

Enclosure 4

to circular DBS.CO.PP.BC.11/11.01.005/2001-2002 dt 17-04-02

Long Form Audit Report to the Management by Central Statutory Auditors of Banks¹

The following paragraphs list the important matters with regard to advances, liquidity and funds management, internal control, automation and computerisation, and profitability besides certain general matters, which the statutory central auditors of banks are expected to comment upon in their long form audit reports. It may be mentioned that this list is illustrative and not exhaustive. Therefore, if it is felt that certain other important matters deserve to be included in the long form audit report, the central statutory auditor may do so.

Many of the matters to be dealt with by the central statutory auditors in their LFARs will be based on the LFARs received from the branches. In dealing with such matters, the central statutory auditors are expected to make their observations on the basis of review of branch auditors' LFARs.

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 judgement based on the facts and circumstances of each case. Where the auditors have any reservation or adverse remarks with regard to any of the matters to be dealt with in their Long Form Audit Reports, they may give the reasons for the same. Also, where relevant, instances of situations giving rise to their reservations or adverse remarks may also be given.

I. Advances

1. Loan Policy

- * Existence of Loan Policy - specifying the prudential exposure norms, industry-wise exposures, regular updation of the policy, system of monitoring and adherence thereto.

2. Credit Appraisal

- * Existence of a well laid-down system of appraisal of loan/credit proposals, including adequacy of information for appraising the credit worthiness of applicant, and adherence thereto.

3. Sanctioning/ Disbursement

- * Delegation of powers/authority at various levels; adherence to authorised limits; whether limits are disbursed after complying with the terms and conditions of sanction.

4. Documentation

- * System of ensuring that documents are executed as per the terms of sanction.
- * Nature of documentation defects observed during audit and suggestions to avoid such defects.
- * System of documentation in respect of joint/consortium advances.
- * Renewal of documents.

5. Review / Monitoring / Supervision

- * Periodic balance confirmation / acknowledgement of debts.
- * Receiving regular information, Stock/Book Debt statements, Balance Sheet etc.
- * Receiving audited accounts in case of borrowers with limits beyond Rs. 10 lakhs.
- * System of scrutiny of the above information and follow-up by the bank.
- * System of periodic physical verification or inspection of stocks, equipment and machinery

and other securities.

- * System and periodicity of stock audits;
- * Inspection reports and their follow up.
- * Norms and awarding of Credit Rating.
- * Review/renewal of advances including enhancement of limits.
- * Monitoring and follow - up of overdue arising out of other businesses such as leasing, hire purchase, credit cards, etc.
- * Overall monitoring of advances through maturity/ aging analyses; Industry-wise exposures and adherence to the Loan Policy
- * System of monitoring of off - balance sheet exposures including periodic reviews of:
 - (a) claims against the bank not acknowledged as debts
 - (b) letters of credit
 - (c) Guarantees
 - (d) ready forward transactions
 - (e) co-acceptances
 - (f) swaps, etc.

6. **Recovery Policy in respect of and Bad/doubtful debts / NPAs**

- * Existence of Recovery Policy, regular updation thereof; monitoring and adherence thereto: compliance with the RBI guidelines.
- * System of monitoring of recovery from credit card dues in respect of credit cards issued.
- * Effectiveness of the system for compiling data relating to the bad and doubtful debts and the provision in respect thereof.
- * System for identification, quantification and adequacy of provision (including at foreign branches).
- * System for suspension of charging of interest and adherence thereto.
- * Ascertaining the realisable value of securities (including valuation of fixed assets) and the possible realisation from guarantors including DICGCI/ECGC;
- * Assessment of the efficacy of rehabilitation programmes.
- * Method of appropriation of recoveries against principal, interest, etc.
- * **System of compromise settlements** : Review all such cases and cases of recovery of over Rs. 1.00 crore and also the cases wherein limits of sacrifice laid down in the Recovery Policy is exceeded. Compliance with RBI guidelines.
- * Provision / write-off: under proper authority.
- * Recovery procedures including that relating to suit filed and decreed accounts.
- * System of identifying and reporting of willful defaulters.

7. **Large Advances**

- * Comments on adverse features considered significant and which need management's attention.

II. **Liquidity and Funds Management**

1. **Investments**

- * Existence of Investment Policy and adherence thereto; compliance with RBI guidelines.
 - * System of purchase and sale of investments; delegation of powers; reporting systems, segregation of back office functions, etc.
 - * Controls over investments, including periodic verification/reconciliation of investments with book records.
 - * Valuation; mode; changes in mode of valuation compared to previous year; shortfall and provision thereof.
 - * Investments held at foreign branches; valuation mode; regulatory reserve requirements; liquidity.
 - * Composition of investment portfolio as per RBI guidelines and the depreciation on investments, if any, not provided for.
 - * System relating to unquoted investments in the portfolio and the liquidity of such investments.
 - * System relating to SGL / BRs; control over SGL / BRs outstanding at the year end and their subsequent clearance.
 - * System and periodicity of concurrent and internal audit/ inspection of investment activities; follow up of such reports.
 - * System of recording and accounting of income from investments.
 - * System of monitoring of income accrued and due but not received.
 - * System of monitoring matured investments and their timely encashment.
 - * Average yield on investments.
 - * System relating to Repos.
2. **SLR / CRR Requirements - System of ensuring compliance**
- * System of compiling weekly DTL position from branches.
 - * Records maintained for the above purpose.
3. **Cash**
- * System of monitoring of cash at branches; and management of cash through currency chest operations.
 - * Insurance cover (including insurance for cash in transit).
 - * System and procedure for physical custody of cash.
4. **Call money Operations**
- * System relating to inter-bank call money operations.
5. **Asset Liability Management**
- * Existence of Policy on Asset - Liability Management and monitoring thereof; compliance with the RBI guidelines.
 - * Functioning of Asset Liability Management Committee.
 - * Structural Liquidity at periodical intervals.

III Internal Control

1. **Written guidelines/instructions/manual for accounting aspects.**
2. **Balancing of Books/Reconciliation of control and subsidiary records**
 - * System of monitoring the position of balancing of books/reconciliation of control and

subsidiary records.

- * Follow-up action.

3. Inter-branch Reconciliation

- * Comments on the system/procedure and records maintained.
- * Test check for any unusual entries put through inter-branch/head office accounts.
- * Position of outstanding entries; system for locating long outstanding items of high value.
- * Steps taken or proposed to be taken for bringing the reconciliation up-to-date.
- * Compliance with the RBI guidelines with respect to provisioning for old outstanding entries.

4. Branch Inspections

- * System of branch inspections: frequency; scope/coverage of inspection/internal audit, concurrent audit or revenue audit: reporting.
- * System of follow-up of these reports; position of compliance.

5. Frauds/Vigilance

- * Observations on major frauds discovered during the year under audit.
- * System of follow-up of frauds / vigilance cases.

6. Suspense Accounts, Sundry Deposits, Etc.

- * System for clearance of items debited/credited to these accounts.

IV. Capital Adequacy

(Enclose a copy of the capital adequacy certificate)

V. Automation and Computerisation

- * Existence of Computerisation and Automation Policy; progress made during the year under review.
- * Critical areas of operations not covered by automation.
- * Number of branches covered by computerisation and the extent of computerization
- * Procedures for back-ups, off-site storage, contingency and disaster recovery and adherence thereto
- * Existence of Systems/ EDP audit; coverage of such audit.
- * Electronic Banking; existence of systems and procedures; monitoring; regular updation of technology; method of review and audit of procedures.
- * Suggestions, if any, with regard to computerisation and automation.

VI. Profitability

- * Analysis of variation in major items of income and expenditure compared to previous year.
- * Important ratios such as RoA, RoE, etc: comparison and analysis in relation to previous year.
- * Policy relating to general provisions/ reserves.

VII. System and Controls

- * Existence of systems and procedures for concurrent and internal audits, inspections, EDP audit of computer systems / software, etc., monitoring and follow - up of such reports:
- * Existence of Management Information System: method of compilation and accuracy of information.
- * Reliability of regulatory reporting under the Off Site Surveillance System of the RBI.

VIII. Other Matters

1. Comments on accounting policies including comments on changes in accounting policies made during the period.
 2. Policies and systems for monitoring activities such as underwriting, derivatives, etc.
 3. Adequacy of provisions made for statutory liabilities such as Income Tax, Interest Tax, Gratuity, Pension, Provident Fund, etc.
 4. Adequacy of provisions made for off-balance sheet exposures and other claims against the bank.
 5. Any major observations on branch returns and process of their consolidation in final statement of accounts.
 6. Balances with other banks - observations on outstanding items in reconciliation statements.
 7. Procedure for revaluation of NOSTRO accounts and outstanding forward exchange contracts.
 8. Observations on the working of subsidiaries of the bank:
 - (a) reporting system to the holding bank and
 - (b) major losses of the subsidiary, if any.
 9. Any other matter, which the auditor considers should be brought to the notice of the management.
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1. The Central Statutory Auditors should address their Long Form Audit Report to the Chairman of the bank concerned and a copy thereof should be forwarded to the designated office of the Reserve Bank of India.