guidance given under the heading- Sanctioning/Disbursement).

ii. Prudential Limits

In order to limit the magnitude of credit risk, prudential limits should be laid down on various aspects of credit:

a) Stipulate the benchmark current/debt equity and profitability ratios, debt service coverage ratio or other ratios, with flexibility for deviations. The conditions subject to which deviations are permitted and the authority therefor should also be clearly stated in the loan policy.

b) Single/group borrower limits, which may be lower than the limits prescribed by the Reserve Bank of India to provide a filtering mechanism.

c) Substantial exposure limit i.e. sum total of exposures assumed in respect of those single borrowers enjoying credit facilities in excess of a threshold limit, say 10% or 15% of capital funds. The substantial exposure limit may be fixed at 600% or 800% of capital funds, depending upon the degree of concentration risk the bank is exposed.

d) Maximum exposure limits to industry, sector, etc. should be set up.

- There must also be systems in place to evaluate the exposures at reasonable intervals and the limits should be adjusted especially when a particular sector or industry faces slowdown or other sector/industry specific problems.
- The exposure limits to sensitive sectors, such as, advances against equity shares, real estate, etc., which are subject to a high degree of asset price volatility and to specific industries, which are subject to frequent business cycles, may necessarily be restricted.
- Similarly, high-risk industries, as perceived by the bank, should be placed under the lower portfolio limit.
- Any excess exposure should be fully backed by adequate collaterals or strategic considerations.

e) Banks may consider maturity profile of the loan book, keeping in view the market risks inherent in the balance sheet, risk evaluation capability, liquidity, etc.

iii. Risk Rating

- An effective risk rating system would:

  - Provide the foundation for credit risk measurement, monitoring, and reporting.
  - Support management and Board decision-making.
  - Be sufficiently flexible to allow for use with various types of credit exposure.
  - Provide appropriate granularity of risk ratings that accurately reflect the risk of default and credit losses.
  - Offer multiple options for the complexity and risk of the portfolio that adequately differentiates risk rating.
  - Precisely define ratings criteria using both objective (quantitative) and subjective (qualitative) factors.
  - Consider both the borrower's expected performance and the transaction structure.
  - Be independently validated.
- Banks should have a comprehensive risk rating system for taking credit decisions.
- A substantial degree of standardization is required in ratings across borrowers.
- The risk rating system is designed to reveal the overall risk of lending, critical input for setting pricing and non-pricing terms of loans as also present meaningful information for review and management of loan portfolio.
- The risk rating reflects the underlying credit risk of the loan book. The rating exercise also facilitates the credit granting authorities some comfort in their knowledge of loan quality at any moment of time.
- The risk rating system is drawn up in a structured manner including financial analysis, projections and sensitivity, industrial and management risks.
- Banks can use any number of financial ratios and operational parameters and collaterals as also qualitative aspects of management and industry characteristics that have bearings on the creditworthiness of borrowers.

- Since a lot of developments have happened in the last year, banks should appropriately weigh the ratios on the basis of the years or periods to which they represent for giving importance to near term developments for better comparability and analytics.
- Within the rating framework, banks can also prescribe certain level of standards or critical parameters, beyond which no proposals should be entertained.
- Banks may also consider separate rating framework for large corporates, small borrowers, traders, etc. that exhibit varying nature and degree of risk.
- Forex exposures assumed by corporates who have no natural hedges have significantly altered the risk profile of banks. Banks, therefore, factor the unhedged market risk exposures of borrowers also in the rating framework.
- The overall score for risk is to be placed on a numerical scale ranging between 1-6, 1-8, etc. on the basis of credit quality.
- For each numerical category, a quantitative definition of the borrower, the loan's underlying quality, and an analytic representation of the underlying financials of the borrower should be presented.
- Further, as a prudent risk management policy, each bank prescribes the minimum rating below which no exposures would be undertaken.
- Any flexibility in the minimum standards and conditions for relaxation and authority therefor should be clearly articulated in the loan policy.
- The credit risk assessment exercise is generally repeated biannually (or even at shorter intervals for low quality customers) and needs to be delinked invariably from the regular renewal exercise.
- The updating of the credit ratings should be undertaken normally at quarterly intervals or at least at half-yearly intervals, in order to gauge the quality of the portfolio at periodic intervals.

- Variations in the ratings of borrowers over time indicate changes in credit quality and expected loan losses from the credit portfolio.
- Thus, if the rating system is to be meaningful, the credit quality reports should signal changes in expected loan losses. In order to ensure the consistency and accuracy of internal ratings, the responsibility for setting or confirming such ratings should vest with the loan review function and examined by an independent loan review group.
- Banks should undertake comprehensive study on migration (upward – lower to higher and downward – higher to lower) of borrowers in the ratings to add accuracy in expected loan loss calculations.
- The auditor needs to go through the entire risk rating system and the same should be commented in the loan policy review of the bank. The auditor may consider any internal /external audits/ reviews of the rating systems by experts.

iv. Risk Pricing

- Risk-return pricing is a fundamental tenet of risk management. In a risk-return setting, borrowers with weak financial position are placed in high credit risk category, and are generally priced high. Thus, banks should evolve scientific systems to price the credit risk, which should have a bearing on the expected probability of default.
- The pricing of loans normally is to be linked to risk rating or credit quality.
- The probability of default could be derived from the past behavior of the loan portfolio, which is the function of loan loss provision/charge offs for the last five years or so.
- Banks build historical database on the portfolio quality and provisioning / charge off to equip themselves to price the risk. However, value of collateral, market forces, perceived value of accounts, future business potential, portfolio/industry exposure and strategic reasons may also play important role in pricing.

- Flexibility should also be there for revising the price (risk premia) due to changes in rating / value of collaterals / competitive reasons over time.
- Large banks across the Globe have already put in place risk adjusted return on capital (RAROC) framework for pricing of loans, which calls for data on portfolio behavior and allocation of capital commensurate with credit risk inherent in loan proposals. Under RAROC framework, the lender begins by charging an interest mark-up to cover the expected loss – expected default rate of the rating category of the borrower. The lender further allocates additional capital to the prospective loan to cover amounts of unexpected loss-variability of default rates, if any.

v. Portfolio Management

- The existing framework of tracking the non-performing loans around the balance sheet date does not signal the quality of the entire loan book.
- Banks have evolved proper systems for identification of credit weaknesses well in advance.
- The CRMD, set up at the head office is assigned the responsibility of periodic monitoring of the portfolio.
- The portfolio quality could be evaluated by tracking the migration (upward or downward) of borrowers from one rating scale to another.
- This process would be meaningful only if the borrower-wise ratings are updated at quarterly / half-yearly intervals.
- Banks also consider the following measures to maintain the portfolio quality:
    - stipulating quantitative ceiling on aggregate exposure in specified rating categories, i.e. certain percentage of total advances should be in the rating category of 1 to 2 or 1 to 3, 2 to 4 or 4 to 5, etc.
    - evaluating the rating-wise distribution of borrowers in various industry, business segments, etc.

- exposure to one industry/sector is evaluated on the basis of overall rating; distribution of borrowers in the sector/group. In cases where portfolio exposure to a single industry is badly performing, banks may increase the quality standards for that specific industry.
- targeting rating-wise volume of loans, probable defaults and provisioning requirements as a prudent planning exercise. For any deviation/s from the expected parameters, an exercise for restructuring of the portfolio should immediately be undertaken, if necessary.
- undertaking rapid portfolio reviews, stress tests and scenario analysis when external environment undergoes rapid changes; stress tests would reveal undetected areas of potential credit risk exposure and linkages between different categories of risk.
- introducing discriminatory time schedules for renewal of borrower limits. Lower rated borrowers whose financials show signs of problems should be subjected to renewal control twice/thrice a year.

- Banks have evolved suitable framework for monitoring the market risks especially forex risk exposure of corporates who have no natural hedges on a regular basis.
- Banks also appoint portfolio managers to watch the loan portfolio's degree of concentrations and exposure to counterparties.
- For a comprehensive evaluation of customer exposure, banks appoint relationship managers to ensure that overall exposure to a single borrower is monitored, captured and controlled. The relationship managers have to work in coordination with the Treasury and Forex Departments. They may service mainly high value loans so that a substantial share of the loan portfolio, which can alter the risk profile of the bank, would be under constant surveillance. Further, transactions with affiliated companies/groups need to be aggregated and maintained close to real time.
- Banks have also put in place formalized systems for identification of accounts showing pronounced credit weaknesses well in advance and also prepare internal

guidelines for such an exercise and set time frame for deciding courses of action.

vi. Loan Review Mechanism (LRM)

- LRM is an effective tool for constantly evaluating the quality of loan book and to bring about qualitative improvements in credit administration. Banks should, therefore, put in place proper loan review mechanism for large value accounts with responsibilities assigned in various areas such as, evaluating the effectiveness of loan administration, maintaining the integrity of credit grading process, assessing the loan loss provision, portfolio quality, etc.

- The complexity and scope of LRM normally vary based on banks' size, type of operations and management practices. It may be independent of the CRMD or even a separate department in large banks.

- The main objectives of LRM are:

    - to identify promptly loans which develop credit weaknesses and initiate timely corrective action; ·
    - to evaluate portfolio quality and isolate potential problem areas; ·
    - to provide information for determining the adequacy of loan loss provision; ·
    - to assess the adequacy of and adherence to loan policies and procedures, and to monitor compliance with relevant laws and regulations; ·
    - to provide the top management with information on credit administration, including credit sanction process, risk evaluation and post-sanction follow-up. Accurate and timely credit grading is one of the basic components of an effective LRM. Credit grading involves assessment of credit quality, identification of problem loans, and assignment of risk ratings.
    - A proper credit grading system should support evaluating the portfolio quality and establishing loan loss provisions. Given the importance and subjective nature of credit rating, the credit ratings awarded by Credit Administration

Department should be subjected to review by loan review officers who are independent of loan administration.

- Banks formulate loan review policy and that is reviewed annually by the Board.
- The policy, *inter alia,* addresses the following aspects:
  - Qualification and Independence
    - The loan review officers should have a sound knowledge in credit appraisal, lending practices and loan policies of the bank.
    - They should also be well versed in the relevant laws/regulations that affect lending activities.
    - The independence of loan review officers should be ensured and the findings of the reviews should also be reported directly to the Board or Committee of the Board.
  - Frequency and Scope of Reviews
    - Loan reviews are designed to provide feedback on effectiveness of credit sanction and to identify incipient deterioration in portfolio quality.
    - Reviews of high value loans should be undertaken usually within three months of sanction/renewal or more frequently when factors indicate a potential for deterioration in the credit quality.
    - The scope of the review should cover all loans above a cut-off limit. In addition, banks should also target other accounts that present elevated risk characteristics. At least 30-40 % of the portfolio should be subjected to LRM in a year to provide reasonable assurance that all major credit risks embedded in the balance sheet are tracked.
  - Depth of Reviews

    The loan reviews should focus on: ·
    - Approval process.

  - Accuracy and timeliness of credit ratings assigned by loan officers.
  - Adherence to internal policies and procedures, and applicable laws / regulations.
  - Compliance with loan covenants.
  - Post-sanction follow-up.
  - Sufficiency of loan documentation.
  - Portfolio quality.
  - Recommendations for improving portfolio quality.
- The findings of reviews are discussed with the concerned officials and corrective actions should be taken for all deficiencies. Deficiencies that remain unresolved should be reported to top management.
- The auditor should check that the loan review mechanism process followed is in accordance with the policy framed. Deviations, if any, should have been escalated for necessary action. Any divergence noted should be appropriately reported in the LFAR along with management explanations.

vii. Business Strategy and Actual Performance

The LFAR requires the auditor to comment on the above strategy facets with the actual performance. The auditor should seek the MIS that the bank's top management has used to do this comparison. It is not expected of the auditor to prepare this comparison. The auditor should inquire the manner in which the bank management assesses the actual performance with the laid down business strategy and comment on its efficacy. The auditor may also inquire whether any course correction has been done by the bank to align performance with strategy.

2. Credit Assessment

Whether the credit assessment process is sufficiently placed to capture the risk as also the adequacy of information/data available with the bank. The quick mortality cases be closely examined.

- For traditional bank lending, competitive pressures and the growth of loan syndication techniques create time constraints that interfere with basic due diligence.

- Globalization of credit markets increases the need for financial information based on sound accounting standards and, timely macro-economic and flow of funds data.
- When this information is not available or reliable, banks may dispense with financial and economic analysis and support credit decisions with simple indicators of credit quality, especially if they perceive a need to gain a competitive foothold in a rapidly growing foreign market.
- Banks may require new types of information, such as risk measurements, and more frequent financial information, to assess relatively newer counterparties, such as institutional investors and highly leveraged institutions.
- Some credit problems arise from subjective decision-making by senior management of the bank. This includes extending credits to companies they own or with which they are affiliated, to personal friends, to persons with a reputation for financial acumen or to meet a personal agenda, such as cultivating special relationships with celebrities.
- Many banks that experienced asset quality problems lacked an effective credit review process. Credit review at large banks usually is by a department made up of analysts, independent of the lending officers, who make an independent assessment of the quality of a credit or a credit relationship based on documentation such as financial statements, credit analysis provided by the accounts officer and collateral appraisals.
- The purpose of credit review is to provide appropriate checks and balances to ensure that credits are made in accordance with bank's policy and to provide an independent judgement of asset quality, uninfluenced by relationships with the borrower.
- Effective credit review not only helps to detect poorly underwritten credits, it also helps prevent weak credits from being granted, since credit officers are likely to be more diligent if they know their work will be subject to review.

3. Sanctioning / Disbursement

Policy relating to delegation of powers at various levels, appropriateness of checks and balances, adherence to authorised limits, disbursal after complying with terms and conditions of disbursal be examined.

Credit approving Mechanism/Authority

Each bank should have a carefully formulated scheme of delegation of powers. Banks should also evolve multi-tier credit approving system where the loan proposals are approved by an 'Approval Grid' or a 'Committee'. The credit facilities above a specified limit may be approved by the 'Grid' or 'Committee', comprising at least three or four officers and invariably one officer should represent the CRMD, who has no volume and profit targets.

Banks can also consider having credit approving committees at various operating levels i.e. large branches (where considered necessary), Regional Offices, Zonal Offices, Head Offices, etc. Banks could consider delegating powers for sanction of higher limits to the 'Approval Grid' or the 'Committee' for better rated / quality customers.

Banks should also evolve suitable framework for reporting and evaluating the quality of credit decisions taken by various functional groups. The quality of credit decisions should be evaluated within a reasonable time, say 3–6 months, through a well-defined loan review mechanism.

The auditor should familiarise himself with the system of sanctioning and disbursement of advances. He should also familiarise himself with the relevant directives of RBI. Normally, the system in a bank provides for limits on the sanctioning powers of authorities at various levels. The auditor should examine the documents prescribing such limits, e.g., operation manual, circulars from head office, etc. Where the branch auditors' reports indicate cases of credit facilities sanctioned beyond the aforesaid limits, the auditor should draw attention to this fact in his LFAR. The auditor should also examine the branch auditors' report to ascertain whether such cases have been promptly reported to higher authorities as per the procedure laid down in this regard. If not, the auditor should report the fact, giving illustrations of non-compliance with the laid down procedure in his LFAR.

The Auditor should also review the sanctions made at different levels. For this purpose, the Auditor should randomly select a sample of sanctions made at various levels and review whether the procedure laid down for the concerned level has been followed. Where the Auditor has serious reservations about any of the aspects thereof, he should give his observations in this regard in LFAR. Where the branch auditors' reports indicate cases where limits have been disbursed without complying with the terms and conditions of the relevant sanctions or cases of frequent overdrawing beyond sanctioned limits, the Auditor should state this fact in LFAR, giving such cases as illustrations.

4. Documentation

The entire process, including the system of ensuring execution as per the terms of sanction, system of documentation in respect of joint/consortium advances, availability of relevant documents to ensure creation of charge in favor of banks when required, renewal of documents, should be examined. Defects observed along with compliance to RBI guidelines/bank's internal policy in this regard be also examined.

Generally, the system of a bank prescribes the specific documents to be executed in respect of various types of credit facilities, including special documentation required in cases of consortium advances, advances to companies, statutory corporations and Government undertakings, etc. It may be noted that in case of consortium advances, original documents are held by the lead bank; however, copies of such documents are available with each of the participating banks. Banks also usually have a system of renewal of documents and of periodically obtaining confirmation of balances to ensure that the documents do not become time-barred.

The Auditor should review the system of obtaining the loan documents, including renewal thereof. He should examine whether the system provides for obtaining all such loan documents which are required to protect the interests of the bank.

Where the branch auditor's reports indicate cases of credit facilities accorded without proper documentation, the Auditor should state this fact in his LFAR, giving such cases as illustrations.

The Auditor is also required to comment on the nature of documentation defects observed during the audit and to make suggestions to avoid such defects. The Auditor can obtain the relevant information substantially from the branch auditors' reports and from records maintained at the head office / regional or zonal offices of the bank.

5. Review / Monitoring / post sanction follow-up/Supervision

Extent of coverage and effectiveness of credit monitoring system covering both on balance sheet and off-balance sheet exposures, along with the quality of reporting both within the bank and outside agencies (like RBI CRILC, CIBIL, etc.) be examined along with adherence to RBI instructions/bank's own policy be examined. Special focus be given on functioning and effectiveness of system of identifying and reporting of red flagged accounts, early- warning system (EWS), receipt of periodic balance conformation / acknowledgement of debts, stock/book debt statements, balance-sheet, audited-accounts etc. System of scrutiny of the above information and follow-up by the bank should also be examined to identify process gaps. System of periodic physical verification or inspection of stocks, equipment, machinery, other securities etc. and review/renewal of advances including enhancement of limits, overall monitoring of advances through maturity/aging analysis should also be examined and suitably factored-in.

Generally, banks have a system of periodic review of each advance. The primary purpose of such a review is to ensure that the assumptions on the basis of which the loan had been sanctioned continues to hold good; the loan is used for the purpose for which it was sanctioned and in case of deviation in respect of any aspect of the sanction, approval of appropriate authority has been obtained; the project has been implemented as per the approved lines; there are no unexplained overruns in cost of the project; the borrowing unit is functioning properly; the stipulated installments/interest are being paid regularly and promptly and, in case of default or delay in payment, the reasons are looked into; the terms and conditions of the loan, particularly restrictive covenants, are being duly complied with; the required margins have been maintained in the account at all times; the properties mortgaged/hypothecated/ pledged are maintained in good order by the borrower and adequately insured, etc. The Auditor should examine whether the system of periodic review is functioning effectively. He should review the LFARs given by the branch auditors to identify any weaknesses in the design of the system and in its implementation.

The Auditor should examine whether there is an effective system of obtaining confirmations / acknowledgement of debts periodically. For this purpose, the Auditor should also review the branch auditors' reports.

The RBI has issued a circular no. DBOD.No.BP.BC. 33 /21.04.018/2002-03 dated October 21, 2002 on Certification of Borrower's Account by Chartered Accountants advising all scheduled commercial banks to have their Board fix a suitable cut-off limit with reference to the borrower's overall exposure to banking system, over which the accounts of borrower would be required to be audited by chartered accountants in the prescribed manner. The Auditor is expected to report on compliance with this requirement in case of sanction or renewal of limits, primarily on the basis of a review of branch auditors' reports. The Auditor should report the number of branches and the total number of accounts in respect of which audited accounts have not been placed on record.

The Auditor is also expected to comment on the effectiveness of system of physical verification or inspection of stocks, machineries and such other securities which have been charged to the bank.

The Auditor's comments will be based primarily on a review of branch auditors' reports.

In 1985, the RBI advised banks to introduce a comprehensive and uniform health code system indicating the quality or health of individual advances. At present the health code system is not in operation.

However, in the wake of the introduction of guidelines for income recognition, assets classification and provisioning vide RBI's Circular No. DBOD.BP.BC.129/ 21.04.043-92 dated April 27, 1992, the RBI reviewed the need to continue to require the classification of advances as per the health code system. Based on the review, the RBI made the continuance of the health code system discretionary for banks. In case a bank uses this tool, auditors may peruse the information from an audit perspective.

The Auditor may review the statistical and analytical reports on advances which are often placed for information before the Board of Directors or submitted to the RBI. Based on this data, the Board assesses the bank's exposure to various industries. The Auditor is expected to comment on the effectiveness of such reporting system in vogue in the bank.

Generally, banks have a system of periodic review of credit rating awarded to various clients. The purpose is to review whether the rating which had been awarded to a particular client continues to hold good as per the norms or whether a review of the credit rating is required.

The Auditor should examine whether the system of periodic review is functioning effectively as per the norms fixed by the bank. He should review the LFARs given by the branch auditors to identify whether the norms for credit rating are being followed consistently. Where the branch auditors have pointed out any weaknesses in the review / monitoring / supervision of such norms, the Auditor should, if the weaknesses are material, comment and find out the impact.

Apart from conducting the normal banking business, banks also undertake other activities like, leasing, hire purchase, etc. The Auditor should examine whether the bank has a system for monitoring the overdue arising out of this business. The Auditor should also examine whether for the purpose of overdue, regular follow-up is done with the customers from whom the funds are due.

The RBI vide its circular no. RBI/2016-17/294 DBR.BP.BC.No.65/21.04.103/2016-17 dated April 27, 2017 on Risk Management Systems – Role of the Chief Risk Officer (CRO) advised the banks to lay down a Board-approved policy clearly defining the role and responsibilities of the Chief Risk Officer (CRO). The Auditor should examine the board policy and go through the minutes of Risk Management Committee. Also banks have established the compliance department which evaluates the compliance risk in each business line at periodical intervals and put up the results to the Board/Management Committee. The same should be examined by the Auditor.

The Auditor should review the process of reporting to RBI / CRILC / CIBIL as may be necessary. The information to be reported should flow from the core banking solution and MIS reporting within the Bank. The Auditor should verify whether the reporting is done on a timely basis.

The Auditor should also inquire about the parameters set in the early warning system (EWS). The reports generated through the EWS need to be perused to be satisfied that the set parameters are functioning as desired. Action taken by the bank on the EWS should be verified. Any deficiency needs to be reported in the LFAR

The Auditor should verify whether the bank has taken action on red flagged accounts. Such accounts need to be resolved or declared as a fraud within six months of tagging them as RFA. The Auditor should ascertain the progress of such accounts which includes conduct of a forensic audit / investigation. In case the bank is the lead banker, the onus of closure of a RFA within six months is more critical. In case the bank is not the lead banker, the Auditor should verify whether the matter has been taken up with the lead banker for resolution within prescribed timelines.

6. Restructuring/Resolution of Stressed Accounts:

Comments on Deviations observed in restructured accounts/stressed accounts under resolution with reference to Internal / RBI guidelines should be provided. Special emphasis should be given on the stance of the bank with respect to resolution of stressed accounts, specially covering compliance to regulatory guidelines, formulation of board approved policies including timelines for resolution, the manner in which decisions are taken during review period, board approved policies regarding recovery, compromise settlements, exit of exposure through sale of stressed assets, mechanism of deciding whether a concession granted to a borrower would have to be treated as restructuring or not, implementation of resolution in accordance with the laid down conditions, among others.

RBI Guidelines on Restructuring/Resolution of Stress Accounts

RBI has issued guidelines on restructuring/resolution of stress accounts vide its circular no. BR.No.BP.BC.45/21.04.048/2018-19 dated June 7, 2019 on Prudential Framework for Resolution of Stressed Assets. The important aspects of the abovementioned circular are given below.

- Lenders shall recognise incipient stress in loan accounts, immediately on default, by classifying such assets as special mention accounts (SMA) as per the following categories:

SMA Sub Categories	***Basis for classification – Principal or interest payment or any other amount wholly or partly overdue between***
SMA-0	1-30 days
SMA-1	31-60 days
SMA-2	61-90 days

- In the case of revolving credit facilities like cash credit, the SMA sub-categories will be as follows:

SMA Sub Categories	***Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for a period of:***
SMA-1	31-60 days
SMA-2	61-90 days

- As provided in terms of the circular RBI/2013-14/601 DBS.OSMOS. No.14703/33.01.001/2013-14 dated May 22, 2014 on Reporting to Central Repository of Information on Large Credits (CRILC) and subsequent amendments thereto, lenders shall report credit information, including classification of an account as SMA to Central Repository of Information on Large Credits (CRILC), on all borrowers having aggregate exposure of Rs.50 million and above with them. The CRILC main report shall be submitted on a monthly basis. In addition, the lenders shall submit a weekly report of instances of default by all borrowers (with aggregate exposure of Rs.50 million and above) by close of business on every Friday, or the preceding working day if Friday happens to be a holiday.

Implementation of Resolution Plan

- All lenders must put in place Board-approved policies for resolution of stressed assets, including the timelines for resolution. Since default with any lender is a lagging indicator of financial stress faced by the borrower, it is expected that the lenders initiate the process of implementing a resolution plan (RP) even before a default. In any case, once a borrower is reported to be in default by any of the lenders mentioned at Para 3(a), 3(b) and 3(c) of the abovementioned circular, lenders shall undertake a prima facie review of the borrower account within thirty days from such default (“review period”). During this review period of thirty days, lenders may decide on the resolution strategy, including the nature of the RP, the approach for implementation of the RP, etc. The lenders may also choose to initiate legal proceedings for insolvency or recovery. In cases where RP is to be implemented, all lenders shall enter into an inter creditor agreement (ICA), during the above-said review period, to provide for ground rules for finalisation and implementation of the RP in respect of borrowers with credit facilities from more than one lender. The ICA shall provide that any decision agreed by lenders representing 75 per cent by value of total outstanding credit facilities (fund based as well non-fund based) and 60 per cent of lenders by number shall be binding upon all the lenders. Additionally, the ICA may, *inter alia,* provide for rights and duties of majority lenders, duties and protection of rights of dissenting lenders, treatment of lenders with priority in cash flows/differential security interest, etc. In particular, the RPs shall provide for payment not less than the liquidation value due to the dissenting lenders.

- In respect of accounts with aggregate exposure above a threshold with the lenders, as indicated below, on or after the 'reference date', RP shall be implemented within 180 days from the end of review period. The review period shall commence not later than: (a) the reference date, if in default as on the reference date; or (b) the date of first default after the reference date.

- The reference dates for the above purpose shall be as under

Aggregate exposure of the borrower to lenders	***Reference Date***
Rs. 20 billion and above	Date of these directions
Rs. 15 billion and above, but less than Rs.20 billion	January 1 , 2020
Less than Rs. 15 billion	To be announced in due course

- The RP may involve any action / plan / reorganization including, but not limited to, regularization of the account by payment of all over dues by the borrower entity, sale of the exposures to other entities / investors, change in ownership and restructuring. The RP shall be clearly documented by the lenders concerned (even if there is no change in any terms and conditions).

- RPs involving restructuring / change in ownership in respect of accounts where the aggregate exposure of lenders is Rs. 1 billion and above, shall require independent credit evaluation

(ICE) of the residual debt by credit rating agencies (CRAs) specifically authorised by the Reserve Bank for this purpose.

- While accounts with aggregate exposure of Rs. 5 billion and above shall require two such ICEs, others shall require one ICE.
- Only such RPs which receive a credit opinion of RP4 or better for the residual debt from one or two CRAs, as the case may be, shall be considered for implementation.
- Further, ICEs shall be subject to the following:

  (a) The CRAs shall be directly engaged by the lenders and the payment of fee for such assignments shall be made by the lenders.

  (b) If lenders obtain ICE from more than the required number of CRAs, all such ICE opinions shall be RP4 or better for the RP to be considered for implementation.

- A RP in respect of borrowers to whom the lenders continue to have credit exposure, shall be deemed to be 'implemented' only if the following conditions are met:

  (a) A RP which does not involve restructuring/change in ownership shall be deemed to be implemented only if the borrower is not in default with any of the lenders as on 180th day from the end of the review period. Any subsequent default after the 180 day period shall be treated as a fresh default, triggering a fresh review.

  (b) A RP which involves restructuring/change in ownership shall be deemed to be implemented only if all of the following conditions are met:

    - All related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge/ perfection of securities, are completed by the lender concerned in consonance with the RP being implemented.
    - The new capital structure and/or changes in the terms of conditions of the existing loans get duly reflected in the books of all the lenders and the borrower; and,

  - Borrower is not in default with any of the lenders.

- A RP which involves lenders exiting the exposure by assigning the exposures to third party or a RP involving recovery action shall be deemed to be implemented only if the exposure to the borrower is fully extinguished.

- Where a viable RP in respect of a borrower is not implemented within the timelines given in the aforesaid circular, all lenders shall make additional provisions as per the aforesaid circular.

- The additional provisions shall be made by all the lenders with exposure to such borrower.

- The additional provisions shall also be required to be made in cases where the lenders have initiated recovery proceedings, unless the recovery proceedings are fully completed.

- The above additional provisions may be reversed as under:

  (a) Where the RP involves only payment of overdues by the borrower – the additional provisions may be reversed only if the borrower is not in default for a period of 6 months from the date of clearing of the overdues with all the lenders;

  (b) Where RP involves restructuring/change in ownership outside IBC – the additional provisions may be reversed upon implementation of the RP;

  (c) Where resolution is pursued under IBC – half of the additional provisions made may be reversed on filing of insolvency application and the remaining additional provisions may be reversed upon admission of the borrower into the insolvency resolution process under IBC; or

  (d) Where assignment of debt/recovery proceedings are initiated – the additional provisions may be reversed upon completion of the assignment of debt/recovery.

Audit Guidance

- The Auditor should obtain a list of stressed accounts and those taken up for restructuring. Restructuring should be done within the guidelines of RBI and Board approved internal policy. Any deviation from the RBI guidelines / internal policy should be appropriately reported. It should be noted that the primary duty to restructure the stressed accounts as per the policy, is of the senior management of the bank and the Auditor is responsible only to express his view on the absence of adherence with the process. The RBI has issued specific guidelines for restructuring of accounts affected by the Covid pandemic and the same has to be duly addressed by the bank in letter and spirit.

- The Auditor should verify whether the laid down process of the bank is followed in the cases of restructuring examined by him. Any deviation would need to be mentioned in the LFAR. Particular focus needs to be given to cases where the ICA is not signed. The Auditor needs to inquire the reasons for the delay and its potential impact on the recoveries of such loans.

- The Auditor should peruse the MIS with respect to such cases. It is advisable to peruse MIS of not only the position at the year-end but also the MIS of intermittent months. This will enable the Auditor to form an opinion on the adequacy of the process of restructuring of loans.

- <u>MSME Sector – Restructuring of Advances</u>

  The auditor should duly note the below mentioned circulars regarding restructuring of advances.

  The RBI issued circular RBI/2020-21/17 DOR.No.BP.BC /4/21.04.048/2020-21 dated August 6, 2020 on Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances in continuation of earlier circular RBI/2019-20/160 DOR.No.BP.BC.34/21.04.048/2019-20 dated February 11, 2020 on Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances extending the one-time restructuring of MSME advances classified as 'standard' without a downgrade in the asset classification and aligning the guidelines with the resolution framework for COVID19 – related stress announced for other advances, with amended conditions as specified in the said circular.

- <u>COVID19 Regulatory Package</u>

  The RBI issued COVID19 Regulatory Package vide circular

RBI/2019-20/186 DOR.No.BP.BC.47/21.04.048/2019-20 dated March 27, 2020 granting relief to borrowers, which was further followed by another circular RBI/2019-20/220 DOR.No.BP.BC. 63/21.04.048/2019-20 dated April 17, 2020 on COVID 19 Regulatory Package - Asset Classification and Provisioning, granting relief w.r.t. asset classification and provisioning. The RBI also issued circular RBI/2019-20/219 DOR.No.BP.BC.62/21.04.048/2019-20 dated April 17, 2020 on COVID 19 Regulatory Package - Review of Resolution Timelines under the Prudential Framework on Resolution of Stressed Assets.

- Resolution Framework for COVID19 related Stress

  The RBI issued circular RBI/2020-21/16 DOR.No.BP.BC/3/ 21.04.048/2020-21 dated August 6, 2020 on Resolution Framework for COVID-19-related Stress providing window under prudential framework to enable lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership and personal loans, while classifying such exposures as standard, subject to certain conditions, enabling to retain the class of assets.

7. Asset Quality

Special emphasis should be given on continuous monitoring of classification of accounts into Standard, SMA, Sub-standard, Doubtful or loss as per IRAC Norms by the system, preferably without manual intervention, correct recognition of income, and adequacy of provision thereof. Effectiveness of the system for compiling data relating to NPA and their provision, data integrity, system of suspension of charging of interest and adherence thereto, should be examined and commented upon. Deviations observed, if any, should be provided along with requisite examples. Further, comments be provided on the procedure followed by the bank in upgradation of NPAs, updation of the value of securities with reference to RBI regulations and compliance by the bank with divergences observed during earlier RBI Inspection(s) with requisite examples of deviations, if any.

LFAR requires the auditor to comment in detail the asset quality of the bank based on data. The auditor should review all internal MIS and audit inspection reports before commenting on the asset quality.

The auditor should also select advances in each category like large, medium, small or loan wise category to check and review the asset quality of the bank.

The Auditor should inquire about the automation of the process of identification of NPA through the system without manual intervention. This process is also required to be extended to the asset classification, interest reversal, suspension of charging of interest, amount of provisioning, upgradations when recoveries happen etc. The RBI vide circular no. RBI/2020-21/37 Ref. No. DoS.CO.PPG./SEC.03/11.01.005/2020-21 dated September 14, 2020 on Automation of Income Recognition, Asset Classification and Provisioning processes in banks has prescribed a timeline upto June 2021 for banks to be fully automated. The Auditor needs to assess the extent of such automation in the preparation of annual financial statements. The RBI has also directed Auditors to certify the position of automation as on March 31, 2021.

- The Auditor should specifically ensure:
  - NPA is identified from the system. Any exceptions should be formally reconciled with reasons for addition / deletion from the system generated list of NPAs. The approval should be only at senior management levels. Branch should not be given authority to alter NPA statements generated by the system.
  - Upgrades should be specifically checked to ensure that entire overdues are recovered.
  - Where the business has closed down and there is no certainty of cash flows, any downgrade in asset classification and enhancement of provisioning should be considered.
  - Fall in valuation of securities and the fact that the asset may not be realized on time due to liquidity constraints should be factored.
  - Policy followed by the bank considering the Supreme Court's interim order should be appropriately disclosed

and followed consistently for classification, income reversal and provisioning.

  - SMA accounts are duly tracked for recovery.

- The Auditor needs to peruse MIS of intermittent months during the year to assess whether the process of NPA identification and provisioning was functioning as per the regulatory requirements.
- The Auditor should verify whether all RBI identified divergences are adequately provided. Details of the same can be mentioned in the LFAR.

8. Recovery Policy

The existence and effectiveness of recovery policy, along with regular updates, manner of appropriation of recovery, instances wherein the appropriation was not as per the recovery policy be examined and commented upon. Instances observed / reported wherein the instructions of controlling authority related to legal action for recovery or recalling of advances is not acted upon, system of compromise settlements, system of monitoring accounts under Insolvency and Bankruptcy Code 2016 (IBC), write-off be specifically commented. In respect of compromise settlement, special emphasis should be given to the systems and processes relating to cases of recovery of Rs. 1.00 crore and above and also the cases wherein limits of sacrifice laid down in the recovery policy is breached. Further, the auditors should verify the list of accounts where insolvency proceedings had been initiated under IBC, but subsequently was taken out of insolvency under Section 12A of the IBC. The auditors may satisfy themselves regarding the reasons of the creditors, especially the bank concerned, to agree to exiting the insolvency resolution process, and may comment upon deficiencies observed, if any.

- The Auditor should specifically ensure:
  - The recovery policy is in accordance with the RBI requirements.

- The recovery policy is reviewed at appropriate levels and updated.
- Recovery is consistently appropriated to principal or interest as the case may be as per the recovery policy.
- List of accounts where recall is ordered should be obtained. Whether appropriate action is duly taken on time should be verified and deviations if any, reported.
- List of accounts under IBC should be obtained. Status report of such accounts should be obtained along with monitoring undertaken. Any gaps in the process should be duly commented upon.
- List of accounts where OTS (One Time Settlement) / compromise is done should be obtained. Accounts where the compromise is over Rs. 1 Crore should be specifically checked for adherence to policy.
- It should be noted that the primary responsibility of adherence to policy is of the appropriate bank functionaries. Bank officials to maintain sufficient documentation and ensure availability of audit trail to satisfy the auditor that adequate compliance is done as per the recovery policy.
- List of accounts taken in IBC and then subsequently taken out of IBC should be obtained. The Auditor should be satisfied with the reasons formally recorded and documented by the bank to have such accounts taken out of IBC.

In this regard, the Auditor may also refer to some publications of the Committee on Insolvency and Bankruptcy Code of ICAI. These publications are given as under:

- Frequently asked questions on the IBC Code 2016 (Revised 2019 edition).
- Question Bank on IBBI Limited Insolvency Examination.
- Judicial Pronouncements under IBC Code 2016 – Series 1.
- Judicial Pronouncements under IBC Code 2016 – Series 2.
- Judicial Pronouncements under IBC Code 2016 – Series 3.

9. Large Advances

Comment on adverse features considered significant in top 50 standard large advances and the accounts which need management's attention be provided. In respect of advances below the threshold, the process needs to be checked and commented upon, based on a sample testing.

- The Auditor should obtain a list of top 50 standard large advances and duly comment on adverse features in these accounts. Issues raised by other auditors in these accounts including RBI queries, if any, should be looked into and reported if not duly addressed.

- For other accounts, the methodology of selecting the sample as well as the details of all such accounts chosen for verification should be documented by the Auditor. General adherence to the process of sanction, disbursal, documentation, monitoring, review and recovery and gaps noted in conduct of such accounts should be duly reported.

- In reporting under this point, the Auditor should give relevant details in the LFAR. The details to be given in respect of each such account should include the name of the borrower, the amount outstanding and a brief history and statement of facts. It would be desirable for the Auditor to obtain the relevant explanations from the management in writing.

- As regards adverse features in large accounts, the Auditor can obtain relevant information substantially from the branch auditors' LFARs and from records maintained at the head office/regional or zonal offices. Banks usually have a system of reporting to the Board on large accounts (e.g., accounts in respect of which the outstanding amount is in excess of 10 % of outstanding aggregate balance of fund based and non-fund based advances of the branch or Rs.10 crores, whichever is less) where the adverse features have been observed, including accounts which require a review or close monitoring to ensure that they do not become sub-standard or doubtful at a later stage. Unhealthy features in such accounts include frequent over-drawing beyond sanctioned limits, non-furnishing of data relating to security, defaults in furnishing of the information relating to the security charged to the bank, non-registration of charge in the case of companies, default in the matter of various stipulations for borrowings (for example, keeping the security uninsured, accumulation of old/obsolete stocks, etc.), non-renewal of documents, defaults in complying with the repayment schedules, frequent returning of bills in bill-discounting facility, and non-observance of the covenants between the bank and the borrower which may have a significant impact on the realisability of the advance or which may cause detriment to the security charged. The auditor should review the relevant reports submitted to the Board, where available.

- The Auditor should indicate the name of the branch, the name of the borrower, the balance as at the year-end and the general nature of adverse features noticed during the year. In case the adverse features have been persisting over a period of time and adverse comments have been made by the previous auditor(s) on these accounts, the same should also be reported.
- In case the Auditor notices a trend of the adverse observations then he may suitably report them in a summarised manner. In case this adverse trend is of a significant nature the Auditor will have to consider the same while reporting on the effectiveness of internal financial controls, if such reporting is applicable to the bank.

10. *Audit Reports*

Major adverse features observed in the reports of all audits/inspections, internal or external, carried out at credit department during the financial year should be suitably incorporated in the LFAR, if found persisting.

- The auditor needs to incorporate all material discrepancies reported by Branch Auditors, Concurrent Auditors, Revenue Auditors, other auditors, internal inspection etc. It may be noted that such inclusion in the LFAR should be made only if the observations are found to be persisting. The Auditor should do his own analysis of these reports and form an opinion on the persistency of the observations. To enable the above, the Auditor should peruse the reporting to the Audit Committee of the Board on the findings of Concurrent Auditors, Revenue Auditors, other auditors, internal inspection etc. Due weightage should be given to rectification actions taken by the bank on these audit observations.

- Reasons for non-conduct of any audits or non-submission of reports thereon should be verified. The Bank's comments on the adverse issues raised, if any, for closure of the process gap rather than the transactional error should be noted.
- Any gap in timely closure of audit issues should be highlighted. High risk issues should be closed within deadlines fixed as per the internal policy.
- During the Covid pandemic, conduct of audits would have been delayed. These factors should have been considered by the bank to formally accept delays in submission of audit reports without compromising the quality of audit concerned.

11. Recovery Records

Recovery from all the written-off accounts during the finance year should be examined and commented upon.

- Banks normally have a policy when an account can be written off. Such write offs are done when the possibility of recovery is remote. In some cases banks do technical write offs too. These write offs do not waive of the right of the bank to recover the amounts. Recovery processes would continue by the bank.
- The Auditor needs to inquire about the recoveries made from such written off cases. He may seek data of accounts written off over the past three financial years and assess the recovery that has happened. The Auditor should also peruse the MIS placed to the top management with regards to such recoveries.

12. Wilful Defaulter

System of identifying and reporting of wilful defaulter should be examined and commented upon.

RBI Guidelines on Wilful Defaulter

RBI has issued guidelines on wilful defaulter vide its Master Circular no. DBR.No.CID.BC.22/20.16.003/2015-16 dated July 1, 2015 on Wilful Defaulters. The important aspects of the abovementioned Master Circular are given below.

A 'wilful default' would be deemed to have occurred if any of the following events is noted:

(a) The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honour the said obligations.

(b) The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.

(c) The unit has defaulted in meeting its payment / repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

(d) The unit has defaulted in meeting its payment / repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given for the purpose of securing a term loan without the knowledge of the bank / lender.

The identification of the wilful default should be made keeping in view the track record of the borrowers and should not be decided on the basis of isolated transactions / incidents. The default to be categorised as wilful must be intentional, deliberate and calculated.

Mechanism for identification of Wilful Defaulters

- The evidence of wilful default on the part of the borrowing company and its promoter / whole-time director at the relevant time should be examined by a Committee headed by an Executive Director or equivalent and consisting of two other senior officers of the rank of GM / DGM.
- If the Committee concludes that an event of wilful default has occurred, it shall issue a show cause notice to the concerned borrower and the promoter / wholetime director and call for their submissions and after considering their submissions issue an order recording the fact of wilful default and the reasons for the same.
- An opportunity should be given to the borrower and the promoter / whole-time director for a personal hearing if the Committee feels such an opportunity is necessary.
- The order of the committee should be reviewed by another committee headed by the Chairman / Chairman & Managing Director or the Managing Director & Chief Executive Officer / CEOs and consisting, in addition, to two independent directors / non-executive directors of the bank and the Order shall become final only after it is confirmed by the said Review Committee.
- However, if the Identification Committee does not pass an order declaring a borrower as a wilful defaulter, then the Review Committee need not be set up to review such decisions.
- As regard a non-promoter / non-whole time director, it should be kept in mind that Section 2(60) of the Companies Act, 2013 defines an officer who is in default to mean only the following categories of directors: (i) whole-time director (ii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified; (iii) every director, in respect of a contravention of any of the provisions of Companies Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings and who has not objected to the same, or where such

contravention had taken place with his consent or connivance. Therefore, except in very rare cases, a non-whole time director should not be considered as a wilful defaulter unless it is conclusively established that:

- o he was aware of the fact of wilful default by the borrower by virtue of any proceedings recorded in the minutes of meeting of the Board or a Committee of the Board and has not recorded his objection to the same in the Minutes; or,
- o the wilful default had taken place with his consent or connivance.

The above exception will however not apply to a promoter director even if not a whole time director. (iv) As a one-time measure, Banks / FIs, while reporting details of wilful defaulters to the Credit Information Companies may thus remove the names of non-whole time directors (nominee directors / independent directors) in respect of whom they already do not have information about their complicity in the default / wilful default of the borrowing company. However, the names of promoter directors, even if not whole time directors, on the board of the wilful defaulting companies cannot be removed from the existing list of wilful defaulters.

- A similar process as detailed in sub-paragraphs (a) to (c) of the abovementioned Master Circular should be followed when identifying a non-promoter / non-whole time director as a wilful defaulter.

Criminal Action against Wilful Defaulters

- It is essential that offences of breach of trust or cheating construed to have been committed in the case of loans should be clearly defined under the existing statutes governing the banks, providing for criminal action in all cases where the borrowers divert the funds with mala fide intentions.
- It is essential that banks closely monitor the end-use of funds and obtain certificates from the borrowers certifying that the funds have been used for the purpose for which these were obtained.

- Wrong certification should attract criminal action against the borrower.
- Accordingly, banks / FIs are advised, as under:
  - Monitoring end-use of funds, it is advised that banks / FIs should closely monitor the end-use of funds and obtain certificates from borrowers certifying that the funds are utilised for the purpose for which they were obtained.
  - In case of wrong certification by the borrowers, banks / FIs may consider appropriate legal proceedings, including criminal action wherever necessary, against the borrowers.
  - Criminal Action by Banks / FIs- It is essential to recognise that there is scope even under the existing legislations to initiate criminal action against wilful defaulters depending upon the facts and circumstances of the case under the provisions of Sections 403 and 415 of the Indian Penal Code (IPC), 1860. Banks / FIs are, therefore, advised to seriously and promptly consider initiating criminal action against wilful defaulters or wrong certification by borrowers, wherever considered necessary, based on the facts and circumstances of each case
  - It should also be ensured that the penal provisions are used effectively and determinedly but after careful consideration and due caution. Towards this end, banks / FIs are advised to put in place a transparent mechanism, with the approval of their Board, for initiating criminal proceedings based on the facts of individual case.

Reporting

- ***Need for Ensuring Accuracy*** **-** Credit information companies disseminate information on non-suit filed and suit filed accounts respectively of wilful defaulters, as reported to them by the banks / FIs and therefore, the responsibility for reporting correct information and also accuracy of facts and figures rests with the concerned banks and financial institutions.

- Banks / FIs may also ensure the facts about directors, wherever possible, by cross-checking with Registrar of Companies.
- ***Position regarding Guarantors***
    - Banks / FIs may take due care in identifying and reporting instances of wilful default in respect of guarantors also.
    - While reporting such names to RBI, banks/FIs may include ‘Guar’ in brackets i.e. (Guar) against the name of the guarantor and report the same in the Director column.
- ***Government Undertakings***
    - In the case of Government undertakings, it should be ensured that the names of directors are not reported. Instead, a legend ‘Government of -------- undertaking’ should be added.
- ***Inclusion of Director Identification Number (DIN)***
    - Ministry of Corporate Affairs had introduced the concept of a Director Identification Number (DIN) with the insertion of Sections 266A to 266G in the Companies (Amendment) Act, 2006. In order to ensure that directors are correctly identified and in no case, persons whose names appear to be similar to the names of directors appearing in the list of wilful defaulters, are wrongfully denied credit facilities on such grounds, banks / FIs have been advised to include the Director Identification Number (DIN) as one of the fields in the data submitted by them to credit information companies.
    - While carrying out the credit appraisal, banks should verify as to whether the names of any of the directors of the companies appear in the list of defaulters / wilful defaulters by way of reference to DIN / PAN etc.
    - Further, in case of any doubt arising on account of identical names, banks should use independent sources for confirmation of the identity of directors rather than seeking declaration from the borrowing company.

Audit Guidance

The RBI guidelines for identification and reporting of wilful defaulters have been clearly spelt out above. The Auditor should check whether the bank's policy has been appropriately drafted considering the above guidelines. Any non-adherence to the policy and non-reporting should be asked to be formally explained. Weaknesses in the process of identification should be specifically reported. List of accounts not reported should be placed at appropriate controlling authority levels for reporting.

II

Market Risk Areas

Introduction

1. As per section 5 of the Banking Regulation Act, 1949 - '"banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise'. Thus, the definition of 'banking' indicates that besides 'lending', 'investment' is one of the basic objectives of a banking entity. Further, section 6 of the Banking Regulation Act, 1949 specifies 'Forms of business in which banking companies may engage' which includes 'investments of all kinds' and purchase & sale of bonds, scrips or other form of securities. This depicts the vitality of the investment function for a bank. The said investment function is akin to 'market risk'. The format of LFAR for SCAs issued by the RBI requires the Auditor to review and comment on 'market risk areas'. By definition, 'market risk' can be defined as possibility of an investor (read here as bank as an investor) requiring to face the risk of loss related to the investments due to uncertainties in the financial market.

2. The format of LFAR requires auditors to offer their comments on following aspects of market risk areas:

1. Investments including derivatives
2. SLR / CRR requirements
3. Asset liability management

Though these three functions are separable from each other to some extent, the same are inter-linked with each other too. The thrust of reporting on these aspects is focused towards regulatory compliances and the Auditor is expected to review and comment on the same.

1. Investments including Derivatives

The focus should be on the merit of investment policy and adherence to RBI guidelines. Any deviations to the RBI directives, and guidelines issued by FIMMDA / FIBIL / FEDAI should be suitably highlighted. Special focus should be given on system of purchase and sale of investments, delegation of powers, reporting systems, segregation of back, middle and front office functions, efficacy of control over investments, including periodic verification/reconciliation of investments with book records, valuation mode, changes in mode of valuation, system relating to inter-bank call money operations, system relating to unquoted investments in the portfolio, system of audit including periodic verification/verification of investment activities/portfolios, policies and systems for monitoring activities such as underwriting, derivatives, etc. among others. With respect to RBI directives, special focus should be given on compliance to exposure norms, classification of investments into HTM / AFS / HFT category and inter-category shifting of securities, compliance to valuation, asset classification and provisioning norms, along with deviation from accounting and disclosure norms, among others. In respect of investment held at foreign branches, valuation mode, regulatory reserve requirements, liquidity etc. should be examined. Comments should also be made on the composition of investment portfolio as per RBI guidelines and the depreciations on investments, if not provided for. System of recording of income from investments, income accrued and due but not received, monitoring of mature investments and their timely encashment etc. should be examined and commented. The auditor may also comment upon the veracity of liquidity characteristics of different investments in the books, as claimed by bank in different regulatory/statutory statements. The internal control system, including all audits and inspections, IT and software being used by the bank for investment operations be examined in detail.

3. There are various regulatory guidelines, directives and pronouncements related to investment function of the bank which are issued by the RBI, FIMMDA, FBIL, FEDAI. The Auditor is required to focus on the merit of the investment policy and adherence to RBI guidelines. The Auditor should read the investment policy of the bank and determine whether the same is in sync with the business strategy of the bank. The Auditor may request the bank to furnish a mapping of its business strategy and objectives and the investment policy. The Auditor is required to review the investment policy of the bank to comment in case of deviations observed related thereto. Further, it would be pertinent to note that a bank may have an investment policy which is more stringent as compared to the applicable regulatory guidelines.

4. The Auditor is required to have a special focus on the following aspects related to the investment function of the bank:

i. System of purchase and sale of investment.

ii. Delegation of powers.

iii. Reporting systems.

iv. Segregation of back, middle and front office functions.

v. Efficacy of control over investments, including periodic verification / reconciliation of investments with book records, valuation mode, changes in mode of valuation, system relating to inter-bank call money operations, system relating to unquoted investments in the portfolio, system of audit including periodic verification/verification of investment activities/portfolios, policies and systems for monitoring activities such as underwriting, derivatives, etc. among others.

System of purchase and sale of investment

5. The Auditor should verify the various platforms (e.g.: NDS-OM, NDS-Call, E-Kuber, F-Trac, Fx-Clear, FXT, BSE / NSE, etc.) used by the dealers for purchase and sale of securities (investments) and the compliances related to the trading platforms and / or trading avenues.

Delegation of Powers

6. Banks have an authority matrix depicting delegation of powers related to investment function typically through investment policy of the bank. It would be pertinent for the Auditor to review the implementation and compliance related to the said delegated power in true spirit including verification of effectiveness of the internal control system of the bank related to adherence thereto.

Reporting systems

7. It would include internal MIS reporting as well as regulatory reporting that is initiated by the treasury department of the bank. The Auditor needs to review the system of compilation and generation of the reports by the treasury department and its functional accuracy. In case the reports are system-driven, the Auditor can satisfy himself of the manner in which the report is populated and consider the possibility of manual intervention. If there are manual interventions, the auditor should assess the controls around it. The Auditor should make suitable enquiries related to the implementation of the reporting system including UAT, functional testing thereto carried out by the bank as to whether the same is subjected to periodic verification in terms of adoptability of changes in regulatory norms related thereto. If the reporting system is manual, the Auditor should obtain an understanding of the internal process of the bank in compilation of the information and control over its compliance with related regulatory norms.

Segregation of back, middle and front office functions

8. The RBI has specified the segregation of back, middle and front office related to the Treasury Department in the Master Circular RBI/2015-16/97 DBR No BP.BC.6 /21.04.141/2015-16 dated July 01, 2015 on Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks, which needs to be adhered to by the bank. The Auditor should verify the physical as well as functional separation of back, middle and front office of the bank, with underlying principal of not having an overlapping functionality in any form being enabled to any treasury personnel. Further, the Auditor may have a walk-through exercise carried out related to various activities of Treasury Department to

review and verify the effective segregation of back, middle and front office functions.

Efficacy of control over investments, including periodic verification / reconciliation of investments with book records, valuation mode, changes in mode of valuation, system relating to inter-bank call money operations, system relating to unquoted investments in the portfolio, system of audit including periodic verification/verification of investment activities/ portfolios, policies and systems for monitoring activities such as underwriting, derivatives, etc. among others

9. The Auditor should review the efficiency of internal control systems of the bank related to investments which would include:

- ***Periodic verification / reconciliation of investments with book records, valuation mode***

The Auditor should review system of the bank for physical verification of investments and its reconciliation with the books of account / records of the bank. The Auditor should conduct a physical verification and verify the reconciliation of investments of the bank. The Auditor should verify the valuation of investments in compliance with the regulatory norms related thereto and applicable accounting standards.

- ***Change in mode of valuation***

If there is a change in mode of valuation, the Auditor should review the underlying reasons thereto and verify the same being in compliance with regulatory norms and applicable accounting standards. Further, the Auditor should verify the requisite disclosure of the same in the financial statements along with quantification of impact of change in mode of valuation.

- ***System relating to inter-bank call money operations***

The Auditor should verify the system of inter-bank call money operations undertaken by the bank and the adherence to regulatory guidelines related thereto considering the platform used by the bank for the inter-bank call money operations.

- ***System relating to unquoted investments in the portfolio***

The Auditor should refer the internal policies of the bank related to the investment in unquoted investments by the bank and the procedures related thereto as defined by the bank and verify its compliance. The Auditor should verify compliance of the exposure norms, internal as well as regulatory related thereto.

- ***System of audit including periodic verification / verification of investment activities / portfolios***

The Auditor should review the internal as well as concurrent audit system of the bank related to the investment activities of the bank in terms of its efficacy. The focus should be on the open issues, especially those which the bank has agreed to implement but has not yet done so. Remediation actions and their timelines need to be inquired and ageing of the same needs to be commented upon.

- ***Policies and systems for monitoring activities such as underwriting, derivatives***

With respect to RBI directives, special focus should be given on compliance to exposure norms, classification of investments into HTM / AFS / HFT category and inter-category shifting of securities, compliance to valuation, asset classification and provisioning norms, along with deviation from accounting and disclosure norms, among others.

10. The Auditor should verify:

i. The compliance to the exposure norms related to investment function as specified in the extant RBI directives.

ii. The classification of investments into HTM / AFS / HFT category and the internal process adopted by the bank related thereto.

iii. The shifting of investments from one category to other with reference to the extant guidelines specified in the Master Circular RBI/2015-16/97 DBR No BP.BC.6 /21.04.141/2015-16 dated July 01, 2015 on Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks issued by RBI and any further circulars issued by RBI related thereto.

iv. The valuation of the securities in compliance with the regulatory directives.

v. Classification of investments into performing and non-performing and verify as to whether the requisite provision is made related to the non-performing investments to the extent of 100% unless otherwise permitted specifically by RBI directives.

vi. The accounting and disclosure norms with reference to regulatory guidelines, applicable laws (like the Banking Regulation Act, 1949) and mandatory accounting standards applicable to the bank.

In respect of investment held at foreign branches, valuation mode, regulatory reserve requirements, liquidity etc. should be examined.

11. In case of investments held at foreign branches of the bank, the Auditor should verify compliance with respect to the regulatory reserve requirements and other compliances like liquidity, etc. related to the said branch. The Auditor should comment if the method and manner of valuation is different from that prescribed by the RBI.

Comments should also be made on the composition of investment portfolio as per RBI guidelines and the depreciations on investments, if not provided for. System of recording of income from investments, income accrued and due but not received, monitoring of mature investments and their timely encashment etc. should be examined and commented.

12. The Auditor should verify:

i. Whether the composition of investment portfolio is in compliance with the RBI guidelines?

ii. Whether the depreciation on investment/investment depreciation reserve (IDR) on investment is calculated and accounted correctly by the bank?

iii. Whether the income recognition on investments is as per the extant RBI guidelines?

iv. Whether the bank has internal control system as regards the matured investments and its timely encashment. In case of any lacunas in the system, the auditor should specify the same.

The auditor may also comment upon the veracity of liquidity characteristics of different investments in the books, as claimed by bank in different regulatory/statutory statements.

13. The Auditor should assess the correctness of liquidity characteristics of investments as reported by the bank in various regulatory / statutory statements vis-à-vis the nature and characteristics of the investments. For this purpose, the Auditor can ask the bank to demonstrate the liquidity characteristics of the relevant investment on the basis of trades that have taken place in the concerned market for that investment. If there is any variance in the market-based information and the return submitted by the bank, the same needs to be commented upon.

The internal control system, including all audits and inspections, IT and software being used by the bank for investment operations be examined in detail.

14. The Auditor should objectively review in detail the internal control system of the bank related to treasury function and review the audit and inspections procedures adopted by the bank related to the same. The Auditor is required to comment on the said internal control system of the bank in terms of nature and its effectiveness as envisaged by the Auditor.

2. *SLR / CRR Requirements*

Any discrepancies in the process of compilation and calculation of NDTL by the bank should be highlighted in the report. It should be specifically commented whether the bank has complied with CRR/SLR requirements, with the instances of non-compliance, thereof.

15. The Auditor should review the mechanism of calculation of NDTL factoring in the manual interventions, if any, and verify the correctness of calculation of NDTL. The Auditor should further verify the compliance with the CRR / SLR requirements by the bank and report the specific instances of non-compliance along with lacunas observed in calculation methodology of NDTL. The readers may refer to Chapter 5 – Treasury Operations of Section A - Statutory Central Audit of Guidance Note on Audit of Banks 2021 Edition for detailed procedures related to the verification of NDTL / CRR / SLR.

3. Asset Liability Management

Existence of policy on asset-liability management and monitoring thereof, along with compliance with RBI guidelines and functioning of Asset Liability Management Committee should be examined.

16. The Auditor should acquaint himself with the RBI guidelines related to the ALM and verify the bank's internal systems related to ALM in compliance thereto. The Auditor may undertake the walk-through with the ALM report generation methodology adopted by the bank and also assess basis of the adequacy of the assumptions factored in by the bank in the ALM exercise undertaken by the bank. The Auditor should review the functioning of Asset Liability Management Committee (ALCO) and refer the minutes of the ALCO meetings and relevant agenda papers.

III

Governance, Assurance Functions and Operational Risk Areas

1. The format of LFAR requires auditors to offer their comments on the following aspects of governance, assurance functions and operational risk areas:

1. Governance and Assurance Functions
2. Balancing of Books/Reconciliation of control and Subsidiary Records
3. Inter-branch Reconciliation
4. Frauds / Vigilance
5. Suspense Accounts, Sundry Deposits, etc.
6. KYC / AML
7. Cash and other security items
8. Para-Banking Activity
9. Management Information System
10. Any Other comments relating to People, Process and System Risks

1. Governance and Assurance Functions

Observations on governance, policy and implementation of business strategy and its adequacy vis-à-vis the risk appetite statement of the bank, effectiveness of assurance functions (risk management, compliance and internal audit) should be examined and suitably incorporated in the LFAR. Adequacy of risk-awareness, risk-taking and risk-management, risk and compliance culture per se, compliance testing, including the sustenance of the compliance, as also system of branch inspection, frequency, scope/coverage of inspection/internal audit, concurrent audit or revenue audit should also be examined along with the system of follow-up of these reports, position of compliance, corrective action taken by the bank among others.

2. The Auditor should specifically ensure:

a) The bank has a clearly articulated risk appetite statement. The Auditor needs to specifically request the management for this statement. Some banks may have it articulated in a distinct document while some banks may use the ICAAP document as a base for defining risk appetite.

b) Internal monitoring in the bank that the business strategy adopted by the bank is in synchronization with the risk appetite.

c) The Auditor can request the bank to prepare a mapping between its risk appetite and various policy documents, such as loans, investments, recovery etc.

d) The Bank should have a system of measuring the effectiveness of control functions like risk management, compliance and internal audit. In case these functions have a clear-cut mandate than the same should be verified by the Auditor for adherence. If there is an internal review system then the same should have clear parameters for measuring effectiveness of control functions. If the above processes are not present, then the auditor should have his own objective assessment of commenting on effectiveness of control functions. The Auditor needs to make inquiries on the manner of ensuring such compliance. The auditor should specifically mention the process followed by him in the LFAR so as to substantiate his opinion.

e) The Auditor should inquire about the process of disseminating risk appetite information at various levels within the bank. The Auditor should comment on the trainings conducted by the bank for sensitization, awareness on risks among employees. Auditor should enquire into the process adopted by the bank to ensure that all employees are on the same page as regards their understanding of risk assessment, measurement and classification. This would need structured documentation which the bank should undertake.

f) The Auditor should sensitize the bank on the benefits of effective risk management and structured risk process documentation so as to have all employees to be on the same level of risk understanding.

It should be noted that designing an effective risk framework is the responsibility of the bank management. They also need to ensure that the same is working effectively and efficiently. The measurement of risks and its monitoring has to be conducted in a structured manner, documented and evidenced so that the audit trail will enable the auditor to comment on the effectiveness of the risk management process in the bank.

g) Closure of audit issues within agreed timelines is another area which the Auditor should look into. It is the process gap which is resulting in the transactional errors that need to be corrected so that the errors are significantly reduced or completely eliminated.

h) Adequacy of coverage of areas under audit apart from the branch concurrent audit should be looked into. Functional areas, control aspects, geographical locations, ledger account items, non-quantitative factors should be duly factored to have a comprehensive, holistic coverage. The Auditor should specifically comment on the adherence to the Risk Based Internal Audit (RBIA) based on RBI circular no. DBS.CO.PP.BC.10/11.01.005/2002-03 dated December 27, 2002 on Risk-based Internal Audit read with RBI circular no. Ref.No.DoS.CO.PPG./SEC.04/11.01.005/2020-21 dated January 7, 2021 on Risk Based Internal Audit (RBIA) Framework – Strengthening Governance arrangements.

i) The Auditor may also consider the bank's compliance with any observation in the RBI risk assessment report on governance and assurance matters.

2. Balancing of Books/Reconciliation of control and subsidiary records

Special focus should be given on the system of control for internal accounts along with effectiveness of the system of monitoring the position of balancing of books/reconciliation of control and subsidiary records, with details of books not balanced, if any. The item wise details of system generated transitory accounts not nullified at the year-end should be given separately with ageing of such items.

3. The Auditor should obtain the list of accounts not balanced, reconciliation statements and study the process for reconciliation and also comment on the pending items finding reasons for non-closure of such entries. Auditor may also inquire on the process adopted by the bank to nullify transitory accounts on a regular basis throughout the year. If these processes are covered by internal / concurrent audit, the auditor may comment on the efficacy of the same.

3. Inter-branch Reconciliation

The effectiveness of the system of inter-branch / inter-office reconciliation with respect to each type of entries, along with sufficiency of audit trail should be examined and commented upon. Age-wise analysis of unreconciled entries for each type of entry covered under inter-branch reconciliation, as on balance sheet date along with subsequent clearance, thereof if any should be provided. Any unusual entries observed in the reconciliation process along with procedure for auto and forced matching of entries should be commented. Compliance with RBI guidelines with respect to provisioning for old outstanding entries, should be factored in the observations.

4. The Auditor should specifically look into the following:

a) Sufficiency of audit trail.

b) Unusual entries.

c) Ageing analysis.

d) Auto and forced entries.

e) Subsequent clearance.

f) Provisioning for old outstanding entries.

Post verification of these processes, gaps noted, if any, should be specifically commented by the Auditor with suggestions for improvement. The Auditor may also inquire on the process adopted by the bank for the above reconciliations on a regular basis throughout the year. If these processes are covered by internal / concurrent audit, the Auditor may comment on the efficacy of the same.

4. Frauds / Vigilance

Appropriateness of fraud risk management system and processes for early detection, timely reporting to RBI, investigation of frauds as also adequacy of provisioning with respect to reported frauds and deviations observed in compliance with directives issued by RBI should be examined and commented upon. Age-wise analysis of the cases/complaints investigated/under investigation of Vigilance Department along with observations on major frauds discovered during the year under audit be provided. Special focus should be given on the potential risk areas which might lead to perpetuation of fraud (e.g. falsification of accounts/false representation by the borrower; misappropriation of funds especially through related party / shell company transactions; forgery and fabrication of financial documents like invoices, debtor lists, stock statements, trade credit documents, shipping bills, work orders and encumbrance certificates and avail credit; Use of current accounts outside consortium where Trust and Retention Account (TRA) is maintained, to divert funds; list of debtors/ creditors were being fabricated and receivables were not followed up/ write off of debt of related parties; fake export/shipping bill, etc.; Over statement of invoice amounts, stock statements, shipping bills, turnover; fly by night operations -including the cases where vendors, related/ associate parties, manufacturing units etc. aren't available on the registered addresses; round Tripping of funds, etc.)

5. The Auditor should specifically check the anti-fraud policy of the bank and check whether the same is updated annually. Fraud awareness, trainings and sensitizations, drawing up fraud risk scenarios and mapping the existing anti-fraud controls to fraud risks should be verified by the Auditor. The existence of current systems to pro-actively prevent frauds from happening or

detect these frauds as soon as they have occurred to minimize losses, if any should be the key. For current fraud cases detected and reported, the bank should conduct a review to find out the threats and vulnerabilities to check what went wrong to ensure that these do not recur again.

6. RBI Master Directions on frauds should be checked by the Auditor for adherence. Some illustrations have been enumerated below but there could be various other likely scenarios which the Auditor should note. The Auditor should specifically look into cases of:

i. Diversion and siphoning of funds.

ii. Non-availability of primary security after the account turns NPA.

iii. Discrepancies in stock and book debts amounts as submitted to the bank in monthly stock statements and those verified by stock auditors or reflected in audited financials.

iv. Wilful defaults.

v. Money laundering.

vi. Manipulation of accounts, valuations, documents etc.

vii. Opening of current accounts in other banks without permissions.

viii. Related party transactions.

ix. Reactivation of dormant accounts.

x. Suspense accounts.

7. The Auditor should also look at the manner and time in which red flagged accounts (RFA) are declared as frauds or closed. Where the bank is the lead bank, the responsibility is greater to close out a RFA as fraud or otherwise. In case the bank is not the lead bank then the Auditor should examine the communication by the bank with the lead bank to follow up on the closure of the RFA cases within the prescribed time.

5. Suspense Accounts, Sundry Deposits, etc.

System of clearance of items debited / credited to suspense / sundry accounts should be examined with the focus on audit trail, along with age-wise analysis of un-cleared entries of suspense account, sundry deposit, etc. as on balance sheet date along with subsequent clearance, thereof, if any. Any unusual entries observed in suspense account, sundry deposit etc. should be specifically commented. An examination of inactive/ inoperative accounts may also be carried out, as it is a fraud prone area. It should also be examined, whether the bank has made adequate provision with respect to un-cleared entries in suspense account, sundry deposits, etc. as per the RBI guidelines and to the satisfaction of the auditor.

8. The Auditor should enquire about the reasons of opening the suspense accounts in the first place, who is authorized to pass and park entries in such accounts, whether there is an MIS or competent officials who monitor such accounts regularly.

9. Timely clearance and adequate provisioning, appropriate sign-offs, ratifications should all be verified by the auditor.

10. The Auditor should inquire on the process adopted by the bank to clear suspense and sundry deposit accounts on a regular basis throughout the year. If these processes are covered by internal / concurrent audit, the Auditor may comment on the efficacy of the same.

11. In core banking solutions, many of these suspense / sundry deposit accounts are auto generated. The Auditor should examine whether the balances are cleared in such auto generated accounts on a daily basis. Age wise analysis of amounts outstanding should be verified.

6. KYC / AML

It should be examined whether the bank has duly updated and approved KYC and AML policies in synchronization with RBI circulars / guidelines and whether the said policies are effectively implemented by the bank. Assessment of the effectiveness of provisions for preventing money laundering and terrorist financing may be provided for.

12. The Auditor should specifically refer the KYC-AML Master Circular issued by RBI and check adherence to the same by the bank. The Bank's internal policy should be in synchronization with this circular.

13. The Auditor should specifically obtain an understanding of and monitoring the efficacy of:

i. Process for identifying alerts especially the parameters laid down.

ii. Process for classifying and reporting suspicious transactions.

iii. Process for white washing transactions and documentation.

iv. Periodical reviews of the aforesaid process and rectification of gaps if any.

v. Adherence to FATCA regulations.

vi. Adequacy and sanitization of data on record to conduct meaningful analysis.

vii. Training and sensitization of personnel.

viii. Process of filing documents with the FIU.

7. Cash and other security items

System of monitoring of cash at branches, and management of cash through currency chest operations, including adequacy of insurance cover, system and procedure for physical custody of cash, systems and controls for procurement, issue and custody of valued stationary items such as cheque books, demand drafts, pay orders, gold coins etc. should be examined.

14. The Auditor should specifically look into:

i. Process of arriving at cash retention limits.

ii. Rationale and basis for insuring cash and other security items.

iii. Control over custody of cash and security items.

iv. Disposal and recording / reporting of fake notes.

v. Liquidity issues.

vi. Opportunity loss due to excess cash holdings.

vii. Disposal of unwanted security items.

8. Para-Banking Activity

It should be examined whether the bank has effective internal control system with respect to para-banking activities undertaken by the bank. A list of such para-banking activities undertaken by the bank should be provided.

15. The Auditor should obtain a list of para-banking activities handled by the bank and the internal process notes regarding handling of such activities. Some areas that could be looked into by the Auditor are risks of mis-selling, training and accreditation as well as renewals, realistic setting of targets, receipt of commission and business handled versus targets set. The Auditor may also inquire about the manner of adherence by the bank to respective regulations (e.g. insurance, mutual funds, pension etc.) and the process of monitoring it as well as the findings of internal / concurrent audit.

9. Management Information System

Existence and adequacy of management information system, method of compilation and accuracy of information, appropriateness of procedures for preparation of supervisory returns and its reliability under the off-site surveillance system of the RBI, reliability of information flow for the internal risk management system should be commented. Additionally, comment should also be provided on whether the bank has effective system of preparation and consolidation of branch returns and financial statements.

16. The Auditor should request the management for a list of the regular MIS that it prepares for various levels of top and senior management. On the basis of the MIS, the Auditor should specifically check:

i. The list of returns that the bank needs to file to RBI and other regulators and the periodicity of filing along with the data to be submitted.

ii. The source of origination of data from the system, the method of compilation, consolidation and verification by various officials to ensure accuracy before submission.

iii. Process of validation of accuracy by external sources apart from the original maker-checker.

iv. Any gaps in design of compilation of MIS should be plugged.

v. Manual compilation should be gradually eliminated and automated.

10. Any Other comments relating to People, Process and System Risks

Any other concerns relating to people, process and system risks may be commented upon

17. It is known that the preparation of financial statements of a bank is a combination of work done by people through systems and with processes.

18. There could be various activities carried out within a bank from start to finish especially intermediate activities which may not directly impact a ledger output however if these activities are not implemented or executed effectively and efficiently they may have a financial impact. It is these key or critical activities that should be focused.

19. The Auditor should note the areas not specifically commented above. These could be reported from:

i. Individual material ledger accounts in trial balance.

ii. Key activity or sub-activity carried out by the bank where errors could have substantial financial impact. The SOPs could be verified for this aspect to identify such areas.

iii. Persons handling various functions whose job profile does not directly impact a financial transaction. These could be obtained from the organizational chart and also off-roll contractual employees and the work done by them.

iv. Key processes and systems should be listed down by the bank and given to the auditor and be checked for structure and documentation. The Auditor should inquire whether:

   a. The bank has a regular process and system reviews for re-engineering efficacy and effectiveness.

   b. Identification of redundant process to be eliminated and replaced by automated process with inbuilt corrective controls is done.

   c. Cost of operations is constantly measured for reduction.

   d. Benchmarking to best practices is done.

v. In case the reports or detailed listings are not available to the Auditor, he should report the same appropriately in the LFAR with consequential impact on risk, controls and profitability.

20. It should be understood that the areas for checking are vast and the Auditor needs to understand and consider all facts to arrive at his judgment. This would need complete clarity on the objective of reporting in the LFAR. Focus will always be on addressing of residual risks resulting in gaps which need to be cured from the root. The purpose of LFAR is to highlight material deficiencies if any in working of banks. Appropriate use of work done by Concurrent Auditors, noting down observations in previous year LFAR, discussions with Branch and other function heads, discussions with other peer bank auditors, guidance issued by the ICAI should be duly considered. The Auditor should discuss the draft LFAR with the appropriate authorities in the bank, duly incorporate their responses before finalizing the LFAR within set deadlines.

IV

Capital Adequacy

1. The format of LFAR requires auditors to offer their comments on the following aspects of capital adequacy:

- Capital adequacy
- ICAAP Document

Capital Adequacy

A copy of the capital adequacy certificate be provided along with comments as to whether the bank has effective system of calculation of capital adequacy as per the directives of RBI. Any concerns which is considered material relating to the bank's solvency and capital may be commented upon.

2. The calculation of capital adequacy is made in accordance with methodology defined in RBI Master Circular No. RBI/2015-16/58 DBR.No.BP.BC.1/21.06.201/2015-16 dated July 1, 2015 on Basel III Capital Regulations. The major components of capital adequacy calculation are eligible total capital, credit risk RWA, market risk RWA and operational risk RWA. Detailed information about aforesaid four components is provided in Guidance Note on Audit of Banks 2021 edition, Section A- Statutory Central Audit, Chapter 13- Risk Management Department.

3. The Auditor should conduct a process walkthrough to understand the process of calculation of each component of capital adequacy calculation. The calculation of credit risk RWA and market risk RWA are generally carried out through a software or it may be spread-sheet driven.

4. In respect of credit risk RWA, the details like credit ratings, security value, nature of security, etc. are updated in software based on returns submitted by Branch Auditors. The Auditor should verify on sample basis that details are updated correctly in the software.

5. In respect of market risk RWA, the major input is from the Treasury Department. In many banks, the output from treasury software is uploaded in software used for calculating market risk RWA. The Auditor should verify whether important components like market value of AFS, HFT portfolios, type of securities, ratings of securities, open positions in forex and derivatives, etc. are correctly uploaded. Inquiry should be made by the Auditor whether the reports from treasury software are correctly entered in software used for calculating market risk RWA.

6. The Auditor may ask the management for interface audit report & functional audit report in respect of software used for calculation of RWA.

7. In respect of operational risk RWA, the Auditor should verify whether gross income has been calculated correctly for previous three years.

8. In respect of calculation of eligible total capital, the auditor should verify that only eligible components are included in Tier I and Tier II capital. Specific attention should be provided w.r.t. deduction in respect of reciprocal cross holdings.

9. If the Auditor finds any lacunae in respect of calculation or controls in the process, the same should be reported in LFAR. Also, any suggestions for improvement required for strengthening controls in the process may be reported in LFAR.

ICAAP Document

Whether stress test is done as per RBI stress test guidelines. Whether assumptions made in the document are realistic, encompassing all relevant risks. Also, banks strategies are aligned with their Board approved Risk Appetite Statements.

10. The new capital adequacy framework (NCAF), based on the Basel II Framework evolved by the Basel Committee on Banking Supervision, was adapted for India vide RBI Master Circular No. RBI/2006-2007/357DBOD.No.BP.BC.90/20.06.001/ 2006-07 dated April 27, 2007 on Prudential Guidelines on Capital Adequacy and Market Discipline –Implementation of the New Capital Adequacy Framework. In terms of paragraph 2.4 (iii)(c) of

the Annex to the aforesaid circular banks were required to have a Board-approved policy on internal capital adequacy assessment process (ICAAP) and to assess the capital requirement as per ICAAP. It is presumed that banks would have formulated the policy and also undertaken the capital adequacy assessment accordingly.

11. An illustrative outline of the format of the ICAAP document, to be submitted to the RBI, by banks, is as under:

I. Executive Summary

II. Background

III. Summary of current and projected financial and capital positions

IV. Capital Adequacy

V. Key sensitivities and future scenarios

VI. Aggregation and diversification

VII. Testing and adoption of the ICAAP

VIII. Use of the ICAAP within the bank

12. The Auditor should go through the ICAAP document to review whether stress test framework mentioned in ICAAP is as per RBI Guidelines on stress test mentioned in RBI circular no. RBI / 2006-07/444 DBOD.No.BP.BC.101/21.04.103/2006-07 dated June 26, 2007 on Guidelines on Stress Testing and circular no. RBI/2013-14/390 DBOD.BP.BC.No.75/21.04.103/2013-14 dated December 2, 2013 on Guidelines on Stress Testing. Stress testing is an integral part of the ICAAP, which requires banks to undertake rigorous, forward looking stress testing that identifies severe events or changes in market conditions that could adversely impact the bank. The reports on stress testing may be placed in Risk Management Committee (RMC) and Asset Liability Management Committee (ALCO) of the bank. The RBI has suggested stress testing scenarios (shocks) to be applied for stress testing including reverse stress testing scenario. The Auditor should review minutes of meetings of these committees to identify directions and suggestions given by the committee

members based on stress testing report and the action taken thereon.

13. Though RBI has suggested shocks to be applied, the bank is expected to carry out detailed risk analysis and develop stress testing scenarios based on the analysis. The scenario analysis and the future business projections needs to be discussed with the management of the bank and should be asked to substantiate as part of management representation letter / investors' presentations / availability and validity of the business licenses (like primary dealership / IBU / Branch licenses, etc.)

14. The Auditor should review the ICAAP document, assumptions thereon, minutes of meetings of RMC & ALCO and stress testing results to verify whether the results of the same are within the acceptable level in risk appetite statement. If the same are not within the acceptable level in risk appetite statement, then the Auditor should check whether corrective actions are initiated by the Bank.

15. The Auditor should report the process used by the bank for stress testing, basis for assumptions and action taken, in case where results of stress test scenarios are not within the acceptable levels of risk appetite statement.

V

Going Concern and Liquidity Risk Assessment

1. The format of LFAR requires auditors to offer their comments on the following aspects of going concern and liquidity risk assessment:

1. Going Concern Assessment
2. Profitability
3. Liquidity assessment

1. Going Concern Assessment

The auditor should comment whether the going concern basis of preparation of financial statements is appropriate; and Auditor's evaluation of the bank's assessment of its ability to continue to meet its obligations for the foreseeable future (for at least 12 months after the date of the financial statements) with reasonable assurance for the same. Any material uncertainties relating to going concern should be disclosed.

2. Standard on Auditing (SA) 570 (Revised), "Going Concern" states as under:

"The Auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern."

3. As part of process of assessing bank's ability to continue to meet its obligations in near future, the Auditor should review inter-alia asset liability management reports submitted to ALCO, Board of Directors and RBI. The Auditor should review the projected financials/ budget prepared by the Bank and presented to Board of Directors. Further, the Auditor may also consider the bank's

projected / forecasted financials presented to him as evidence of virtual certainty if deferred tax asset is created on unabsorbed losses by the bank. It is recommended that the Auditor obtains from the bank a formal document of its own annual assessment of going concern.

4. The Auditor should mention the evidence obtained to review bank's assessment to continue as going concern and its ability to meet its obligations. If the Auditor observes that management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, he should express an opinion in accordance with SA 570(Revised) and report appropriately in the LFAR.

2. Profitability

Analysis of variation in major items of income and expenditure compared to previous year should be carried out along with important ratios such as RoA, RoE, etc.

5. The Auditor should obtain variances for each head of balance sheet and profit & loss account as compared to previous year and important ratios like return on asset, return on equity, net interest margin, capital adequacy ratio, return per employee, interest income to non-interest income, etc.

6. The Auditor should ask the management reasons for such variances and verify whether the explanations provided by the bank are proper. Usually such an analysis is done by the bank in its memorandum placed to the Audit Committee as well as the Board of Directors while adopting the financial statements. The Auditor may use this memorandum as a point of reference.

3. Liquidity Assessment

As a part of assessment of the bank on going concern basis, the Auditor should also consider the robustness of the bank's liquidity risk management systems and controls for managing liquidity, any external indicators that reveal liquidity or funding concerns, the availability of short-term liquidity support and compliance with norms relating to liquidity coverage ratio (LCR) and net stability funding ratio (NSFR- as and when applicable) among others.

7. The Auditor should refer RBI circular No. 2012-13/285 DBOD. BP. No. 56/ 21.04.098/ 2012-13 dated November 7, 2012 on Liquidity Risk Management by Banks, circular RBI/2013-14/635 DBOD.BP.BC.No.120/21.04.098/2013-14 dated June 9, 2014 on Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards and circular RBI/ 2019-20/ 217 DOR. BP. BC.No.65/21.04.098/2019-20 dated April 17, 2020 on Basel III Framework on Liquidity Standards –Liquidity Coverage Ratio (LCR) and annexures to the same to review the compliance by the Bank with guidelines for Liquidity Risk Management.

8. The LCR promotes short-term resilience of banks to potential liquidity disruptions by ensuring that they have sufficient high quality liquid assets (HQLAs) to survive an acute stress scenario lasting for 30 days. The NSFR promotes resilience over longer-term time horizons by requiring banks to fund their activities with more stable sources of funding on an ongoing basis. As per the RBI guidelines, the LCR should be minimum 100 %. The stock of unencumbered HQLAs is intended to serve as a defence against the potential onset of liquidity stress.

9. The Auditor should obtain the Board approved policies for asset liability management (ALM), Liquidity Risk Management and Liquidity Coverage Ratio (LCR).

10. The RBI guidelines define stress test scenarios to be applied to LCR to assess that the Bank has sufficient liquidity on hand to survive for upto 30 days.

11. The Auditor should inquire of the analysis done by the bank for any liquidity mismatch i.e. gap in asset and liability in each maturity bucket and how the bank is managing its funds to cover such mismatch. The Auditor should review the minutes of meetings of ALCO and RMC to identify the directions by such Committees in respect of liquidity mismatches and liquidity risk management and the action taken thereon.

12. The reports of stress test scenarios for ALM & LCR as discussed above shall be reviewed by the auditor to assess whether the risks are within the acceptable limits and the bank has sufficient liquidity on hand to survive for upto 30 days.

13. The Auditor should conduct a process walkthrough to understand process of preparation of ALM report and LCR. Also, the auditor should verify that the bank has adequate controls - manual and IT related in respect of importing data from various software which is used to prepare ALM report and calculate LCR/NSFR. If the bank is using any software, the Auditor should review the interface audit report and functional audit report of the software.

14. The Auditor should mention the bank's process for managing liquidity risk and calculating /preparing relevant ratios / reports. Also, the Auditor should mention evidence obtained to verify the compliance with RBI guidelines and adequacy of controls in the process.

VI

Information Systems

1. The format of LFAR requires auditors to offer their comments on the following aspects of information systems:

1. Robustness of IT Systems
2. IT Security and IS Policy
3. Critical Systems / Processes

1. Robustness of IT Systems

Auditors should comment on the robustness of IT systems covering all the software used by the bank along with functions thereof, inter-linkage/interface between different IT systems, ATM network and its security, payment system products and services, among others. Further, it should be examined whether the software used by the bank were subjected to information system & security audit, application function testing and any other audit mandated by RBI. Adequacy of IS audit, migration audit (as and where applicable) and any other audit relating to IT and cyber security system and bank's compliance to the findings of those audits should be commented upon.

2. ***IT Security and IS Policy***

Auditors should comment whether the bank has duly updated and approved IT Security and IS Policy and whether the bank has complied with the RBI advisory/directives relating to IS environment/cyber security, issued from time-to-time.

2. In this regard, it should be noted that the Auditor should ask the bank to identify and give the list of RBI advisories, alerts etc. This is because not all of them are in public domain. The bank should give such a list and compliance with it, which the Auditor should verify.

3. The Auditor needs to understand the entire information system and technology ethos of the bank. While the auditor may adopt to perform test work on systems that are relevant for financial reporting, the auditor may adopt alternative approaches such as reviewing reports of internal/ system audits and other such mechanism w.r.t systems that do not have a direct bearing on financial reporting. A walk through of all these systems and processes should be done by the Auditor at the initial stages of the audit. Similarly, a review of the internal audit reports or any external review / audit reports on the adequacy of the IT hardware, software, networking, applications including the core software, cyber security etc. should be done by the Auditor. The open issues of such reports will indicate to the Auditor, vulnerabilities, if any, in these systems and processes. The auditor should inquire with the bank its mechanism and plan to rectify the open issues and implement controls. Till such controls are implemented, the Auditor should examine the mitigating controls the bank would have in place.

3. Critical Systems / Processes

It should be examined whether there is an effective system of inter-linkage including seamless flow of data under straight through process (STP) amongst various software / packages deployed. Special emphasis should be placed on outsourced activities and bank's control over them, including bank's own internal policy for outsourced activities.

4. The Auditor may inquire about the controls within the bank to ensure that flow of data between various systems is accurate. This could include perusing the reports that the bank's IT management uses to be satisfied that the controls are effective.

5. The questions given under point VI- information systems of LFAR are inter-related and answers to these questions will have to be with reference to addressing the following aspects:

i. To have a proper understanding and the right perspective to address these questions, the Auditor is required to:

- Obtain the list of all the software used by the bank along with functions thereof.
- Obtain the details of critical reports generated by various software relied upon by the bank in discharging its management functions.
- Analyse and determine the critical reports generated by various software on which the auditor can place reliance while conducting the audit
- Obtain list of outsourced services availed by the bank.

ii. Special emphasis should be given on continuous monitoring of classification of accounts into standard, SMA, sub-standard, doubtful or loss as per IRAC Norms by the system, preferably without manual intervention, correct recognition of income, and adequacy of provision thereof. Effectiveness of the system for compiling data relating to NPA and their provision, data integrity, system of suspension of charging of interest and adherence thereto, should be examined and commented upon. Deviations observed, if any, should be provided along with requisite examples. In this regard, the Auditor is suggested to refer to RBI circular no RBI/2020-21/37 Ref.No.DoS.Co.PPG./SEC.03/11.01.005/2020-21 dated September 14, 2020 on "Automation of Income Recognition, Asset Classification and Provisioning processes in banks". Adherence to the said circular would be one of the crucial aspects of reporting under LFAR.

iii. Review of management information system for existence and adequacy, method of compilation and accuracy of information, appropriateness of procedures for preparation of supervisory returns and its reliability under the off-site surveillance system of the RBI, reliability of information flow for the internal risk management system. Moreover, review of effectiveness of the system of preparation and consolidation of branch returns and financial statements will also provide the Auditor with information about the MIS.

iv. Technology outsourcing framework of the bank should be documented which must include IT related outsourcing process. This process should be formulated after considering all the guidance and circulars issued by regulatory authorities such as RBI for instance Circular No. RBI/2010-11/494 DBS.CO.ITC.BC.No.6/31.02.008/2010-11 dated 29 April 2011 on "Working Group on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds- Implementation of recommendations". Key areas to be covered and commented upon in LFAR as per the framework are (but not limited to):

- Broad category of IT activities outsourced by the bank.
- Governance structure for IT outsourcing e.g. role of the Board and IT Steering Committee.
- Audit coverage and annual compliance certificate.
- Assessment of outsourced IT activities i.e. materiality, risks & controls and data sensitivity assessments.
- Periodic review of service providers.
- Business continuity and agreement covering legal obligations.
- Understand the restrictions pertaining to outsourcing of activities as stipulated by RBI from time to time.

v. Banks offer various services such as internet banking, mobile banking, credit card/debit Card, IMPS, RTGS, NEFT, ATM, Aadhar based payment and prepaid instruments. Digital banking involves high levels of process automation, web-based services and may include APIs enabling cross institutional services, use of payment gateway. Seamless flow of transaction within fraction of second supported by integration of various applications is possible only with the help of third-party service providers. The Auditor should get understanding of and appropriately comment in LFAR upon having observations on:

- Digital products offered by banks.
- Involvement of third-party service providers, NPCI, VISA, Master, aggregator, payment gateways, debit card/ credit card manufacturing company.
- Flow of Transactions of each product.

- Customer on-boarding process, authentication, and OTP generation.
- Daily reports generated from the bank's own system and received from vendors.
- Bank's mechanism of monitoring vendors.
- RBI guidelines on digital products and for third party service providers.

vi. In addition to the above, it is necessary that the Auditor comments on the following:

- Whether the bank has complied with the RBI directives related to IS environment?
- Whether there is an effective system of inter-linkage including seamless flow of data under straight through process amongst software?
- Whether the bank is having an effective internal control system to ensure that all the software(s) used by the bank are inter-linked with adequate controls?
- Whether the bank has effective interface of its internal software with software of the outside entities? Obtain and provide the list of such inter-phases.
- Has the Auditor obtained the required certificates to rely on the effectiveness of the inter-linkage / interface of the software as per requirements of SA 620, "Using the work of an Auditor's Expert", when such an expert is used by the auditor?
- Whether the Auditor is satisfied with respect to such outsourced services availed by the bank in compliance with requirements of SA 402, "Audit Considerations relating to an Entity using a Service Organisation"?
- Whether the software used by the bank was subjected to information system & security audit, application function testing and any other audit mandated by RBI?

6. It is suggested that the Guidance Note on Audit of Bank 2021 Edition should be referred by the members as it elaborates the concepts of IT system audits.

VII

Other Matters

1. The format of LFAR requires auditors to offer their comments on the following aspects of other matters:

1. Comments on accounting policies including comments on changes in accounting policies made during the period.

2. The Auditor should comment whether accounting policies of the bank are in synchronization with the applicable financial reporting framework and these accounting policies are consistently followed. The present financial reporting framework is the Companies (Accounting Standards) Rules, 2006, Accounting Standards issued by ICAI and various RBI Guidelines. Changes, if any, in accounting policies made during the period should be quantified and reported.

2. Adequacy of provisions made for statutory liabilities such as Income Tax, Gratuity, Pension, Provident Fund, etc.

3. While these provisions would be considered during finalisation of accounts as inadequacy or excess of these provisions would impact the true and fair view of financial statements, if material, the LFAR requires specific reporting on these provisions. In case of banks with overseas operations, adequacy of provisions for any overseas liabilities also needs to be commented upon.

3. Adequacy of provisions made for off-balance sheet exposures and other claims against the bank.

4. In the course of finalisation of accounts, the Auditor would need to duly consider all off-balance sheet exposures and other

claims against the bank and consider the consequential provisioning, since any shortfall in provisioning will impact the true and fair view of financial statements, if material.

5. The Auditor should specifically comment on the adequacy of these provisions noting the top cases and commenting on them in more detail especially on the rationale that is used by the bank in determining the amount of provision. Reference to latest legal position could be made by the auditor.

4. Balances with other banks - observations on outstanding items in reconciliation statements.

6. The Auditor should ensure that reconciliation for all bank accounts is done periodically (daily ongoing for active key accounts). The Auditor should specifically comment on pending items in reconciliation covering why these items could not be reconciled or appropriately adjusted, any gaps in the reconciliation process and what should be done to set the process right. Adequacy of provisioning, if any, should also be considered.

5. Procedure for revaluation of NOSTRO accounts and outstanding forward exchange contracts.

7. The Auditor should obtain a listing of all NOSTRO accounts and obtain the policy for revaluation of these accounts. While the revaluation at the year-end will be verified and necessary entries to give effect would be a key item of checking for determining the true and fair view of financial statements, the LFAR requires the Auditor to comment on the process of reconciliation. Maker-checker controls, adherence to policy and regulations, accuracy of calculations and automation of systems to compute revalued amounts should be verified and gaps, if any, and suggestions for improvement to be appropriately reported.

6. Comment on system related to compliance with DEAF norms be provided.

8. The Auditor should familiarize himself with the updated DEAF norms. The procedure followed by the bank to identify accounts eligible for transfers to DEAF and the timing of the transfer should be seen. Automation of systems to be commented. Comments of RBI or other auditors on transfers to DEAF in earlier years or current year concurrent audit should be looked into as to whether these comments have been addressed and closed.

7. Comment on compliance mechanism with regard to recommendations of specific committees appointed by RBI such as Ghosh, Jilani, Mitra, etc.

9. The Auditor should specifically obtain the list of applicable committees and note their recommendations. The procedure within the bank for implementing these recommendations along with the timelines prescribed should be verified. Any non-compliance identified by the internal monitoring mechanism of the bank or noticed by the auditor during the course of his audit of the bank, should be appropriately reported. The Auditor should look into the process followed by the bank to list out the key recommendations of these committees and whether the appropriate internal authorities or committees have been intimated of the same. The implementation of these accepted recommendations should be tracked for implementation as per deadlines.

10. The Auditor should obtain from the bank whether it has captured the essence of these committees' recommendations into implementable actionable items. It is the presence of such an identifiable process that needs to be commented upon. Banks should have a process to identify applicable actionable items from each committee recommendations with an internal review decision making for its inclusion as an operational deliverable within a defined timeline.

11. Ghosh, Jilani and Mitra Committees' recommendations have been specifically covered in the LFAR, so reporting at a minimum should be made on the recommendations of implementable actionable items from them.

8. Observations on the working of subsidiaries/ associates/ joint ventures of the bank:

(a) Reporting system to the holding bank and

(b) Major losses of the subsidiary, if any.

12. The Auditor should specifically obtain a listing of all subsidiaries, associates and joint ventures of the bank. The reporting systems of these subsidiaries, associates and joint ventures should be studied. A detailed note on the working process obtained, including in-built controls for ensuring timeliness, accuracy and completeness of reporting should be verified and appropriately reported. Pending adverse, material issues from audit / inspection reports of these subsidiaries, associates and joint ventures should be obtained and commented.

13. The Auditor should comment on any major events pertaining to these subsidiaries / associates / joint ventures e.g. business restructuring, hiving off, sale in process etc.

14. The Auditor should inquire about the bank's strategy to turnaround any major losses of subsidiaries, associates and joint ventures. In case the bank has guaranteed or committed capital infusion into any of these entities, then the same needs to be reported. Reasons for the losses and analytical comparison with previous year should be done.

9. Comment on business conduct including customer service by the bank describing instances, if any, of wrong debit of charges from customer accounts, mis-selling, ineffective complaint disposal mechanism, etc.

15. The Auditor should familiarize himself with the RBI circulars and other instructions on customer service in banks. The internal processes for recording, handling and closing complaints should be noted and gaps if any to be reported. Analysis of areas in which complaints are received and steps taken to appropriately address them for closure / reduction should be verified. Number of complaints and their resolution should be specifically disclosed.

16. Steps taken to improve customer service including trainings for sensitization, enhancement of quality noting all points of contact should be commented upon. Existence of customer service manuals, external audits to verify efficiency of customer service, usage of service scores or other methods adopted for maintaining quality consistently should be verified and reported.

10. Any other matter, which the auditor considers should be brought to the notice of the management.

17. While all the areas listed down in the LFAR including the above nine items should be commented upon, there could be various issues which could not necessarily come under specific purview of these lists. The Auditor should bear in mind that these points are illustrative and any other material observation which the auditor considers it necessary to be brought to the notice of the management need to be specifically commented.

Section B –
Long Form Audit Report in Case of Bank Branches

A. Guiding Principles on Objective, Strategy, Scope and Coverage of LFAR for Branch Auditors

As per the RBI circular RBI/2020-21/33 Ref.No.DOS.CO.PPG./SEC.01/11.01.005/2020-21 dated 05.09.2020 on Long Form Audit Report (LFAR) - Review, the Long Form Audit Report (LFAR) has been revised, keeping in view the large scale changes in the size, complexities, business model and risks in the banking operations. The revised LFAR formats are required to be put into operation for the period covering Financial Year 2020-21 and onwards. The mandate and scope of the audit will be as per this format and if the SCAs feels the need of any material additions, etc., this may be done by giving specific justification by the SCAs and with the prior intimation of the bank's Audit Committee of Board (ACB).

i. The overall objective of the branch audit should be to have transaction testing and provide inputs to the Statutory central Auditors on adequacy of implementation of various policy and regulatory requirements, including efficacy of the system and assurance functions (risk management, compliance and internal audit) at branch level.

The Long Form Audit Report for the Branches is an important input for Statutory Central Auditors as well as Bank Management which provide information about compliance by Branches with RBI guidelines/directives/instructions and Head office instructions. LFAR does not only expect to bring out transaction level issues but also expect comments on adequacy of controls.

ii. The threshold fixed for different purposes for comments in the LFAR will decide that above the threshold, the transaction detailing needs to be seen and commented upon. However, below the threshold, the system and processes should be checked and commented upon.

In revised LFAR, the RBI expects transaction level comments on Large Borrower and details about sampling. At the same time it is expected from auditors to review the process for accounts below threshold. Hence, it is expected that auditors give equal importance to transaction testing as well as review of processes. Auditors should document properly the extent of checking including the materiality level and sample selected.

iii. Verification of data integrity and data related control systems and processes should be carried out and commented upon, with the special thrust on those data inputs which are to be used for MIS at corporate office level and for supervisory reporting purposes.

Since all banks are now on core banking system, the availability of data centrally facilitates not only in audit but also in decision making for top management. However, the data available centrally will be useful only if the MIS generated from such data is correct. Since the correctness of data depends on information entered at the branch level, the controls at the branch gain importance. Hence, auditor is expected to test various controls like input, data integrity at the branches and comment on the same.

iv. Where any of the comments made by the auditors in their LFAR is adverse, they should consider whether a qualification in their main report is necessary. It should not, however, be assumed that every adverse comment in the LFAR would necessarily result in a qualification in the main report. In deciding whether a qualification in the main report is necessary, the auditors should use their professional judgment in the facts and circumstances of each case.

As the branch LFAR is an input to SCAs, auditors should write descriptive answers to questions in LFAR and wherever possible substantiate the answers by including facts, figures and examples to the extent possible. Auditor should test the impact of adverse comments in LFAR and check whether such comments warrant any qualification in main audit report or financial adjustment through MOC. A comment on inadequacy of controls may not result in qualification in main audit report but a comment on depletion in valuation of security may require an adjustment through MOC.

I-1

Assets – Cash

a. Does the system ensure that cash maintained is in effective joint custody of two or more officials, as per the instructions of the controlling authorities of the bank?

The auditor should obtain the Bank's policy regarding the custody of cash and verify during the audit whether cash is maintained in effective joint custody of two or more officials as per the policy. The auditor should verify the process of opening and closing of cash chest and confirm that during the audit, the said process is carried out effectively by two or more officials. Further, the auditor should verify the cash registers / CBS records to confirm that there is proper maker / checker, preparer / authorizer present for all transactions / activities.

The auditor should verify Concurrent Audit Report (if any)/ Internal Inspection reports (if any) for the period under audit and check whether there are any adverse comments in these reports.

b. Have the cash balances at the branch/ATMs been checked at periodic intervals as per the procedure prescribed by the controlling authorities of the bank?

The auditor should obtain the Bank's policy regarding the physical verification of cash at the branch / ATMs and verify during the audit whether cash is checked properly as per the requirements of the said instructions.

The auditor should verify whether surprise verification of cash balances is carried out by the branch head / officer from other branches during the year under audit and comment.

During the audit, the auditor should verify cash register and ATM related records at the branch / ATMs and verify whether the procedure prescribed by the bank regarding verification of cash at periodic intervals is followed.

c (i) Does the branch generally maintain / carry cash balances, which vary significantly from the limits fixed by the controlling authorities of the bank?

The auditor should obtain the bank's policy regarding retention of cash at branches. Also verify the retention limit prescribed for the branch under audit and any modification issued for the same during the year. Based on the amount of retention limit, the auditor should verify the closing cash balance held by the branch throughout the year under audit and comment whether the branch has maintained cash balance which vary significantly from the limits fixed by the controlling authorities.

The auditor should decide based on his judgment, the materiality threshold limit and report all the dates on which the cash balance was carried more by the branch in following format:

"It was observed that the cash balance at the branch was held beyond the retention limit on ___ number of days during the year under audit. Following are instances of excess cash balances held at the branch above ___ (depending on materiality level) of retention limits during the year:"

Date	Retention Limit Rs.	Closing Balance of Cash Rs.	Excess Rs.	% of Excess

c (ii) Does the figure of the balance in the branch books in respect of cash with its ATM(s) tally with the amounts of balances with the respective ATMs, based on the year end scrolls generated by the ATMs? If there is any difference, same should be reported.

The auditor should obtain closing reports for cash balance at ATMs (Online/Offline) and verify the same with closing reports / year end scrolls generated by the ATMs as on the year end (31st March). The auditor should report the difference, if any, in following format:

ATM Balance as per GL	Balance as per ATM Scroll	Difference	Branch Remarks	Auditor's Remarks

There is possibility that ATM scroll is generated other than day end time, hence the balance as per scroll and balance as per GL may be different. In such case, the Auditor should request the branch to provide reconciliation for difference.

d. Whether the insurance cover available with the branch adequately meets the requirement to cover the cash-in hand and cash-in transit?

The auditor should obtain cash insurance policy of the Bank (generally details are provided in annual closing instructions) and verify the amount of Insurance for cash in hand and cash in transit. The auditor should verify whether during the year under audit, cash balance was maintained at the branch over and above the amount insured and report.

I-2

Assets - Balances with RBI, State Bank of India and Other Banks (For Branches with Treasury Operations)

a. Were balance confirmation certificates obtained in respect of outstanding balances as at the year-end and whether the aforesaid balances have been reconciled? The nature and extent of differences should be reported.

The auditor should verify the balance confirmation certificates in respect of outstanding balances at the year-end in case of accounts maintained with RBI, SBI and other banks by the branch and verify the general ledger balance. The auditor should verify the reconciliation statement prepared by the branch (for all the 12 months of the year under audit) and comment about the same.

b. Observations on the reconciliation statements may be reported in the following manner:

(i) Cash transactions remaining un-responded (give details)

The auditor should verify the reconciliation statement prepared by the branch and check whether item/ (s) of cash withdrawal and deposit remained un-responded. The auditor should verify the reasons for the same and report accordingly.

(ii) Revenue items requiring adjustments / write-off (give details)

The auditor should verify the reconciliation statement prepared by the branch and comment about the items of income and expenditure appearing in reconciliation which should have been accounted for by the branch during the year under audit. If they are above the materiality threshold limits, the auditor should suggest appropriate MOC for the same.

(iii) Other credit and debit entries originated in the statements provided by RBI/other banks, remaining un-responded for more than 15 days:

The auditor should verify the reconciliation statement prepared by the branch and comment about the other items appearing in reconciliation along with appropriate narrations and report about the same in LFAR. If they are above the materiality threshold limits, and require accounting in the financial statements of the branch as at year end in opinion of the auditor, then suggest appropriate MOC for the same.

(iv) Where the branch maintains an account with RBI, the following additional matter may be reported:

Entries originated prior to, but communicated/ recorded after the year end in relation to currency chest operations at the branch/other link branches, involving deposits into/ withdrawals from the currency chest attached to such branches (Give details)

In case if the account is maintained with RBI, the auditor should verify the reconciliation statement prepared by the branch and check whether reconciliation statement contain any entry originated prior to, but communicated/ recorded after the year end in respect of cash withdrawal and deposit for currency chest operation. The auditor should verify the reasons for the same and report accordingly. The auditor should also give details of such transactions.

c. In case, any matter deserves special attention of the management, the same may be reported.

The accounts maintained with RBI, SBI or Other Banks are generally operated for specific type of transactions. The auditor should verify the transactions recorded in these general ledger accounts (maintained in CBS) with the transactions reflected in bank statements throughout the year, on test check basis and comment about the same.

I-3

Assets - Money at Call and Short Notice

a. Has the branch kept money-at-call and short notice during the year?

- The auditor should confirm whether the branch is designated branch.
- In case of a designated branch, the auditor should obtain details of transaction entered throughout the year and verify the same with relevant documents.

b. Has the year-end balance been duly confirmed and reconciled?

- In case of designated branches – The auditor should check & verify transactions related to money at call and short notice with banks and other institutions on sample basis.
- The auditor should verify the year end balances under the relevant sub-heads, with reference to:
  - The relevant deposit receipts.
  - The relevant correspondence in case of subsequent squared up transactions.

  and the auditor should ascertain whether the aggregate balances comprising these as shown in the relevant register/ system generated report, tally with the control ledger as per general ledger.
- The auditor should verify confirmation of balances as on 31^{st} March with the bank where the funds are parked.

c. Has interest accrued upto the year-end been properly recorded?

- The auditor should verify and check interest adjustments made upto the year end based on terms on which moneys were placed at call or short notice.

d. Whether instructions / guidelines if any, laid down by the controlling authorities of the bank have been complied with?

- The auditor should obtain the instructions/ guidelines laid down by the controlling authorities of the bank and examine the compliance thereof.

I-4

Assets – Investments (For Branches outside India)

a) In respect of purchase and sale of investments, has the branch acted within its delegated authority, having regard to the instructions/ guidelines in this behalf issued by the controlling authorities of the bank?

- The auditor should obtain the instructions issued by the controlling authorities of the bank and check compliance thereof.

b) Have the investments held by the branch whether on its own account or on behalf of the Head office/ other branches been made available for physical verification? Where the investments are not in the possession of the branch, whether evidences with regard to their physical verification have been produced?

- The auditor should obtain bifurcation of the investments into those held physically and those held in other forms such as dematerialised or with the head office.
- The auditor should verify the investments physically held (i.e. certificates). In respect of investments not held in physically at the branch or not held in physical form, the auditor should verify the relevant documents like Demat statement, custodian reports, confirmation from other branch.
- The auditor should verify whether investment register (physical or in software) is maintained as per the prescribed guidelines by Head Office and it is upto date.
- The auditor should verify the recording of sale and purchase transactions of securities on sample basis to check that transactions are recorded timely and correctly.

c) Is the mode of valuation of investments in accordance with the RBI guidelines or the norms prescribed by the relevant regulatory authority of the country in which the branch is located whichever are more stringent?

- The auditor should obtain the relevant guidelines of regulatory authority of the country and compare those with the guidelines issued by RBI and check compliance thereof based on conservative principal of whichever guidelines are more stringent.
- The auditor should check the valuation methodology and verify that valuation is made as per principles laid down by the relevant guidelines of regulatory authority of the country or RBI guidelines whichever is more stringent.

d) Whether there are any matured or overdue investments which have not been encashed and/ or has not been serviced? if so, give details?

- The auditor should check the maturity of all investments and verify whether there are any matured or overdue investments then details of the same may be given as under –

Sl. No.	Particulars	Book Value of Investment	Maturity Date

If the investments are matured but maturity amount was not received or interest was not served, for more than 90 days, then the same should be classified as Non-Performing Investment (NPI) and provision should be made as per prescribed guidelines. If the auditor observed that the branch has not adhered to NPI related guidelines, then the same should be reported in main report, in LFAR and MOC should be passed.

I-5

Assets - Advances

The format of LFAR requires the auditor to offer his comments on the following aspects of advances:

a) List of accounts examined for audit

b) Credit Appraisal

c) Sanctioning / Disbursement

d) Documentation

e) Review/Monitoring/Supervision

f) Asset Classification, Provisioning of Advances and Resolution of Stressed Assets

g) Non-Fund Based facilities

General Instructions

(i) The answers to the following questions may be based on the auditor's examination of all large advances.

For this purpose, large advances are those in respect of which the outstanding amount is in excess of 10% of outstanding aggregate balance of fund based and non-fund based advances of the branch or Rs.10 crores, whichever is less.

Care-For all accounts above the threshold, the transaction audit/account specific details to be seen and commented, whereas below the threshold, the process needs to be checked and commented upon. Comments of the branch auditor on advances with significant adverse features, which might need the attention of the management / Statutory Central Auditors, should be appended to the LFAR.

(ii) The critical comments based on the review of the above and other test check should be given in respective paragraphs as given in LFAR given below.

(a)	*List of accounts examined for audit*			
Account No.	**Account Name**	**Balance as at year end – Funded**	**Balance as at year end – Non-funded**	**Total**
Total		A	B	C = A + B
Total Outstanding of the branch		X	Y	Z = X + Y
Percentage examined		A as % of X	B as % of Y	C as % of Z

In this section of LFAR, criteria for Sample Selection of Large Advance Accounts to be verified by auditors is prescribed. As per the Old LFAR formats, Large advances were those where Outstanding amount was in excess of 5% of the aggregate advances of the branch or Rs. 2.00 crores, whichever is less. Also, there was no requirement to report the details of accounts verified.

However, in the revised LFAR formats, Criteria for selection of Large advances has been modified and it will be those accounts where Outstanding amount is in excess of 10% of the aggregate advances of the Branch or Rs. 10.00 crores whichever is less. Further, auditors are required to report the details of the Large Advances examined.

For example, Advances of a Particular Branch is Rs. 200 Crores then as per the Criteria given in revised LFAR formats i.e. All Accounts having outstanding in excess of Rs. 10.00 Crores being Lower than Advances in excess of 10% of the Aggregate Advances of the Branch which comes to Rs. 20.00 cores of the Branch are to examined by the Auditor and reported accordingly.

For all accounts above the threshold, the transaction audit/ account specific details to be seen and commented, whereas below the threshold, the process needs to be checked and commented upon and branch auditor has to comment on advances in LFAR with significant adverse features, which might need the attention of the management / Statutory Central Auditors. To verify the process for accounts below threshold, the auditor should conduct following steps:

i. Process walkthrough: Review of process vis-à-vis Process Manuals/ Circulars from the Head office.

ii. Data Analysis: In today's time most of the information in respect of accounts is entered in CBS. The Auditor should request branch to give data in excel format and carry out analysis of the accounts, the illustrative criteria for analysis is as under:

   - Delay in submission of stock statements.
   - Overdue accounts regularized nearing balance sheet date.
   - Frequently overdrawn accounts.

iii. Sample Selection: Based on result of data analysis, the Auditor should select samples.

iv. Verification of advances selected as sample: Post selection of samples, the auditor should verify the advances as explained in detail in the Chapter on Advances in Guidance Note on Audit of Banks 2021 edition.

While selecting sample, the Auditor should follow SA 530, Audit Sampling.

(b) Credit Appraisal

i) 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. What, in your opinion, are the major shortcomings in credit appraisal, etc.

The Auditor should refer to Credit policy of the Bank and relevant circulars including circular for Delegation of Powers issued by the Head Office. Also, the Auditor should refer to Product Notes, if any of retail / MSME/ Thematic loans.

The auditor should verify that the branch has followed the laid down procedure and disclosed all important points in Appraisal Note while conducting credit appraisal of the borrower. Also, the Auditor should verify that the deviations, if any, are approved by the competent authority mentioned in the Credit policy/ circular for Delegation of powers.

The detailed guidance for verification of credit appraisal is provided in the Chapter on Advances in Guidance Note on Audit of Banks 2021 edition.

ii) Have you come across cases of quick mortality in accounts, where the facility became non-performing within a period of 12 months from the date of first sanction? Details of such accounts may be provided in following manner:-

- ***Account No. :***
- ***Account Name :***
- ***Balance as at year end :***

The definition of Quick Mortality is as under:

i. All accounts becoming NPA within a period of 12 months from the date of first disbursement in respect of the limits sanctioned for the first time.

ii. In cases where repayment holiday is given either of interest or instalments, the period of 12 months shall be reckoned after the expiry of the repayment holiday.

iii. All accounts renewed with or without any enhancement shall be excluded for this purpose.

Details of such accounts should be reported by the auditor in prescribed format and the auditor should verify action taken by the Bank with respect to such accounts including staff accountability.

iii) Whether in borrowal accounts the applicable interest rate is correctly fed into the system?

The Auditor should examine Sanction Letter and verify from the system that Correct Rate of Interest is being entered and modified from time to time in terms of Sanction. The auditor should examine that any concession in rate of interest is specifically approved by the Competent Authority authorized to approve such concession. For Correct rate of Interest as stipulated in the Sanction letter, reference should be made to the sanction letter and Interest Circulars issued by the Bank from time to time.

iv) Whether the interest rate is reviewed periodically as per the guidelines applicable to floating rate loans linked to MCLR / EBLR (External Benchmark Lending Rate)?

For any change in Rate of Interest, Circulars related to Change in Rate of Interest issued by the Bank's Concerned Department should be examined. Where there is change in Rate of Interest, The auditor should verify on sample basis whether rate of interest in account master is correctly modified based on circular.

v) Have you come across cases of frequent renewal / rollover of short-term loans? If yes, give the details of such accounts.

In case of Working Capital Facilities, account has to be renewed every year from the date of sanction. As per IRAC Norms, if any account is not renewed within 6 Months of its renewal date then the Account is to be classified as NPA. In many cases, renewal is pending at Sanctioning Authority Level for various issues. The auditor should examine and report such cases where frequent renewal/rollover has been done without obtaining the requisite information and data.

The extract of relevant RBI Circular (circular no. RBI/2020-21/27 DoS.CO.PPG.BC.1/11.01.005/2020-21 dated August 21, 2020 on Ad-hoc/Short Review/Renewal of Credit Facilities) is as under:

In terms of circular DBOD.No.BP.(SC).BC.98/21.04.103/99 dated October 7, 1999 on Risk Management System in Banks, Scheduled Commercial Banks (SCBs) are required to put in place a board approved credit policy, which, inter alia, should prescribe the periodicity and methodology of review/renewal of credit facilities. The policy should also prescribe differential time schedules for review/renewal of borrower limits so that lower rated borrowers whose financials show signs of problems are subjected to renewal control more frequently.

2. Further, in terms of the Master Circular RBI/2015-16/101 DBR.No.BP.BC.2/ 21.04.048/ 2015-16 dated July 1, 2015 on Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, an account where the regular/ad-hoc credit limits have not been reviewed/renewed within the prescribed timeline from the due date/date of ad-hoc sanction will be treated as Non-Performing Asset.

3. Banks are, therefore, expected to have a detailed Board approved policy on methodology and periodicity for review/renewal of credit facilities within the overall regulatory guidelines, and adhere to the same strictly.

4. However, an analysis of practices followed by the lenders while reviewing/renewing credit facilities has brought out certain supervisory concerns, including that of frequent/ repeated ad-hoc review/renewal of credit facilities instead of regular review/renewals, non-capturing and/or inaccurate capturing of review/renewal data in the banking/information systems, and non-coverage of review/renewal activities under the concurrent audit/internal audit mechanism.

5. In this connection, we reiterate that timely and comprehensive review/renewal of credit facilities should be an integral part of the Board approved loan policy and credit risk management framework, and banks should avoid frequent and repeated ad-hoc/short review/renewal of credit facilities without justifiable reasons. Banks are also advised to capture all the data relating to regular as well as ad-hoc/short review/renewal of credit facilities in their core banking systems/management information systems and make the same available for scrutiny as and when required by any audit or inspection by Auditors/RBI. Further, the processes governing review/renewal of credit facilities should be brought under the scope of concurrent/internal audit/internal control mechanism of banks with immediate effect.

vi) 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 relative ranking of borrowers based on the credit rating agency's assessment of creditworthiness of the borrowers. Credit ratings also indicate the credit risk associated with a specific credit facility or a specific security.

The RBI accredited credit rating agencies are as under:

- CARE Ratings Limited.
- CRISIL Ratings Limited
- India Ratings and Research Private Limited
- ICRA Limited
- Brickwork Ratings India Limited
- Acuité Ratings & Research Limited
- INFOMERICS Valuation and Rating Pvt Ltd.

With effect from September 1, 2017, Some External Credit Agencies have aligned the Issuer Rating Scale with the Long-Term Rating Scale. The aforesaid change in the rating scale is not to be construed as a change in the rating. The different rating scales currently in vogue are given below.

AAA Issuers with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such issuers carry lowest credit risk.

AA Issuers with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such issuers carry very low credit risk.

A Issuers with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such issuers carry low credit risk.

BBB Issuers with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such issuers carry moderate credit risk.

BB Issuers with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.

B Issuers with this rating are considered to have high risk of default regarding timely servicing of financial obligations.

C Issuers with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.

D Issuers with this rating are in default or are expected to be in default soon.

Note: *For the rating categories AA through to C, the modifier + (plus) or – (minus) may be appended to the rating symbols to indicate their relative position within the rating categories concerned. Thus, the rating of AA+ is one notch higher than AA, while AA- is one notch lower than AA.*

The credit ratings given by any rating agency is valid for one year and reviewed by Rating Agency every year.

The auditor needs to verify that External Credit Rating of eligible Borrowers is being obtained from RBI accredited credit rating agency and credit rating is correct and valid. The Auditor can independently check the credit ratings on websites of rating agency.

(c) Sanctioning / Disbursement

i) In the cases examined by you, have you come across instances of:

a) credit facilities having been sanctioned beyond the delegated authority or limit fixed for the branch?

b) Are such cases promptly reported to higher authorities?

Operations Manual/Circulars for Delegation of powers / Credit policy of the Bank specifies competent authorities for sanctioning of advances and for approving deviations from sanction terms & conditions, if any.

The Auditor should verify whether the sanctioning and disbursement is approved by competent authorities, if not, the same should be reported. Detailed guidance is provided in Chapter on Advances given in Guidance Note on Audit of Banks 2021 Edition.

- Such type of cases may be reported in the following format.

Sr. No.	Name of the borrower	Account Number	Type of facility	Sanction date/ Authority	Sanction limit	Balance outstanding on 31.03.20XX	Amount sanctioned exceeding the delegated authority	Date of sanction / ratification from Higher Authority

ii) Whether advances have been disbursed without complying with the terms and conditions of the sanction? If so, give details of such cases.

- The Auditor should verify that all terms of sanction inter-alia execution of loan agreement, creation of mortgage, execution of hypothecation deed, pre-disbursement inspection mentioned in sanction letter are complied with before disbursement of advances.
- Report the cases along with the deviations.

iii) Did the bank provide loans to companies for buy-back of shares/securities?

RBI Master Circular on Loans and Advances –Statutory and Other Restrictions (Circular no. RBI/2015-16 /95 DBR.No.Dir.BC.10/ 13.03.00/2015-16 dated July 1, 2015) prohibits banks from providing loans to companies for buy-back of their own shares/securities.

In this regard, paragraph 2.1.4 - Restrictions on Credit to Companies for Buy-back of their Securities of the abovementioned master circular states as under:

In terms of provisions of the Companies Act, 2013, companies are permitted to purchase their own shares or other specified securities out of their

- free reserves, or
- securities premium account, or
- the proceeds of any shares or other specified securities,

subject to compliance of various conditions specified therein. Therefore, banks should not provide loans to companies for buy-back of shares/securities.

The auditor should ensure that no loan is extended to any company for Buy Back of its shares/securities in contravention of abovementioned RBI Master Circular and if any such case is observed, same should be reported.

(d) Documentation

In the cases examined by you, have you come across instances of:

i) Credit facilities released by the branch without execution of all the necessary documents? If so, give details of such cases.

- Report the cases where credit facilities released by the branch without execution of all the documents mentioned in sanction letter, circulars / manuals of the Bank. The auditor should verify the executed original documents.
- Verify Custody of Documents – Whether document movement register tracking changes is maintained. Whether scanning of important documents is maintained.
- If the documents are executed at other branch, then the auditor should obtain confirmation from that branch. Also, the same should be mentioned in LFAR.
- The exact nature of irregularity / document not obtained may be provided in the following format:

Sr. No.	Name of the borrower	Account Number	Type of facility	Sanction date / Authority	Sanction limit	Balance outstanding on 31.03.20XX	Nature of irregularity / documents not obtained

ii) Deficiencies in documentation, including non-registration of charges, non-obtaining of guarantees, etc.? If so, give details of such cases.

- Report cases of deficiencies in documentation, non-registration of charges, non-obtaining of guarantees, etc.
- Verify that the documents are adequately stamped and also that they are executed within six months of purchasing the stamp paper.
- The instances should be reported in the following format:

Sr. No.	Name of the borrower	Account Number	Type of facility & a/c no.	Sanction date / Authority	Sanction limit	Balance outstanding	Nature of irregularity

- Time barred documents list to be furnished as under:

Sr. No.	Name of the borrower	Account Number	Outstanding balance	Sanction limit / Authority	Date of document

- The time barred documents statement can be generated through system.
- When the document becomes time barred, no legal action can be initiated against the borrower.

iii) Advances against lien of deposits have been granted without marking a lien on the bank's deposit receipts and the related accounts in accordance with the guidelines of the controlling authorities of the bank.

- The auditor should ask the branch to generate a report of loan / overdraft against deposits with security details, wherein the auditor should verify that the fixed deposit numbers and amount are mentioned in the security details.
- Also, the auditor should ask the branch to generate report, giving details of fixed deposits under lien and cross check the both reports.
- If these reports reveal any discrepancy, the auditor on sample basis should verify whether lien on fixed deposit is marked in the system, and on fixed deposit receipt.
- Even where the Auditor does not find any discrepancy in sample verification, the Auditor should report about data inconsistency.
- Refer the guidelines issued by the Head Office in this regard.
- Report the cases, where the deposits / NSCs, paper securities etc., are matured, however not adjusted against the respective advances.
- Instances should be given in the following format:

Sr. No	Name of the borrower	Account Number	Sanct-ion limit / Author-ity	Outstan-ding balance	Date of docu-ment	Particulars of Security

(e) Review/Monitoring/Supervision

i) 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? Provide analysis of the accounts overdue for review/renewal.

What, in your opinion, are major shortcomings in monitoring, etc.

a) between 3 to 6 months, and

b) over 6 months

- Refer the guidelines issued by the Head Office in this regard.
- Date / month in which accounts were due for review and the date / month on which the review was done may be obtained.
- Date / Month of review can be verified from the sanction documents / terms.
- Instances should be given in the following format:

Sr. No.	Name of the Borrower	Type of Facility & Account Number	Balance outstanding as on 31.03.20XX	Review overdue since	Ageing

(ii) a) Are the stock/book debt statements and other periodic operational data and financial statements, etc., received regularly from the borrowers and duly scrutinized? Is suitable action taken on the basis of such scrutiny in appropriate cases?

b) Is the DP properly computed?

c) Whether the latest audited financial statements are obtained for accounts reviewed / renewed during the year?

- Borrower wise / month wise record showing receipt of security statements be confirmed.
- Confirm the working of drawing power based thereon.
- Confirm whether these statements are obtained on time.
- Compare movement shown in book debts & creditors with debits/credits in the Bank.
- Confirm calculation of drawing power.
- Check whether latest audited financial statements are obtained for accounts reviewed / renewed during the year.
- If the stock and book debt statements are more than three months old, check whether that account is correctly classified.

Detailed guidance on these aspects is provided in the Chapter on Advances given in Guidance Note on Audit of Banks 2021 edition.

iii) a) Whether there exists a system of obtaining reports on stock audits periodically?

b) If so, whether the branch has complied with such system?

c) Details of:

- ***cases where stock audit was required but was not conducted***
- ***where stock audit was conducted but no action was taken on adverse features***

- Refer the guidelines issued by the Head Office in this regard and confirm the compliance thereof.
- Examine the compliances obtained, action taken in cases wherein deficiencies are reported by the stock auditors.
- Whether adverse issues in stock audit reports are duly factored in review / renewal notes.
- If the stock audit report contains material discrepancies, the auditor should verify action taken by the branch to confirm

replies given by the borrower. If the replies are not satisfactory, then the same should be mentioned in LFAR along with discrepancies observed in stock audit.

iv) Indicate the cases of advances to non-corporate entities with limits beyond that is set by the bank where the branch has not obtained the duly audited accounts of borrowers.

- Verify that the branch has obtained audited financial statements of non-corporate borrowers whose financial statements should be audited as per the Credit policy of the Bank.
- A list of cases where the branch has not obtained audited financial statements is to be given in the following format:

Sr. No.	Name of the Borrower	Account Number	Sanction Limit	Date of last audited accounts obtained

v) Does the branch have on its record, a due diligence report in the form and manner required by the Reserve Bank of India in respect of advances under consortium and multiple banking arrangements. Give the list of accounts where such certificate/report is not obtained or not available on record.

(In case, the branch is not the lead bank, copy of certificate/report should be obtained from lead bank for review and record)

RBI Notification no. RBI/2008-2009/379 DBOD. NO. BP.BC.110/ 08.12.001/ 2008-09 dated February 10, 2009 on Lending under Consortium Arrangement / Multiple Banking Arrangements states as under:

"Please refer to Paragraph 2(iii) of our circular RBI/2008-09/183/ DBOD.No.BP.BC.46 /08.12.001/2008-09 dated September 19, 2008 on the captioned subject.

2. In terms of Paragraph 2(iii) of the above circular, in order to strengthen the information sharing system among banks in respect of the borrowers enjoying credit facilities from multiple banks, the banks are required to obtain regular certification by a professional, preferably a Company Secretary, regarding compliance of various statutory prescriptions that are in vogue, as per specimen given in Annex III to the above circular.

3. In this context it is clarified that in addition to Company Secretaries, banks can also accept the certification by a Chartered Accountants & Cost Accountants. Further, on the basis of suggestions received from Indian Banks Association, Annex III – Part I & Part II (copy enclosed) has also been modified."

The auditor should verify whether diligence report has been obtained or not. If the same is not available, it should be reported.

vi) Has the inspection or physical verification of securities charged to the bank been carried out by the branch as per the procedure laid down by the controlling authorities of the bank? Whether there is a substantial deterioration in value of security during financial year as per latest valuation report in comparison with earlier valuation report on record?

- Refer the guidelines issued by the Head Office in this regard.
- If there is reduction in the value of security, then such deviation should be approved by the competent authority.
- The auditor should verify that valuation is carried out at periodic intervals specified by the Head Office.
- Report deviations, if any, and reasons for the deviations.
- A list of such cases is to be given in the following format.

Sr. No.	Name of the Borrower	Account Number	Sanction Limit	Last date of inspection or physical verification

vii) In respect of advances examined by you, have you come across cases of deficiencies, including in value of securities and inspection thereof or any other adverse features such as frequent/ unauthorized overdrawing beyond limits, inadequate insurance coverage, etc.?

- Note down the remarks regarding deficiencies in value of securities and inspection report submitted by the concerned officer.
- Confirm whether Insurance is in favour of the Bank.
- Check Insurance covers which risks.
- Also, check adequacy of Insurance value for each location.
- The cases where frequent / unauthorized over drawings beyond limits are granted are to be given in the following format:

Sr. No	Name of the Borrower	Account number	Sanction Limit	Balance Outstand-ing	Drawing power	Irregula-rity

- For cases, wherein insurance details are not available, details are to be given in the following format:

Sr. No.	Name of the Borrower	Account Number	Sanction Limit	Value of Security

- For cases, wherein there is inadequate insurance, details may be given in the following format:

Sr. No.	Name of the Borrower	Account Number	Sanction Limit	Value of Security	Insured for Rs.	In-adequate Insurance

viii) Whether the branch has any red-flagged account? If yes, whether any deviations were observed related to compliance of bank's policy related with Red Flag Accounts?

A Red Flagged Account (RFA) is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS). These signals in a loan account should immediately put the bank on alert regarding a weakness or wrong doing which may ultimately turn out to be fraudulent. The illustrative list of Early Warning Signals is given in RBI Master Directions RBI/DBS/2016-17/28 DBS.CO.CFMC.BC.No.1/ 23.04.001/2016-17 dated July 01, 2016 (updated July 3, 2017) on Frauds – Classification and Reporting by commercial banks and select FIs.

If the Branch has any RFA, then action taken by the Branch should be verified. Also, in case the Auditor observes during his verification that discrepancy(ies) in any account are falling under illustrative early warning signal(s) mentioned in the aforesaid Master Directions, then the same should be reported in LFAR.

The auditor should examine whether any Account has been red flagged and reported to the Controlling Office. Also, the auditor should verify whether there is any deviation from the bank's policy in such accounts.

ix) Comment on adverse features considered significant in top 5 standard large advances and which need management's attention.

On the basis of Coverage of all the above sections, the Auditor needs to summarize all the adverse features considered significant in Top 5 Standard large advances (Fund Based + Non-Fund Based) requiring immediate management attention.

x) In respect of leasing finance activities, has the branch complied with the guidelines issued by the controlling authorities of the bank relating to security creation, asset inspection, insurance, etc.? Has the branch complied with the accounting norms prescribed by the controlling authorities of the bank relating to such leasing activities?

- Refer the guidelines issued by the Head Office in this regard.
- Banks should not enter into lease agreements departmentally with equipment leasing companies as well as other Non-Banking Financial Companies engaged in equipment leasing.
- Paragraph 8 of RBI Master Circular no. RBI/2015-16/30 DBR.No.FSD.BC.19/24.01.001/2015-16 dated July 01, 2015 on “Para- banking activities” provides guidelines to banks on Equipment Leasing dealing with methodology, exposure, accounting and prudential norms to be followed by banks undertaking leasing activity. The auditor, in respect of leased assets, should also have regard to the requirements of AS 19, “Leases”. Assets given on Lease need to be separately shown in the same manner as other assets.

(f) Asset Classification, Provisioning of Advances and Resolution of Stressed Assets

i) a) Has the branch identified and classified advances into standard / substandard / doubtful / loss assets through the computer system, without manual intervention?

The RBI has been insisting on automation of NPA identification and classification through system. Banks have implemented the software for the same, however, still NPA identification involves manual intervention.

The NPA reports have been provided to the Branches by Central office, however, the Auditor should apply his checks on sample basis to verify whether the branch has correctly identified and Classified NPAs. The software is generally correctly identifying NPAs based on objective criteria i.e. lie overdue for more than 90 days in case of term loans or out of order status in case of Cash Credit accounts. However, software may not be able to identify NPAs based on subjective criteria like repeated restructuring, non-commencement of project as per DCCO, transfer-in funds to Cash Credit accounts and then Transfer-out within few days.

If the Auditor finds any discrepancy in identification and classification of NPAs, the same should be reported and MOC should be passed.

Auditor needs to ensure that no manual intervention has been done to modify the NPA Classification. Any such cases should be looked into and reported accordingly.

b) Is this identification & classification in line with the norms prescribed by the Reserve Bank of India

- Refer the guidelines issued by Reserve Bank of India in this regard.
- Wherever, such guidelines are not followed, Memorandum of Changes should be given with reasons.
- The Auditor should also verify compliance with the RBI IRAC norms with regard to identification and classification of loan accounts into special mention accounts and incremental provisioning requirement on account of unhedged foreign currency exposures in line with the norms prescribed by the Reserve Bank of India.

c) 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.

- Refer the guidelines issued by Reserve Bank of India in this regard.
- Wherever, such guidelines are not followed, Memorandum of Changes should be given with reasons.

d) Also indicate whether required changes have been incorporated/ suggested in the Memorandum of Changes.

- Refer the guidelines issued by the Head Office in this regard.
- The Auditor should ensure that MOC should be passed wherever he has made comments inter-alia on incorrect identification / classification of NPAs, interest calculation, collection of charges.

e) List the accounts (with outstanding in excess of Rs. 10.00 crore) which have either been downgraded or upgraded with regard to their classification as Non-Performing Asset or Standard Asset during the year and the reason thereof.

The Auditor should obtain list of downgraded and upgraded accounts during the year and report the same as under:

Sr. No.	Name of Borrower & Account Nos.	Amount (Rs.)	Classification as on 31.03.2021	Classification as on 31.03.2020	Remarks

f) Whether RBI guidelines on income recognition and provisioning have been followed.

Based on his comments above, the Auditor should report his comments on compliance with IRAC norms.

ii) a) Whether the branch has reported accounts restructured or rephased during the year to Controlling Authority of the bank?

b) Whether the RBI Guidelines for restructuring on all such cases have been followed.

c) Whether the branch complies with the regulatory stance for resolution of stressed assets, including the compliance with board approved policies in this regard, tracking/reporting of defaults for resolution purposes among others?

- Refer the guidelines issued by Reserve Bank of India together with the Head Office guidelines in this regard.
- During the year, RBI has issued various guidelines with regard to restructuring of accounts in specific sectors affected due to Covid 19 pandemic and restructuring for MSME advances.

- The Auditor should verify compliance with restructuring guidelines issued by RBI and comment on the same.

The detailed guidance on restructuring and Covid 19 related circulars is provided in Chapter on Advances given in Guidance Note on Audit of Banks 2021 edition.

iii) a) Whether the upgradations in non-performing advances is in line with the norms of Reserve Bank of India

b) Where the auditor disagrees with upgradation of accounts? If yes, give reasons thereof.

- Refer the guidelines issued by Reserve Bank of India together with the Head Office guidelines in this regard.
- In case of upgradation of accounts, the auditor should verify whether all overdues are recovered and the Branch has confirmed source of funds used to repay overdues.
- Wherever, such guidelines are not followed, Memorandum of Changes should be given with reasons.

iv) Have you come across cases where the relevant Controlling Authority of the bank has authorized 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.

- Refer the guidelines issued by the Head Office in this regard.
- Wherever, such guidelines are not followed, such cases be reported in the following format.

Sr. No.	Name of the Borrower	Account Number	Sanction Limit	Instructions to take legal action on	Present Status

v) Whether there are any accounts wherein process under IBC is mandated but not initiated by the branch?

Whether there are any borrowers at the branch against whom the process of IBC is initiated by any of the creditors including bank? If yes, provide the list of such accounts and comment on the adequacy of provision made thereto?

Generally, initiation of process under IBC is dealt with by the Head Office and specialized Departments Like Stressed Assets Management Department. In case IBC Proceedings are initiated against the Borrower by any creditors including the bank, the Auditor needs to ensure that Classification of Accounts and Provisioning as per IRAC Norms has been done accordingly. The details of accounts under IBC process should be reported.

vi) a) Have appropriate claims for credit guarantee (ECGC and others), if any, been duly lodged and settled?

b) Give details of claims rejected? (As per the given table)

c) Whether the rejection is appropriately considered while determining the provisioning requirements

Particulars	***Number***	***Amount***
Claim at the beginning of the year		
Further claim lodged during the year		
Total A		
Amounts representing		
(i) Claims accepted/settled ***(ii) Claims rejected***		
Total B		
Balance as at year end (A-B)		

The Auditor should obtain list of ECGC claims lodged along with their current status. In case of claims rejected, the same should be considered as uncovered amount while calculating provisions. Also, the Auditor should verify that the Branch has analysed the reasons for rejections and factored the same in sanctions post rejections and adequate care has been taken while lodging claims based on past rejections.

vii) 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?

- Refer the guidelines issued by the Head Office in this regard.
- Wherever, such guidelines are not followed, such cases be reported in the following format.
- The auditor should verify whether valuation is done on a consistent basis – at fair Market value, Realizable value, Distress value – Whether Fall in Market value has been factored in the valuation -

Sr. No.	Name of the Borrower	Account Number	Sanction Limit	Balance Outstanding	Security	Value of Security	Latest Valuation Report date

viii) In the cases examined by you, has the branch complied with the Recovery Policy prescribed by the controlling authorities of the bank with respect to compromise/settlement and write-off cases? Details of the cases of compromise/ settlement and write-off cases involving write-offs/waivers in excess of Rs. 50.00 lakhs may be given.

- Refer the guidelines issued by the Head Office in this regard.
- Wherever, such guidelines are not followed, such cases be reported in the following format:

Sr. No.	Name of the Borrower	Account Number	Sanction Limit	Balance Outstanding	Compromised / Settlement Amt.	Recovery Effected	Recovery To be effected

ix) Is the branch prompt in ensuring execution of decrees obtained for recovery from the defaulting borrowers? Give Age-wise analysis of decrees obtained and pending execution.

The auditor needs to ensure that proper procedure has been followed by the branch as per the laid down guidelines.

x) Whether in the cases concluded the recoveries have been properly appropriated against the principal /interest as per the policy of the bank?

The auditor needs to ensure that proper procedure has been followed by the branch as per the laid down guidelines.

xi) In cases where documents are held at centralized processing centres / office, whether the auditor has received the relevant documents as asked by them on test check basis and satisfied themselves. Report the exceptions, if any

The auditor should visit the CPC, if required, to verify the documents available at such CPCs, if they are not made available at the Branch.

xii) List the major deficiencies in credit review, monitoring and supervision.

Based on his verification, the Auditor should list down deficiencies with accounts details.

(g) Non-Fund Based facilities

i) List of borrowers with details of LCs devolved or guarantees invoked during the year.

Sr. No.	Invocation Date	Party Name	Beneficiary Name	Amt	Recovery Date

In case of LC Devolvement, the Amount of Payment is Debited to Cash Credit Accounts and due to adequate Limit not available in the Account, the Account Becomes overdrawn. The auditor should identify LC Devolvement and report accordingly.

ii) List of borrowers where the LCs have been devolved or guarantees have been invoked but not paid with amount thereof.

Sr. No.	Invocation Date	Party Name	Beneficiary Name	Amt	Reason for non-Payment

There may be instances of Revocation of Guarantee also wherein the Bank is bound to make payment to beneficiary who has revoked the bank Guarantee. The auditor needs to ensure that Payment is made after following the laid down procedure and followed up for recovery from borrower.

iii) List of instances where interchangeability between fund based and non-fund-based facilities was allowed subsequent to devolvement of LC / invocation of BG.

The auditor can verify such instances by checking Total Outstanding in each facility vis-a-vis the Sanctioned Limit, post LC devolvement and BG invocation. Instances, if any, should be reported.

I-6

Assets - Other Assets

(a) Suspense Accounts/Sundry Assets

i. Does the system of the bank ensure expeditious clearance of items debited to Suspense Account? Details of outstanding entries in excess of 90 days may be obtained from the branch and the reasons for delay in adjusting the entries may be ascertained. Does your scrutiny of the accounts under various sub-heads reveal balances, which in your opinion are not recoverable and would require a provision/write-off? If so, give details.

The auditor should verify the policy of the bank regarding operation of suspense account. The auditor should verify the internal controls regarding operations in suspense account and comment whether the same are adhered to. The auditor should verify the list of age wise outstanding entries (system generated) and comment based on the narration written whether these entries are recoverable. Wherever the explanation and supporting documents are not received, suggest provision by way of MOC for the same.

ii. Does your test check indicate any unusual items in these accounts? If so, report their nature and the amounts involved. Are there any intangible items under this head e.g. losses not provided / pending investigation?

The auditor should verify the transactions recorded in suspense accounts on test check basis and comment whether there are any unusual items which require provision / write off / attention of management. If the amounts involved are above the materiality threshold limits, or the amounts are outstanding for substantial amount of time, the auditor should suggest provision by way of MOC. Further, if there are any intangible items appearing and outstanding under suspense accounts, which require provisioning, the auditor should report the same and suggest MOC. Details of such pending entries in suspense account be given in following manner:

Sr. No.	Particulars of debit entry	Outstanding balance as on 31.03.20XX	Whether provision is necessary, reason thereof and MOC Reference

Please refer Guidance Note on Audit of Banks 2021 Edition for detailed guidance.

II-1

Liabilities - Deposits

a. Does the bank have a system of identification of dormant/ inoperative accounts and internal controls with regard to operations in such accounts? In the cases examined by you, have you come across instances where the guidelines laid down in this regard have not been followed? If yes, give details thereof.

The auditor should verify the RBI Circular and policy of the bank regarding system of identification of dormant/ inoperative accounts and internal controls related to operations in such accounts. The auditor should verify the process of identification of such dormant/ inoperative accounts (auto marking through CBS) and comment about the same. On test check basis, verify the operations carried out in such dormant/ inoperative accounts during the year and comment whether the branch has followed the guidelines with respect to operations in such dormant/ inoperative accounts. The auditor should verify the process followed for converting these accounts to operative accounts and comment about the same. Instances where such guidelines are not followed should be reported. Also, the auditor should verify that the internal controls are effectively working with relation to operations in such dormant/ inoperative accounts and instances where such guidelines are not followed should be reported.

b. After the balance sheet date and till the date of audit, whether there have been any unusual large movements (whether increase or decrease) in the aggregate deposits held at the year-end? If so, obtain the clarifications from the branch and give your comments thereon.

The auditor should compare the deposits at the branch as at year end with the deposits outstanding as on the date of audit. The auditor should check whether there are unusual large movements (increase or decrease) in the deposits. The auditor should enquire with the branch management and ascertain reasons for unusual large movement. If the branch is not able to satisfactorily explain the reasons for such movements, report appropriately.

c. Whether the scheme of automatic renewal of deposits applies to FCNR(B) deposits? Where such deposits have been renewed, report whether the branch has satisfied itself as to the 'non-resident status' of the depositor and whether the renewal is made as per the applicable regulatory guidelines and the original receipts / soft copy have been dispatched.

The auditor should verify the RBI Circular / policy of the bank regarding renewal of FCNR(B) Deposits. The auditor should verify such automatic renewals, if any, at the branch on test check basis and comment whether the guidelines prescribed by RBI/the Head Office are followed. In case of automatic renewal, the branch has to satisfy that the FCNR (B) deposit account holder has a 'non-resident' status on the date of renewal. The auditor should verify the document obtained / relied by the branch for considering the account eligible for auto renewal and comment appropriately.

d. 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?

The auditor should verify the RBI Circular / policy of the bank regarding requirements for maintaining minimum balance and levy of charges for non-maintenance of such minimum balance in individual savings accounts. The auditor should verify the process of identification of individual saving accounts which are not maintaining prescribed minimum balance and check whether appropriate bank charges are levied on the same.

II-2

Liabilities - Other Liabilities - Bills Payable, Sundry Deposits, etc.

a. The number of items and the aggregate amount of old outstanding items pending for one years or more be obtained from the branch and reported under appropriate heads. Give details thereof.

The auditor should obtain a list of number of items and aggregate amount of old outstanding items pending for more than one year in case of Bills Payable, Sundry Deposits and Other Liabilities accounts at the branch. Verify the narrations written against the transaction and report discrepancies in following format.

Year	Number of Items	Amounts	Auditor's Remarks

b. Does your test check indicate any unusual items or material withdrawals or debits in these accounts? If so, give details thereof.

The auditor should verify the Bills payable, Sundry Deposits and Other Liabilities accounts at the branch on test check basis and comment whether there are any unusual items or material withdrawals or debits in these accounts. Based on narration written against these transactions and the auditor's verification of the same on test check basis based on documents and evidence produced by the branch, the auditor should give details of such transactions in LFAR.

Please refer Guidance Note on Audit of Banks 2021 Edition for detailed guidance.

II-3

Liabilities - Contingent Liabilities

List of major items of the contingent liabilities (other than constituent's liabilities such as guarantees, letter of credit, acceptances, endorsements, etc.) not acknowledged by the branch?

The auditor should verify the statement of contingent liabilities not acknowledged as debts by the branch as at year end. The auditor should check the details based on documents and evidence produced for verification. The auditor should comment whether the amounts mentioned are appropriate or they require any changes which can be suggested through MOC. The auditor should also verify the previous years audited financial statements to ascertain movement, if any, in the statement of contingent liabilities during the year under audit.

The examples of such contingent liabilities would include disputes with landlord regarding rent of the branch premises, matters related to property tax levied by local authorities, court cases filed by parties where the branch is made one of the parties, claims filed by aggrieved clients against the bank in various courts etc. The auditor should verify the documents related to contingent liabilities and give his comment in LFAR.

The auditor should obtain confirmation from the branch that, it has not received any other notice or does not have any other communication other than those disclosed in contingent liabilities.

III

Profit and Loss Account

(a) Has the test checking of interest/ discount / commission/ fees etc. revealed excess/short credit of a material amount? If so, give details thereof.

- Obtain the latest copies of Revenue Audit/ Income and expenditure Audit/ Concurrent Audit report of the branch (if any) and verify whether the compliance for the same has been effectively carried out by the branch.
- In case if the branch is not covered by Revenue Audit/ Income and expenditure Audit/ Concurrent Audit report, check the areas of potential revenue leakage and suitably include the same in audit program.
- Obtain the system generated reports regarding interest charged on major advance accounts at the branch (including penal interest) and verify the correctness of rate of interest charged as per the latest sanction letter and extant circulars of the Bank.
- Generate Exceptional transactions report and verify that interest is applied to all applicable accounts.
- Verify on sample basis whether loan processing charges, Lead bank charges (in case of a Consortium Leader bank), etc. are collected on the loans accounts which have been sanctioned/reviewed/renewed during the year.
- Also verify the major Bills discounting transactions and the commission and interest recovered on tenor bills, including overdue interest.
- Verify that BG/LC Commission is charged as per the Bank’s circular for Service charges, including on any extensions, if any, and any amendments made thereafter.

- Check that the penal interest has been charged to borrower accounts as prescribed in latest sanction letter / extant circulars of the bank.
- Wherever excess / short credit of material amount is noticed, such cases may be reported in the following format.

Sr. No	A/c No	Interest/ discount/ commission/ fees calculated by the system	Interest/ discount/ commission/ fees calculated by the auditor	(Short) / Excess Interest/ discount/ commission/ fees calculated by the system

- Ensure recovery/refund of these short/excess credits during the course of audit itself and if the amount is material, give effect by way of MOC.

(b) Has the branch complied with the Income Recognition norms prescribed by R.B.I.? (The Auditor may refer to the instructions of the controlling authorities of the bank regarding charging of interest on non-performing assets).

- Obtain a copy of the latest RBI circular regarding IRAC Norms/ the Bank's Accounting Policy and confirm whether the Branch has complied with Income Recognition Norms.
- Obtain CBS (System) reports regarding income recognition and use Excel or any other Audit tool which can be run on the base (raw) data obtained from the CBS.
- Wherever it is observed that reversal of interest / income not carried out, the MOC should be passed in such cases.

(c) Has the test check on Interest on Deposits revealed any excess/short debit of material amount? If so, give details thereof.

- Refer the guidelines issued by the Head Office/RBI in this regard and check whether such guidelines are followed strictly by the branch.
- Check the correctness of interest rates fed in the system, updation of interest rate parameters in the CBS system, in case of changes the same may be verified. Also verify whether the Master data particulars of the depositors are correctly fed, especially with reference to Senior citizens, staff/ex staff members which have a bearing on rate of interest.
- Verify interest calculation on deposits on test check basis as per the sample selected and report deficiencies observed, if any.
- Verify Interest calculation in case of High Value deposits where the rate of interest is decided by the contract between the bank and the customer.
- Test check Pre-matured withdrawal of Deposits and confirm whether rate of interest is charged according to the tenor of the deposit and penal interest (if applicable) is considered while paying the interest amount.
- Wherever excess / short credit of material amount is noticed, such cases may be reported in the following format.

Sr. No	**A/c No**	**Interest calculated by the system**	**Interest calculated by the auditor**	**(Short) / Excess Interest calculated by the system**

(d) Does the bank have a system of estimating and providing interest accrued on overdue/matured/ unpaid/unclaimed term deposits including in respect of deceased depositors?

- Refer the closing guidelines issued by the Head Office/RBI in this regard and obtain the copies of the latest circulars issued by the bank and whether, such guidelines are followed strictly.

- Generally, the banks are providing interest on overdue/ matured/ unpaid/unclaimed term deposits at head office centrally. Verify and comment whether the same has been done.
- Confirm compliance of DEAF Guidelines issued by the RBI in case of unclaimed deposits of more than 10 years.

(e) Are there any divergent trends in major items of income and expenditure, in comparison with corresponding previous year, which are not satisfactorily explained by the branch? If so, the same may be reported.

- The divergent trends can be identified by way of comparison/ analysis on the basis of previous quarters / half year / nine months and previous year figures, keeping in mind the changes in business volumes and business mix.
- Compare the aggregate figures as on 15th March, 20XX, 31st March, 20XX and last day of audit. Also compare some of the transfers on the last two days of the year and identify whether there are any transfers of undrawn portion from the loan accounts to current account or deposit account.
- Compile the report in Excel format with comparison of figures of the current year and immediate previous financial year along with additional column of deviation (in terms of percentage). Focus on abnormal deviations and obtain the explanations from the Branch officials for such deviations. Report the deviations which could not be satisfactorily explained by the Branch officials.
- Major items of income to be considered would be Interest on Advances and Interest on Deposits which need to be compared in the light of increase/decrease in advances/deposits, rate of interest on advances/deposits, increase/decrease in NPA’s, Deposit Mix etc.

IV-1

General - Gold/ Bullion / Security Items

***(a) Does the system ensure that gold/bullion is in effective joint custody of two or more officials, as per the instructions of the controlling authorities of the bank*?**

- The auditor should refer to the instructions issued by controlling authorities of the bank and accordingly should verify as to whether gold/bullion/security items are in effective joint custody of two or more officials. As the auditor can verify the compliance w.r.t. the guidelines only during the course of audit, and not throughout the year, a suitable reference of the said inherent limitation related thereto should be specified by the auditor.

(b) Does the branch maintain adequate records for receipt, issues and balances of gold/bullion and updated regularly? Does the periodic verification reveal any excess/shortage of stocks as compared to book records and if any discrepancies observed have been promptly reported to controlling authorities of the bank?

- Check the register maintained by the branch and verify as to whether the same is up-to-date or not. The auditor may conduct a physical verification of gold/bullion to verify if the stock tallies as per the register.

- Obtain records of physical verification done by the branch officials from time to time at periodic intervals. The auditor may review the adequacy of the periodicity of such verification based on the volume and value of items dealt.

- Obtain records of any communication with controlling authority with regards to any discrepancies and verify the manner of effecting the same in books of account.

(c) Does the system of the Bank ensure adequate internal control over issue and custody of security items (Term Deposit Receipts, Drafts, Pay Orders, Cheque Books, Traveller's Cheques, Gift Cheques, etc.)? Whether the system is being followed by the branch? Have you come across cases of missing/lost items*?*

- The Head Office instructions to be referred to and review the compliance thereof and existence of adequate internal controls related thereto.

- Verify whether lost security items are reported to Controlling Authority.

- Verify the accounting treatment given related to Inward / Outward / Consumption of Stationery items as per the Bank's policy in this regard.

- The auditor should physically verify the security items including stamps on hand as at the year-end (or nearby the year-end). Any shortage should be inquired into as it could expose the bank to a potential loss from misuse. It may be noted that the auditor is required to specifically comment on the loss items of stationery in LFAR.

- The auditor should review concurrent audit reports to check whether any discrepancy is reported in the same. In case any discrepancy is reported, check how the same has been complied /closed. If not complied, then report the same.

- If there are any missing / loss items observed by the auditor or identified during concurrent audit / internal verification, the same should be provided in the following manner:

Sl. No.	Description of the security item	Consecutive No. of the item	Date of Loss	Missing Reported on

- The auditor should examine whether the cost of stationery and stamps consumed during the year has been charged to the profit and loss account for the year in the context of the accounting policy/instructions from the head office regarding treatment of cost of stationery and stamps.

IV-2

General - Books and Records

(a) Whether there are any software / systems (manual or otherwise) used at the branch which are not integrated with the CBS? If yes, give details thereof.

The auditor should verify the list of software / systems (manual or otherwise) used at the branch during the year under audit. The auditor should check whether all softwares are integrated with CBS. Wherever it is observed that the software is not integrated with CBS system, the auditor should report the same.

(b) (i) In case the branch has been subjected to IS Audit whether there are any adverse features reported and have a direct or indirect bearing on the branch accounts and are pending compliance? If yes give details.

The auditor should verify whether the branch is covered by IS Audit during the year under audit. The auditor should verify the compliance report submitted by the branch. The auditor should check whether there are any adverse comments in the IS Audit report which has direct or indirect bearing on the branch accounts which are not complied by the branch management, if yes, the auditor should report those points in LFAR.

(ii) Whether branch is generating, and verifying exception reports at the periodicity as prescribed by the bank

The auditor should verify whether the branch is generating exception reports as per the policy prescribed by the Head Office and branch officials are verifying the exception reports on daily/weekly/monthly basis.

(iii) Whether the system of bank warrants expeditious compliance of daily exception reports and whether there are any major observations pending such compliance at the year end.

The auditor should verify whether the branch is expeditiously complying with the exception reports generated and compliance related to the major observations is being carried out by the branch. The auditor should verify the compliance based on documents and information available at the branch and comment if there are discrepancies related to major observations pending for compliance as at year end.

(iv) Whether the bank has laid down procedures for manual intervention to system generated data and proper authentication of the related transactions arising there from along with proper audit trail of manual intervention has been obtained.

The auditor should verify the bank's policy regarding procedure for manual intervention to system generated data and authentication of related transactions arising there from along with proper audit trail. The auditor should verify the instances of such manual intervention carried out by the branch during the year and check whether appropriate procedure as laid down by the policy of bank regarding the same has been followed by the branch. Also, the auditor should verify the corresponding transactions recorded in books of account arising out of such manual intervention to system generated documents and report discrepancies.

(v) Furnish your comments on data integrity (including data entry, checking correctness/integrity of data, no back ended strategies etc.) which is used for MIS at HO / CO level.

The auditor should review the bank's Information Technology Security Policy to check the controls with respect to data integrity. The auditor should verify the process of data entry (input of information in CBS system), checking correctness / integrity of data through maker and checker concept is being followed by the branch during the course of audit and should report appropriately about the same. The auditor should on sample basis verify interest calculation by the CBS to confirm correctness of interest charged.

IV-3

General - Inter-Branch Accounts

Does the branch expeditiously comply with/respond to the communications from the designated cell/Head Office as regards unmatched transactions? As at the year-end are there any un-responded/ un-complied queries or communications beyond 7 days? If so, give details?

The auditor should verify the process of reconciliation of Inter-Branch Accounts at the branch as per the Bank's Policy. Verify from the correspondence with designated cell/ Head Office regarding communication to the branch for expeditiously complying / responding to communication regarding unmatched transactions. At the year end, the auditor should verify the transactions in inter-branch accounts which have remained un-responded beyond 7 days and report appropriately.

Please refer Guidance Note on Audit of Banks 2021 Edition for detailed guidance.

IV-4

General – Frauds

Furnish particulars of:

i. Frauds detected/ classified but confirmation of reporting to RBI not available on record at branch.

The auditor should verify the list of frauds detected / classified during the year at the branch and check whether confirmation of reporting of these frauds to RBI is made available for verification. Instances of frauds detected during the year wherein the confirmation for reporting the same to RBI is not made available to the auditor, the same should be reported in LFAR.

ii. Whether any suspected or likely fraud cases are reported by branch to higher office during the year? If yes, provide the details thereof related to status of investigation.

The auditor should verify the list of suspected or likely fraud cases reported by the branch to higher authorities of the bank during the year under audit. Report the list of such cases along with status of investigations in respective likely fraud cases along with the auditor's comments in LFAR.

iii. In respect of fraud, based on your overall observation, please provide your comments on the potential risk areas which might lead to perpetuation of fraud (e.g. falsification of accounts/false representation by the borrower; misappropriation of funds especially through related party/ shell company transactions; forgery and fabrication of financial documents like invoices, debtor lists, stock statements, trade credit documents, shipping bills, work orders and encumbrance certificates and avail credit; Use of current accounts outside consortium where Trust and Retention Account (TRA) is maintained, to divert funds; List

of Debtors/ Creditors were being fabricated and receivables were not followed up/ write off of debt of related parties; Fake export/shipping bill, etc.; Over statement of invoice amounts, stock statements, shipping bills, turnover; fly by night operations - including the cases where vendors, related/ associate parties, manufacturing units etc. aren't available on the registered addresses; Round Tripping of funds, etc.)

Based on various areas covered under audit especially advances, cash and operations, the auditor should report such discrepancies and control lapses, which may lead to perpetuation of fraud.

iv. Whether the system of Early Warning Framework is working effectively and, as required, the early warning signals form the basis for classifying an account as RFA.

Kindly refer to RBI Guidelines on Early Warning Signals as specified in RBI Master Directions on Frauds – Classification and Reporting by commercial banks and select FIs dated July 1, 2016 (Updated as on July 03, 2017). In abovementioned Master Directions, the RBI has specified concepts of Early Warning Signals (EWS) and Red Flagged Accounts (RFA) as a fraud risk control measure. The auditor should verify the Head Office policy incorporating the RBI guidelines regarding EWS and RFA implemented by the branch. A RFA is one where a suspicion of fraudulent activity is thrown up by the presence of one or more Early Warning Signals (EWS).

The auditor should verify from the MIS/CBS reports generated at the branch regarding EWS and RFA framework and comment whether the process of identification / verification and assessment in the loan account regarding a weakness or wrong doing which may ultimately turn out to be fraudulent, has been properly dealt with at the branch. The auditor should comment if the same is not followed properly along with his observations.

IV-5
General - Implementation of KYC/AML Guidelines

Whether the branch has adequate systems and processes, as required, to ensure adherence to KYC/AML guidelines towards prevention of money laundering and terrorist financing

The auditor should verify the RBI Circular / the Head Office policy regarding KYC / AML towards prevention of money laundering and terrorist financing and check whether the branch has followed the same during the year under audit. The Auditor should verify on sample basis the responses by the branch to AML alerts received from the Head Office along with supporting for responses. If the Auditor observes any discrepancy in responses of the branch or deviation in process, the same should be reported in LFAR.

Whether the branch followed the KYC/AML guidelines based on the test check carried out by the branch auditors

The auditor should verify the RBI Circular / the Head Office policy regarding KYC / AML implemented at the branch and verify the compliance on test check basis and report discrepancies, if any. Further, check the reports of Concurrent Auditors / Internal Auditors regarding comments on non-compliance with KYC / AML guidelines and report the persisting irregularities in LFAR.

IV-6

General - Management Information System

(a) Whether the branch has the proper systems and procedures to ensure data integrity relating to all data inputs which are to be used for MIS at corporate office level and for supervisory reporting purposes. Have you come across any instances where data integrity was compromised?

The entire banking operations are subject to efficiency of the IT systems. Besides CBS, Banks uses various softwares that help branches to provide various ready inputs for their smooth and efficient operations.

The MIS reports, though generated by IT department centrally, these reports are based on the input at the branch. The input controls at the branch are very crucial. RBI has mandated the reporting on internal financial controls over financial reporting for the public sector banks for the year ended March 31, 2021 and onwards. The testing of these input controls at the branch would be integral and important aspect of Branch audit. Also, in case the branch is using different softwares then the auditor should check controls over transfer of data (if any at branch level). If the branch is maintaining any records manually, then controls over inclusion of that information while preparing MIS should be verified. If the auditor observes any discrepancy, then the same should be reported.

IV-7
General – Miscellaneous

(a) In framing your audit report/LFAR, have you considered the major adverse comments arising out of the latest reports such as:

i) Previous Year's Branch Audit report/ LFAR;

ii) Internal Audit/Snap Audit/Concurrent Audit Report(s);

- Obtain copy of the Previous year's Branch Statutory Audit Report and LFAR, Inspection Report, Concurrent Audit Reports, along with the Compliance Report submitted by the Branch to Controlling Authorities of the Bank.
- Verify that major adverse observations have been complied with and check whether the same are not repeated based on the audit.
- Obtain Report Compliance Certificate (if any).
- Obtain the latest Concurrent Audit report (Preferably for February or March).
- Verify the compliance report for all these and confirm that all irregularities are being rectified / addressed properly. Highlight the Persisting / non-complied Irregularities in LFAR.
- Select appropriate Audit sampling techniques to cover the transactional audit of such areas and cover them in LFAR.
- Verify the compliance of Ghosh and Jilani Committees' Recommendations (covered by Internal Auditors / Concurrent Auditors).
- Identify and focus on Risk Prone areas based on the previous Audit/inspection reports.

iii) Credit Audit Report;

- Obtain the List of Advances accounts covered under Credit Audit as per the Bank's Norms or Circular or guidelines.
- Verify whether all such accounts have been covered by the Credit Audit during the current year.

- Peruse these reports and analyze the major adverse comments for each of the accounts covered by Credit Audit.
- Confirm whether these have been complied with
- Confirm whether the reported credit deficiencies are still continuing.
- Report on the accounts not covered, reports not obtained, reports not complied or partially complied, incorrect compliance report submitted (if any).

iv)	***Stock Audit Report;***

- Obtain the list of accounts covered under Stock Audit for the Branch as per the Bank's Norms, circular or guidelines.
- Confirm whether all those accounts are covered under Stock Audit during the year.
- Report accounts which are not covered by Stock Audit (even if they are eligible) during the year.
- Whether the Stock Audit Reports received during the year cover all the aspects and areas to be covered as per the Bank's norms.
- Whether Drawing Power calculated by the Stock Auditor has been considered by the Bank in case of Cash Credit Accounts and the same is updated in CBS system.
- Whether the Borrower/Bank has complied with all the major adverse comments made by the Stock Auditor and appropriate compliance report for the same is submitted.

v)	***RBI Inspection Report, if such Inspection took place;***

- Obtain the copy of the RBI inspection Report and verify the compliances. Any major observation and its compliance in details should be verified by the auditor.

vi)	***Income and Expenditure (Revenue) Audit;***

- Confirm whether the branch is covered under Revenue audit as per the Bank's norms and the report/compliance report is available at the branch.

- Confirm whether all the Revenue leakage pointed out by the auditors has been recovered and refunds made in case of excess charge. (Report in case not recovered/ refunded)
- Identify the weak Internal control areas which led to Revenue leakage and confirm whether these have been plugged or not. The auditor needs to give his observations.

vii) IS/IT/Computer/Systems Audit; and

- Confirm whether the branch is covered under IS/IT or Systems Audit during the year under audit. If yes, peruse the report and verify the Compliance Report.
- Focus on the areas where the Internal Controls systems and Access Control Systems which are identified as weak and whether the Branch has made improvement to plug these irregularities.

viii) Any Special Inspection/ Investigation Report*?*

- Obtain the copy of any special inspection/ investigation report and understand the circumstances under which such Special Inspection / Investigation / Forensic Audit was ordered.
- Verify whether the Investigating Officer has conducted the audit as per the scope identified and given by the Controlling authority of the Bank and, the findings of the same have been properly concluded.
- Whether appropriate action as recommended by the Investigating officer has been taken by the Branch.

b) Are there any other matters, which you, as branch auditor, would like to bring to the notice of the management or the Statutory Central Auditors*?*

This section will cover those matters at the branch which are important in the opinion of the auditor and, the auditor would like to bring it to the notice of the SCAs.

Appendix

Additional Questionnaire Applicable to Specialised Branches

Part A - For Branches dealing in Foreign Exchange Transactions

1. Are there any material adverse features pointed out in the reports of concurrent auditors, internal auditors and / or the Reserve Bank of India's inspection report which continue to persist in relation to NRE/ NRO/ FCNR-B/ EEFC/ RFC and other similar deposit accounts. If so, furnish the particulars of such adverse features:

The auditor should obtain the account opening policy and is required to review the compliances w.r.t. provisions on opening and maintenance of NRE, NRO, FCNR-B, EEFC, RFC, DDA, SNRR and other similar deposit accounts. Strict compliance with KYC, AML requirements and requirements of relevant FEMA Act, notifications and circulars issued from time to time is required.

Additionally, these branches are generally covered under internal/ concurrent audit. The Auditor may also refer to the Audit Reports issued by Concurrent Auditors, Internal Auditors and RBI's inspectors and review adverse feature (if any) raised in such Audit Reports for reporting under this point.

The LFAR requires auditors to comment on persistent adverse features observed during their review.

2. Whether the Branch has followed the instructions and guidelines of the controlling authorities of the bank with regard to the following in relation to the foreign exchange and if not, state the irregularities.

(a) deposits

(b) advances

(c) export bills

(d) bills for collection

(e) dealing room operations (where a branch has one)

(f) any other area

The LFAR deals with review of adherence to instructions and guidelines issued by the Head Office with respect to Foreign Exchange Business. The auditor should ensure compliances with internal policies of the Bank and with various Master Circulars & Master Directions issued by RBI (Refer Guidance Note on Audit of Banks 2021 Edition for list of various Master Circulars and Master Directions). If the Auditor observes any non-compliance with respect to guidelines of controlling authorities, the same should be reported in LFAR. The major areas for verification include:

a. Deposits maintained in Foreign Currencies or by Non-Residents.

b. Export Finance and Import Finance (Fund Based and Non-Fund Based).

c. Bills for collection.

d. Dealing room operations (where a branch has one).

e. Inward and Outward remittances.

The auditor should also review linkages between CBS system and SWIFT system.

The RBI has suggested banks to centralize / ensure effective control over access and sending messages through SWIFT system by bank branches. In case the SWIFT message system is centralized, the auditor should review system / process of generation of SWIFT Messages. The Auditor may on test check basis get the SWIFT messages generated from the said system and compare the same with CBS information. Any deviation observed should be reported under LFAR.

3. NOSTRO Accounts

Obtain from the branch management, a list of all NOSTRO Accounts maintained/ operated by the branch

A nostro account refers to an account that a bank holds in a foreign currency at a foreign location with another bank. In case of receipts in foreign currency by the Bank from other countries, the counter party/ foreign bank will remit funds in nostro account of the Bank. Then based on transaction types and obtention of necessary documents, the Bank will transfer amount in nostro account to customer Rupee account post conversion or EEFC accounts.

The starting phase of the audit should be to obtain a list of all the NOSTRO accounts maintained / operated by the branch. Also, the Branch will have mirror account of each nostro account in its Trial Balance. The list shall contain all the relevant details in this regard including the account number, country, currency, etc. Ideally list of Nostro accounts provided by the Branch and details of mirror accounts should match.

(a) Whether the bank has a system of periodic confirmation/ reconciliation of the balances in NOSTRO accounts maintained with each overseas bank/ correspondent? Has such confirmation been received and account reconciled at year end in each case. If not, give details.

One of the important elements of the audit of NOSTRO accounts is to check the transactions entered through these accounts. It is important that these accounts are duly confirmed and reconciled between the two banks. The auditor should check the confirmations received by the bank branch from the overseas bank and also the reconciliation of the same. The auditor should not only verify the same relating to year end but also verify if the branch had process of periodic reconciliation and confirmation of the same. With respect to year end, the auditor may also consider to obtain independent confirmation from the overseas bank in case of material balances / transactions. The reconciliation also needs to be tallied with the subsequent transactions after year end.

(b) Whether the system of the bank ensures that all entries originated by overseas banks/correspondents, have been duly responded promptly in the respective NOSTRO accounts maintained by the bank?

The overseas bank / correspondent intimates to the respective branch for each transaction entered by them relating to them. It is imperative on the part of the branch to respond to the same at the earliest. Timely response results in proper entries and reconciliation of the same on timely basis.

The auditor should study the process and system of the bank in this regard and also whether the branch is acting as per the system defined. The delays in the same, if any, should be properly examined and highlighted for controls testing. Further, the impact of the same at year end needs to be looked upon and wherever required, appropriate entries should be passed or given in MOC.

(c) Are there any dormant/closed NOSTRO accounts in respect of which balances continue to exist in the books of the branch, at year end?

The auditor needs to examine the transactions entered in the respective NOSTRO accounts. There could be some of the accounts where there are no transactions but still the balances are lying outstanding. The reasons for the same need to be asked and verified and reported accordingly.

(d) Have the NOSTRO balances been converted at year end at the rates of exchange as prescribed by controlling authorities?

The NOSTRO accounts are in foreign currency. For the purposes of the accounting as per norms, these would need to be converted into Indian Rupees at each period end. Generally, the rate of conversion is put in the system of the bank and the same rate is used for conversion of all such balances at the bank. The auditor needs to check that the rates fed in the system are the ones which are as prescribed by the controlling authorities.

As per RBI circular RBI/2018-19/34/ DBR. Ret. BC. No.01/ 12.01.001 /2018-19 dated August 02, 2018 on Maintenance of CRR/SLR on Foreign Currency Assets/Liabilities– Reference rate for INR/USD and exchange rate of other major currencies, for conversion of foreign Currency Assets/ Liabilities reference rate from FBIL should be taken. If reference rate is not available from FBIL, Banks may continue to use New York closing rate pertaining to the day and of the reporting Friday for conversion of such currency into USD.

(e) In case, any matter deserves special attention of the management, the same may be reported.

The auditor needs to use his professional skepticism to check if there are any unusual transactions or any unusual trend or significant transactions reflected in the NOSTRO accounts. If any such transactions are noted, the same needs to be further verified with respect to documents and purpose, and in case if the auditor is not satisfied, the same should be referred in LFAR.

4. Does the Branch follow the prescribed procedures in relation to maintenance of Vostro Accounts?

Vostro accounts are bank accounts maintained in India by foreign banks. The procedure and process reported for NOSTRO accounts needs to be carried out for VOSTRO accounts as well.

Appendix

Additional Questionnaire Applicable to Specialised Branches

Part B - For branches dealing in Clearing House Operations, normally referred to as Service Branches

1. Does the branch have a system of periodic review of the outstanding entries in clearing adjustments accounts? In your view has the system generally been complied with?

- Obtain note or review existing SOP followed by the Branch / Bank.
- Check process to review outstanding entries. Whether nature of entries examined and reason assessed. Check action taken to reconcile the unreconciled entries.
- Check any MIS/ exceptional report generated from System.
- Check any process for reporting of long outstanding entries to Head Office.
- Ensure daily printout of inward and outward clearing scroll are generated by the service branch and corrections, if any, are done by the authorised official in the system itself.
- Verify that no high value transactions are routed through personal accounts.
- Examine the report on failure to lodge clearing cheques.
- Whether any amount lying in suspense for clearing difference for an unusual long period - normally any entry should not remain outstanding for more than 3 working days of lodgement.

- Examine whether any instrument stolen or fraudulently obtained by a fraudster if red flagged in the system on the basis of communication from the concerned bank.

The auditor should check all relevant documents maintained by the branch and comment on level of compliance by the Branch. In case the Branch has not followed the defined process/ system like non-reporting of long outstanding entries etc., the auditor should report the same.

2. Whether review of the clearing adjustments accounts (inwards/ outwards) reveals any old/ large/ unusual outstanding entries, which remain unexplained? Give year-wise break-up of outstanding entries in number and value.

- Obtain clearing adjustment account and review old entries.
- Obtain ageing of old entries along with nature of such entries.
- On sample basis, check old entries from system to ensure correctness of ageing given by the Branch.
- On sample basis, check origination of old outstanding entries.
- Check action taken to reconcile the unreconciled entries.

Year-wise break up should be given of outstanding clearing in number and value in the following format:

Inward Clearing	Number	Value
Normal Clearing		
High Value		
Inter-Branch Clearings		
National Clearings		
Returned/ Dishonored Clearings		

Outward Clearing	Number	Value
Normal Clearing		
High Value		
Inter-Branch Clearings		
National Clearings		
Returned/ Dishonored Clearings		

3. Has the Branch strictly followed the guidelines of the controlling authority of the bank with respect to operations related to clearing transactions? Comment on the systems and procedures followed by the branch in this regard.

- Considering the unique nature of operations of the clearing branch, the Controlling authority (Head Office) normally issues guidelines with respect to operations of clearing transactions. The auditor should obtain those guidelines from the Branch / controlling office and ensure that the Branch is complying with it.

- The auditor should carry out walk-through of some sample transactions & check reporting done by the Brach to Head office to understand process followed by the Branch.

- The auditor should comment about the CTS 2010 compliance and also verify the process of authorisation of clearing transactions at Service Branch for all branches under that respective service branch.

- The auditor should verify claims (including claims not acknowledged as debts) on service branch and check whether the same are being appropriately accounted for and reported accordingly.

- The auditor should comment about the deficiencies in internal controls observed, if any.

Appendix

Additional Questionnaire Applicable to Specialised Branches

Part C - For branches dealing in Recovery of Non-performing Assets such as Asset Recovery Branches

1. In respect of borrowers with outstanding of Rs.10.00 Crores and above the information should be obtained from the Branch Management. Comments of the Branch Auditor on advances with significant adverse features and which might need the attention of the management / Statutory Central Auditors should be appended to the LFAR.

- Obtain list and information of borrowers having outstanding balance of Rs.10.00 Crores and above.
- Review movement during the year in those accounts.
- The auditor should review each account and give comments on adverse features, if any, in accounts.
- The comments of the auditor will be either account specific or observations on system which may have impact on the bank as a whole. The auditor should highlight nature of each comment for proper action to be taken by the management / Statutory Central Auditors.
- The reporting in LFAR is not substitute for qualification in main audit report. Hence if the observation of the auditor warrants qualification in main audit report, the auditor should make reporting of same in main audit report.
- If the observation of the auditor is having impact on financial numbers like short provisioning, error in valuation of securities etc., the auditor should get same rectified by suggesting appropriate MOC for the same.

2. List the accounts with outstanding in excess of Rs. 10.00 Crores, which have been upgraded from Non-Performing to Standard during the year and the reasons thereof.

Sr. No.	Name of the Unit / Account	Outstanding [Rs. in crore]	IRAC Status as on 31st March [Last Year]	IRAC Status as on 31st March [Current Year]	Reason/s
1					
2					
3					
4					
5					

- Obtain list of all upgraded accounts during the year. In some cases, once the accounts are upgraded, same are being transferred to other branches hence may not appear in closing balances of the branch.
- Analyze the reason of upgradation and link the same with reason for classifying an account as NPA.
- Check entries for recovery in CBS to ensure there is full recovery of all dues before upgrade of account.

Analysis of upgraded accounts should be made in detail to ensure that the upgradation of account is in accordance with the guidelines laid down by RBI and the Bank.

3. Whether the branch has a system of updating periodically, the information relating to the valuation of security charged to the bank?

- Obtain details of security charged to the bank against all NPA accounts.
- Understand and review process of updating value of security in the system.

- The auditor should enquire as to the existence of the process, if any, pertaining to the valuation of security charged to the bank. If the system is in existence, the auditor should examine whether the system periodically updates the information pertaining to the value of such security and takes necessary steps for increase/diminution in the value of such security.

4. Age-wise analysis of the recovery suits filed and pending may be furnished, for the last three years along with latest status thereof.

Years	No. of Accounts	Amount [Rs. in Crore]
Upto March 2018		
2018-19		
2019-20		
2020-21		

- Obtain list of all recovery suits filed and pending as at reporting date.
- Give details of age-wise details of recovery suits.
- Current Status of the Suit Filed Accounts should also be obtained.

5. Is the branch prompt in ensuring execution of decrees obtained for recovery from the defaulting borrowers? Also list the time barred decrees, if any, and reasons thereof. Give age-wise analysis of decrees obtained and not executed.

- In case decrees have been obtained for recovery from the defaulting borrowers, the auditor should check whether the branch is prompt in execution of decrees like, drawings from these accounts and payment from these accounts have been stopped. If not, the same should be reported. The list should be given in the case of time barred decrees with the reasons therefor.

***6. List the recoveries and their appropriation against the interest and the principal and the accounts settled / written off / closed during the year as per the bank's policy. Give particulars of recoveries which are pending for appropriation as on year-end with reasons thereof*.**

- A list will have to be annexed which will specify the non-performing advances recovered and the amounts adjusted towards interest and principal. A list of the accounts settled, written off or closed, if any, will also have to be attached. The auditor should satisfy himself whether the recoveries appropriated against interest are in accordance with the Head Office guidelines.

7. List the new borrower accounts transferred to the branch during the year. Have all the relevant documents and records relating to these borrower accounts been transferred to the branch? Has the branch obtained confirmation that all the accounts of the borrower [including non-fund-based exposures and deposits pending adjustment / margin deposits] been transferred to the branch?

- A list of new borrower accounts transferred to the branch from the other branches during the year should be annexed. The auditor should verify whether the documents and records relating to the transferred accounts have been obtained like, letter from the transferor branch, details of the accounts, etc. The branch should also obtain a confirmation that all the accounts of the borrower (including non-fund based exposures and deposits pending adjustment/ margin deposits) have been transferred to the branch. In case any adverse features have been observed in such transfer, the same should be reported.

Annexure III

Long Form Audit Report (LFAR) for Large / Irregular / Critical Advance Accounts

(To be obtained by the Branch Auditors from branches dealing in large advances/asset recovery branches)

Sr. No.	Items / Particulars	Details
1.	Name of the Borrower	
2.	Address	
3.	Nature of business/activity	
4.	Total exposure of the branch to the borrower	
	(a) Fund Based (Rs. in crore)	
	(b) Non-Fund Based (Rs. in crore)	
5.	Name of Proprietor / Partners / Directors (As Applicable)	
6.	Name of the Chief Executive, if any	
7.	Asset Classification by the branch	
	(a) as on the date of current audit	
	(b) as on the date of previous Balance Sheet	
8.	Asset Classification by the branch auditor	
	(a) as on the date of current audit	
	(b) as on the date of previous Balance Sheet	

9.	Are there any adverse features pointed out in relation to asset classification by RBI inspection or any other audit	
10.	Date on which the asset was first classified as NPA (where applicable)	
11.	Facilities sanctioned	

Date of Sanction	**Nature of facilities**	**Limit (Rs. in crore)**	**Prime Security**	**Collateral Security**	**Margin %**	**Balance outstanding at the year-end**	
						Current Year	**Previous Year**

Sr. No.	**Items / Particulars**	**Details**
12.	Whether the facility is a consortium facility or a facility made on multiple bank basis	
13.	If Consortium-	
	(a) names of participating banks with their respective shares	
	(b) name of the Lead Bank in Consortium	
14.	If on multiple banking basis, names of other banks	
15.	Has the branch classified the facility under the Credit Rating norms in accordance with the guidelines of the controlling authorities of the bank	

16.	(a) Details of verification of primary security and evidence thereof	
	(b) Details of valuation and evidence thereof	

Date of Verification	**Nature of Security**	**Value**	**Valuation done by**
Insured for Rs. (expiring on____)			

Sr. No.	**Items / Particulars**	**Details**
17.	(a) Details of verification of collateral security and evidence thereof	
	(b) Details of valuation and evidence thereof	
18.	Give details of the Guarantee in respect of the facility	
	(a) Central Government Guarantee	
	(b) State Government Guarantee	
	(c) Bank Guarantee or Financial Institution Guarantee	
	(d) Corporate / Personal / Other Guarantee	
	Provide the date, validity and value of the above Guarantees.	
19.	Compliance with the terms and conditions of the sanction	

Terms and Conditions			Compliance
(i)	**Primary Security**		
	a)	Charge on primary security	
	b)	Mortgage of fixed assets	
	c)	Registration of charges with Registrar of Companies	
	d)	Insurance with date of validity of Policy	
(ii)	**Collateral Security**		
	a)	Charge on collateral security	
	b)	Mortgage of fixed assets	
	c)	Registration of charges with Registrar of Companies	
	d)	Insurance with date of validity of Policy	
(iii)	Guarantees - Existence and execution of valid Guarantees.		
(iv)	Asset coverage to the branch based upon the arrangement (i.e., consortium or multiple-bank basis)		
(v)	**Others**		
	(a)	Submission of Stock Statements / Quarterly Information Statements and other Information Statements	
	(b)	Last inspection of the unit by the branch officials: Give the date and details of errors/omissions noticed	

	(c)	In case of consortium advances, whether copies of documents executed by the company favouring the consortium are available	
	(d)	Any other area of non-compliance with the terms and conditions of sanction	

20.	Key financial indicators of the borrower for the last two years and projections for the current year	

Indicators	**Audited Year ended 31st March**	**Audited Year ended 31st March**	**Projections for Current Year**
Turnover			
Increase in turnover % over previous year			
Profit before depreciation, interest and tax			
Less: Interest			
Net Cash Profit before tax			
Less: Depreciation			
Less: Tax			
Net Profit after Depreciation and Tax			
Net Profit to Turnover Ratio			

Capital (Paid-up)			
Reserves			
Net Worth			
Turnover to Capital Employed Ratio(The term capital employed means the sum of Net Worth and Long Term Liabilities)			
Current Ratio			
Stock Turnover Ratio			
Total Outstanding Liabilities / total Net Worth Ratio			
In case of listed companies, market value of Share?			
(a) High (b) Low (c) Closing			
Earnings Per Share			
Whether the accounts were audited? If yes, up to what date; and are there any audit qualifications			

21.	Observations on the operations in the account	

Particulars	Excess over drawing power	Excess over limit
1. No of occasions on which the balance exceeded the drawing power/sanctioned limit (give details)		
Reasons for excess drawings, if any		
Whether excess drawing were reported to the Controlling Authority and approved		
	Debit Summation (Rs. in crore)	**Credit Summation (Rs. in crore)**
2. Total summation in the account during the year Less : Interest Balance		

Sr. No.	Items / Particulars	Details
22.	Adverse observations in other audit reports / Inspection Reports / Concurrent Auditor's Report / Stock Audit Report / Special Audit Report or RBI inspection with regard to :	
	(a) Documentation	
	(b) Operations	
	(c) Security/Guarantee	
	(d) Others	

23.	Branch Manager's overview of the account and its operations	
24.	(a) In case the borrower has been identified/ classified as NPA during the year, whether any unrealized income including income accrued in the previous year has been accounted as income, contrary to the income recognition norms.	
	(b) Whether any action has been initiated towards recovery in respect of accounts identified / classified as NPA.	

Date, Signature and Seal of Branch In-Charge

Audit Approach / Guidance

Requirement of preparation of the Annexure III should be informed to the Branch along with requirement list sent by the auditor. The Branch should prepare and keep ready the Annexure III and the auditor should verify the same based on sample of advances selected.

It is suggested that at least (minimum) large advances at the branch comprising 10% of outstanding aggregate balance of fund based and non-fund based advances or advances having outstanding balance of Rs. 10 crores, whichever is less should be covered by the auditor.

The auditor is expected to verify the information given in this annexure critically and give his observations / comments in respective section of LFAR. The auditor is advised to refer to Chapter on Advances given in Guidance Note on Audit of Banks 2021 edition for further guidance.

The auditor should comment about the completeness of information filled in this annexure and wherever he observes that the information is not properly filled in, the same should be reported in Advances section of LFAR.