

# Discussion on Revised LFAR Applicable to Statutory Bank Branch Audit From FY 20-21

Hosted by Ernakulam Branch of SIRC of  
ICAI  
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## LFAR Amendment

- Amendment on September 05, 2020
- Applicability from FY 2020-21 onwards
- Guiding Principles
  - Transaction testing
  - Providing input to SCA on
    - Adequacy of Implementation of various policy and regulatory requirements
    - Efficacy of the system and
    - Assurance functions (risk management, compliance and internal audit)

## LFAR Amendment

- Review of transactions
  - beyond threshold limit
    - Transaction Detailing
  - Below threshold limit
    - System and Processes to be checked and commented upon
  
- Verification of Data Integrity and data related control systems with special thrust on data input used in MIS at Corporate Level.

## LFAR Broad Reporting Parameters

- Assets
  - Cash
  - Balances with other Banks
  - Money at Short / Call Notice
  - Investments
  - Advances
- Liabilities
  - Deposits
  - Other Liabilities
- Profit & Loss Account
- General aspects of Banking

## Important amendments

- Advances
  - For all accounts above the threshold (Rs. 10 Crores or 10% of aggregate balance of fund based and non-fund based advances w.e.i. lower), the transaction audit/account specific details to be seen and commented
  - Specific format prescribed for reporting of observations
  - Listing of quick mortality accounts
  - Correctness of Interest updation on system
  - Whether Interest rates have been reviewed in line with the changes in Reference Rates?
  - Frequent renewal of Short Term Loans?

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## Important amendments

- Advances (Cont...)
  - Correctness and Validity of Credit Rating, Updation of Credit Rating in System
  - Loan to companies for Buy-Back Transaction?
  - Correctness of Computation of DP.
  - Stock Audit required but not carried out, Stock Audit carried out but no action taken against adverse remarks
  - Obtaining Diligence Report for Multiple Banking / Consortium Banking arrangements
  - Red flagged accounts. Deviations observed in such accounts.

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## Important amendments

- Advances (Cont...)
  - Adverse features observed in top 5 standard large advances accounts.
  - Security creation in case of lease finance.
  - Identification and classification of advances through Automated system without Manual Intervention.
  - Correctness of classification in SMA types as per RBI Guidelines
  - Accounts with Rs. 10 Crores and above - Downgraded or upgraded - Reasons to be provided
  - Adherence to RBI Guidelines on Restructuring

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## Important amendments

- Advances (Cont...)
  - Upgradation in line with RBI Guidelines? If not, whether auditor disagrees with the said upgradation?
  - Process under IBC is mandated but not initiated.
  - Obtaining valuation reports for NPA Accounts - Once in three year.
  - Details of the cases of compromise/settlement and write-off cases involving write-offs/waivers in excess of Rs. 50.00 lakhs to be provided

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## Important amendments

- Advances (Cont...)
  - Promptness of branch in ensuring execution of decrees obtained for Recovery. Agewise analysis of decrees obtained and pending execution.
  - Appropriation of recovery against Principal / Interest as per Bank's Policy
  - Centralized Record Maintenance - Whether auditor received relevant documents asked for?
  - List of instances where interchangeability between fund based and non-fund-based facilities was allowed subsequent to devolvement of LC / invocation of BG.

## Important amendments

- Liabilities
  - Auto Renewal of FCNR (B) ? If so, whether Non Resident status confirmed by the bank?
  - Compliance with minimum balance charges requirements in Individual Savings Accounts.

## Important amendments

- Books and Records
  - Softwares used at Branch and not integrated with CBS
  - Procedure laid down for manual intervention to system generated data and authentication thereof.
  - Auditor's 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

## Important amendments

- Frauds
  - Fraud detected / classified not having confirmation from RBI
  - Auditor's comment w.r.t. Fraud - Potential Risk (*Refer the detailed Early warning signals mentioned in LFAR*)
  - Effectiveness of EWS

## Important amendments

- **KYC & AML**
  - Adequacy of system and processes w.r.t. KYC and AML
  - Adherence to KYC & AML guidelines by branch (Test Check basis)

## Important amendments

- **Management Information System**
  - Availability of proper system and procedure to ensure data integrity relating to all data input used for MIS.
  - Any case observed during audit wherein data integrity was compromised?

## Important amendments

- Miscellaneous
  - Response to be given against each type of Audit carried out at branch.

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	<p>For this purpose, large advances are those in respect of which the outstanding amount is in excess of <b>10% of outstanding</b> aggregate balance of fund based and non-fund based advances of the branch or Rs. 10 crores, whichever is less.</p> <p>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.</p>	<ul style="list-style-type: none"><li>• Report on all advances (<i>including NFB Limits</i>) - If not readily available, seek the report wherein NFB limits are also included.</li><li>• Ascertain the total advances (FB + NFB) as per GL / Balance Sheet as on Balance Sheet Date</li><li>• Select the Customers qualifying for the limit of 10% / 10 Cr. Based on the above report / computation</li></ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	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.	<ul style="list-style-type: none"> <li>In LFAR it is prescribed that Account No. is to be mentioned. However, alongwith Account No., Auditor should also mention CUST ID.</li> </ul>

Account No. / <u>CUST ID</u>	Account Name	Balance at the end - Funded	Balance at the end - Non Funded	Total
<b>Total</b>		A	B	C = A + B
<b>Total Outstanding of the branch</b>		X	Y	Z = X + Y
<b>Percentage examined</b>		A as % of X	B as % of Y	C as % of Z

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	<p>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:-</p> <ul style="list-style-type: none"> <li>Account No.</li> <li>Account Name</li> <li>Balance as at year end</li> </ul>	<ul style="list-style-type: none"> <li>Obtain List of NPA Accounts.</li> <li>Obtain report containing List of all Advances Accounts with Date of Sanction and Disbursement.</li> <li>Review Accounts identified as NPA in year under review.</li> <li>Use CBS functionality of Account Master verification for Sanction and Disbursement Date</li> <li>Alternatively, Account Statement for transactions can also be reviewed.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Whether in borrowal accounts the applicable interest rate is correctly fed into the system?	<ul style="list-style-type: none"> <li>• Auditor should seek report containing Interest Rate Parameters information for each Advance Account. In case of unavailability of the said report auditor can carry out following alternative process.</li> <li>• Obtain Report containing all Advances Accounts as on 31.03.2021</li> <li>• Use Interest Parameters and Interest change history information related menu codes in CBS.</li> <li>• Review the same with Sanction Letter (including amendments if any)</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Whether the interest rate is reviewed periodically as per the guidelines applicable to floating rate loans linked to MCLR / EBLR (External Benchmark Lending Rate)?	<p>In continuation of previous slide, auditor should review following additional reports / information.</p> <ul style="list-style-type: none"> <li>• Changes in MCLR / EBLR during the year. Datewise change (upward / downward) is required to be compiled in Spreadsheet.</li> <li>• Review Interest Master details from CBS</li> <li>• Review Interest Rate Change History through CBS</li> <li>• Alternatively, the auditor can also generate Interest Report for entire period and can review the different rate of Interest applied in Account.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Have you come across cases of frequent renewal / rollover of short-term loans? If yes, give the details of such accounts.	<ul style="list-style-type: none"> <li>• Each bank has different set of processes to review / renew loans and updation thereof in CBS.</li> <li>• Understand the process followed in CBS by Bank.</li> <li>• Obtain reports of Review / Renewals during the year.</li> <li>• Alternatively the report of all advances at the beginning of year and end of year will also be useful in identifying changes in Limit Expiry.</li> <li>• In case of operative accounts, the renewal would also have entry in Drawing Power Limits under DP History.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	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?	<ul style="list-style-type: none"> <li>• Understand the process of updation of credit rating information in CBS.</li> <li>• At times it has been observed that the same has been updated directly in external system</li> <li>• Correctness of Credit Rating should be ensured as per latest Credit Rating Report.</li> <li>• Obtain list of Accounts wherein External Credit Rating is mandatory.</li> <li>• Check whether cases wherein Credit Score is poor have been marked as Unrated?</li> <li>• If there is any manual intervention (i.e. updation of credit rating directly in Cap. Adequacy computation software) report the appropriate observation under MIS / System related issues.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Did the bank provide loans to companies for buy-back of shares/securities?	<ul style="list-style-type: none"> <li>• Carve out the Corporate Borrowers out of total advances report.</li> <li>• Review Financial Statements of the Corporate Borrowers.</li> <li>• Review the Search Report obtained from CS.</li> <li>• Review Company Master data from MCA Website for any change post to Fin. Statement on record.</li> <li>• Review communication file with Bank seeking permission for change in capital structure.</li> <li>• In case of buyback transaction, review account statement for utilization of CC / OD Limit, Term Loan proceeds for the same.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Is the DP properly computed?	<ul style="list-style-type: none"> <li>• Review the details of stock statements, book debts statements, creditors information and other financial information provided by borrower.</li> <li>• Review the policy of bank to compute DP w.r.t. How the paid stock is arrived at. Whether Creditors amount is reduced from Stock or reduced only to the extent of value in excess of creditors ascertained at the time of Credit assessment</li> <li>• It is advisable for auditor to prepare a template in spreadsheet and compute the amount.</li> <li>• In CBS the DP is computed / updated in multiple ways. In certain cases, the CBS derives the DP using Margin % and Value of Security updated. In such case review the information from the Security related menu codes from CBS.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Comment on adverse features considered significant in top 5 standard large advances and which need management's attention.	<ul style="list-style-type: none"> <li>• Report containing details of All Advances Accounts should be obtained.</li> <li>• Apply Filter for Standard Accounts.</li> <li>• Apply Top 5 Filter on Standard Accounts for review.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Has the branch identified and classified advances into standard / substandard / doubtful / loss assets through the computer system, <b><u>without manual intervention?</u></b>	<ul style="list-style-type: none"> <li>• The most challenging part in the process of audit is to ascertain the classification and marking of NPA Accounts in CBS.</li> <li>• Each bank has different set of processes followed for identifying and marking of NPA.</li> <li>• Whether any feature of manual intervention is available at branch end or at HO Level (directly in backend database) should be ascertained. MR Letter can also be obtained on the same.</li> <li>• From Branch level (Front End) the manual intervention may not be available. However, as discussed earlier in the Presentation certain events may hamper the Asset Classification.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	<p>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.</p> <p><i>SMA-0 - Principal or interest payment not overdue for more than 30 days but account showing <u>signs of incipient stress</u></i></p> <p><i>SMA-1 - Principal or interest payment overdue between 31-60 days</i></p> <p><i>SMA-2- Principal or interest payment overdue between 61-90 days</i></p>	<ul style="list-style-type: none"> <li>• Obtain list of all Advance Accounts as at the end of the year and refer the overdue amount.</li> <li>• Review from NPA related menu codes in CBS for classification of account correctly as per IRAC guidelines.</li> <li>• For SMA-0 Refer sign of Stress (Appendix to Part C-1 of Master Cir. on IRAC dt. 01.07.2015) which will warrant the classification.</li> <li>• Delay in submission of Stock Statements / other stipulated returns / financial statements / non renewal of limits based on Audited Fin. Statements (<i>Within + out of CBS</i>)</li> <li>• Falling short of projections (<i>Out of CBS</i>)</li> <li>• Return of 3 or more cheques on ground of Non availability of Funds / Limits (<i>CBS</i>)</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	<p>(Cont...)</p> <p><i>SMA-0 - Principal or interest payment not overdue for more than 30 days but account showing <u>signs of incipient stress</u></i></p> <p><i>SMA-1 - Principal or interest payment overdue between 31-60 days</i></p> <p><i>SMA-2- Principal or interest payment overdue between 61-90 days</i></p>	<ul style="list-style-type: none"> <li>• Devolvement of LC / Invocation of BG and non payment within 30 days (<i>CBS</i>)</li> <li>• Third request for extension of time for creation of security (<i>Out of CBS</i>)</li> <li>• Increased frequency of overdrafts in Current Accounts (<i>CBS</i>)</li> <li>• Borrower reporting stress in the business and financials (<i>Out of CBS</i>)</li> <li>• Promoters pledging shares in the borrower company due to financial stress. (<i>Out of CBS</i>)</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Whether the upgradations in non-performing advances is in line with the norms of Reserve Bank of India	<ul style="list-style-type: none"> <li>• Obtain list of NPA Accounts upgraded during the year.</li> <li>• Report as at the end of Previous Year and as at the end of Current Year to be compared</li> <li>• Quarterly reporting on NPA should also be reviewed.</li> <li>• Whether at the time of upgradation entire overdue (across all facilities) have been recovered</li> <li>• Information can be accessed through Menu codes in CBS for Account Ledger Inquiry, Outstanding EMI etc.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	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?	<ul style="list-style-type: none"> <li>• Review the valuation date from NPA report as at the end of each financial year.</li> <li>• Review the physical valuation report for correctness of information updated in CBS.</li> </ul>

## Audit Requirements in terms of revised LFAR

5.	Advances	Requirements & Audit Process
	Whether in the cases concluded the recoveries have been properly appropriated against the principal / interest as per the policy of the bank?	<ul style="list-style-type: none"> <li>Obtain Accounting Policy followed by bank for appropriation of recovery in NPA Accounts.</li> <li>Review in CBS through EMI Recovery menu options and reversal of Memorandum Interest Transactions from Account Statement menu option for recovery sequence followed.</li> </ul>

## Audit Requirements in terms of revised LFAR

II.	LIABILITIES - Deposits	Requirements & Audit Process
	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.	<ul style="list-style-type: none"> <li>Review GL for FCNR (B) Deposits</li> <li>List of FCNR (B) Deposits Accounts from Detailed GL</li> <li>Review the date of Deposit and Date of Maturity.</li> <li>In case of high volume of FCNR Deposits, a specific report should be requested containing outstanding FCNR Deposits as on 01.04.2020, 31.03.2021 and transactions during FY 20-21</li> </ul>

## Audit Requirements in terms of revised LFAR

II.	LIABILITIES - Deposits	Requirements & Audit Process
	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?	<ul style="list-style-type: none"><li>• Obtain Minimum Balance requirement in different types of savings accounts prescribed by the bank.</li><li>• Select sample from different types of Savings Accounts.</li><li>• Extract Account Statement for the year and ascertain average monthly balance. (If the charges are prescribed on Average Monthly Balance).</li><li>• Review the transactions from Account Statement for Charges levied.</li></ul>

# Thank You

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