

## **LONG FORM AUDIT REPORT AS A TOOL FOR MANAGERIAL CONTROL SYSTEM**

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### **ABSTRACT**

*In a developing country like India the role of banks is more constructive and purposeful than in a developed one. Banks are playing important role in two ways; firstly mobilization of savings to provide the required resources for investment activity of the public and private sectors and secondly, deployment of credit in such a manner that the macro economic goals of government general economic policy and plan objectives are adequately fulfilled. In this way, banks are becoming a catalytic agent of socio-economic growth in post-independence India.*

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**Keywords:** *Mobilization, Public and Private Sectors, Macro Economic Goals, Economic Policy.*

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### **Introduction**

The various categories of functions or business, which a banking company can undertake in terms of Section 5(b) and 6 of the Banking Regulation Act, 1949, are divided mainly in three categories as primary functions, agency functions and general utility functions. Primary Functions: Functions which give an identity to a banking institution i.e., which are primary and basic functions of each and every bank. These are: borrowing of money and lending of money. Agency Functions: The services that a bank renders as an agent or mediator, are called agency functions. Obviously, these are different from primary or basic functions and optional for a bank. These are: Collection and payment of cheques, bills and promissory notes; execution of standing orders; collection of dividends and interest; purchase and sale of securities; remittance of funds and acting as trustee or executor.

General Utility Functions: Other than primary and agency functions, a modern bank performs many general utility or miscellaneous functions also. The important ones are as follows: The transaction of foreign exchange business; acceptance of bills of exchange on behalf of customers; the safe custody of valuables and securities; specialized advisory service; supplying trade information and statistics; underwriting of loans raised by the government, public bodies or trading corporations; sale of rupee traveller's cheques and gift cheques; issue of personal and commercial letters of credit, etc.

To sum up, the functions or the services rendered by modern commercial banks are of immense value. They mobilize the scattered savings of the community and redistribute them into more useful channels. They constitute the very lifeblood of an advanced economic society. The internal audit function is an important part of the ongoing monitoring of the system of internal controls because it provides an independent assessment of the adequacy of, and compliance with, the established policies and procedures. It is critical that the internal audit function is independent from the day-to-day functioning of the bank and that it has access to all activities conducted by the banking organisation, including at its branches and subsidiaries.

### **Long form Audit Report (LFAR)**

Long Form Audit Report (LFAR), a detailed questionnaire prepared by Reserve Bank of India (RBI), has been in use since 1992-93. It is not an annexure to the Auditors Report but a Management Letter to be addressed to the Bank's Management. The LFAR was revised in consultation with ICAI and a few selected banks' representatives to re-reflect changes in regulatory/ supervisory framework of banks as also the expanded role of statutory auditors who are now required to include certain additional certification/ validations in their report.

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Banks were advised to apply the revised format from the year ending March 31, 2003. The revised format mainly focuses on systemic issues in banks, tries to address them through the insight of the bank branch auditors and acts as an early whistle blower for the irregularities persisting in the branch/bank. The format of Long Form Audit Report (LFAR) is in a questionnaire manner. Mainly, the questions in this format have been divided into five parts which has been given here briefly.

- **Capital:** Capital of a bank comprises of share capital from Government, member societies individual and share holding of Government in the total capital. The auditor has to verify all the points in relation to capital, changes made in opening and closing capital.
- **Liabilities:** Liabilities include deposits from various persons, loan taken from RBI, contingent liabilities and other liabilities. Auditor has to check whether loans are repaid on time or not, interest calculated on loan is proper or not, etc.
- **Assets:** Assets of a bank includes advances given to various persons, cash balance, investments, balance with RBI and other banks, money at call or short notice and other assets. Auditor has to verify that whether receipt of principle and interest are regular or not, whether cash balance is up to the limit or not, etc.
- **Profit & Loss Account:** This account includes interest income, facility related income, interest expense, various charges etc. Auditor has to check whether interest income and expenses are properly calculated at appropriate rate or not, whether all the incomes and expenses are provided for or not, etc.
- **General:** In general, the miscellaneous points are included like inter branch accounts, proper books of accounts, appropriate controls, adequate internal control etc. Auditor has to verify whether proper books of accounts are kept or not, whether appropriate controls are placed or not, etc.

Following are some important points to be kept in mind while drafting Long Form Audit Report (LFAR) by an auditor:

- The format of LFAR report is questionnaire format but the auditors are not necessarily require to limit their answers to YES or NO, they can express their opinion as well.
- The LFAR report is neither a substitute nor a part of statutory audit report. It is a separate provision set by RBI.
- The central statutory auditor should carefully read the LFAR report issued by various branches of the Bank, before issuing the LFAR report for Head office of the bank.
- The qualifications expressed in LFAR report should be supported by appropriate evidences.
- The central statutory auditor can also get any information from the branch management.

The researcher benefited from previous studies to know what is new about the Internal and Managerial Control System.

**Table 1: Literature reviewed related to Internal and Managerial Control in Banking System**

Year	Author(s)/ Researcher(s)	Subject	Conclusion & Research Gap
2019	Saibal Ghosh	Loan delinquency in banking systems: How effective are credit reporting systems	The analysis concludes that credit reporting system reforms leads to a decline in bad loans by roughly 40 percent. – Study focused on credit reporting systems in banks and has nothing about audit requirement.
2017	Saibal Ghosh	Leverage, managerial monitoring and firm valuation: A simultaneous equation approach	The firm valuation is found to exert a significant influence on managerial ownership and vice versa. Robustness tests indicate a weak but growing role of bank debt as a disciplinary mechanism. – No role of audit or LFAR considered.
2017	Mostak Ahamed	Asset quality, non- interest income, and bank profitability: Evidence from Indian banks	The results of this paper provide valuable insights for policymakers, and conclude that ensuring diversification activities enhances bank profitability, in particular for the banks that have lower asset quality. – Nothing about audit requirement
2016	Abhiman Das and Saibal Ghosh	Financial deregulation and efficiency: An empirical analysis of Indian banks during the post reform period	The study concluded that medium-sized public sector banks performed reasonably well and are more likely to operate at higher levels of technical efficiency. – No role of audit or LFAR considered.

2011	Asish Saha and Ravisankar	Rating of Indian commercial banks: A DEA approach	It was concluded from this empirical analysis that Data Envelopment Analysis (DEA) could be a suitable approach towards measuring the relative efficiency of banks in the Indian context. – Nothing about audit requirement
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**Table 2: Literature reviewed related to Audit Reporting and Long Form Audit Report in Banks**

Year	Author(s)/ Researcher(s)	Subject	Conclusion & Research Gap
2019	Saibal Ghosh	Loan delinquency in banking systems: How effective are credit reporting systems	The analysis concludes that credit reporting system reforms leads to a decline in bad loans by roughly 40 percent. – Study focused on credit reporting systems in banks and has nothing about audit requirement.
2018	Lawrence J. Abbott, William Buslepp and Matthew Notbohm	The audit market effects of disputing a GAAP-deficient PCAOB inspection report	In this paper, researchers investigated whether and to what extent the auditor's response - which is also encapsulated in the inspection report - impacts the reaction to GAAP-deficient inspection reports. – Useful study about auditing but no LFAR has been considered
2018	Reiner Quick and Florian Schmidt	Do audit firm rotation, auditor retention, and joint audits matter? - An experimental investigation of bank directors' and institutional investors' perceptions	Authors failed to identify a positive impact of the regulatory measures taken or supported by the European Commission on perceptions of auditor independence and audit quality. – The subject is not concerned with practical auditing and LFAR
2017	Saibal Ghosh	Leverage, managerial monitoring and firm valuation: A simultaneous equation approach	The firm valuation is found to exert a significant influence on managerial ownership and vice versa. Robustness tests indicate a weak but growing role of bank debt as a disciplinary mechanism. – No role of audit or LFAR considered.
2017	Mostak Ahamed	Asset quality, non-interest income, and bank profitability: Evidence from Indian banks	The results of this paper provide valuable insights for policymakers, and conclude that ensuring diversification activities enhances bank profitability, in particular for the banks that have lower asset quality. – Nothing about audit requirement
2017	Peter Carey, Li Liu and Wen Qu	Voluntary corporate social responsibility reporting and financial statement auditing in China	Authors find that non-state-owned enterprises with more highly rated CSR performance or longer CSR reports are associated with lower audit fees and less earnings management. – Not a practical study about audit and LFAR
2017	Najeb Masoud	An empirical study of audit expectation-performance gap: The case of Libya	Researcher observed that reducing the expectations gap is to improve knowledge responsibilities between the auditors and user groups and understanding of the auditor's role and responsibilities through the provision of auditing illegal acts. – Not an analytical study of audit
2017	Gholamhossein Mahdavi and Abbas Ali Daryaei	Attitude	The results of this study show that the auditors having positive attitude toward marketing and those who consider it as significant are able, to a large extent, balance spent time for inherent auditing tasks and marketing activities. – Not an analytical study of audit
2016	Abhiman Das and Saibal Ghosh	Financial deregulation and efficiency: An empirical analysis of Indian banks during the post reform period	The study concluded that medium-sized public sector banks performed reasonably well and are more likely to operate at higher levels of technical efficiency. – No role of audit or LFAR considered.
2014	Khairul Anuar Abd Hadi, Halil Paino, Zubaidah Ismail and Muhammad Haziq Dhiyauddin	Forgery in the Making of Audit Report: The Liabilities and Breach of Professional Duties	This paper examined the liability of the auditors in case of their failure to identify the existence of forgery as well as to exercise due diligence in the making of audit report. – Not an analytical study of audit
2011	Asish Saha and Ravisankar	Rating of Indian commercial banks: A DEA approach	It was concluded from this empirical analysis that Data Envelopment Analysis (DEA) could be a suitable approach towards measuring the relative efficiency of banks in the Indian context. – Nothing about audit requirement

2011	David Y. Chan and Miklos A. Vasarhelyi	Innovation and practice of continuous auditing	This paper defines how continuous auditing methodology introduces innovation to practice in seven dimensions and proposes a four-stage paradigm to advance future research. – LFAR is not considered
2006	Nilesh S. Vikamsey and Ketan S. Vikamsey	Long Form Audit Report and Tax Audit in Respect of Bank Branches	This article focuses on certain aspects of reporting in LFAR and certain issues involved in Tax Audit of Bank Branches. – Initial study about certain aspects of reporting in LFAR
1993	Grant Gay and Peter Schellugh	The effect of the Longform Audit Report on users' perceptions of the Auditor's Role	The Audit Report on a General Purpose Financial Report, issued in July 1993, significantly increased users' understanding of the role of the auditor, the nature of the audit process and the financial reporting process in Australia. – Earlier study of LFAR in Australia

Since no previous study found on the title selected for the present work, this study is an attempt on a new topic with new concept.

A questionnaire based survey had been conducted to collect the information and data related to LFAR. For this purpose,

The main objectives of this study are as follows:

- To study the LFAR and identify the shortcomings of banking system.
- To study the auditors' opinion at present format of LFAR and there outcomes.

The data obtained through questionnaire were analyzed by using appropriate statistical tools. The filled up questionnaire sets were coded and master data sheet was prepared. The data were then tabulated and classified, interpreted and conclusions have been drawn using a number of statistical tools like mean, standard deviation, coefficient of variation, p-test, F-test etc. The researcher collected primary data from senior managers and branch managers of different banks, from CA, CS and CMA, by means of questionnaire responses.

#### Limitations of the Study

There are some factors not controllable during the research work and can be considered as limitations of this study. These are as follows:

- Due to limitations, only Jaipur district had been considered for this study in the Rajasthan State.
- The finding of the study is based on a small sample. So one should be careful while generalizing the results.
- The impact, mentioned in the present study, is the perception of the respondents. The percentages indicate the number of respondents, who reported that there has been a change i.e., increase or decrease in the parameter.
- The study may be affected with quality of reply received in response of questionnaire. Some respondents may be biased.
- Further, the techniques and tools of investigations have also inherent limitations.
- Lastly, the study has subjected to general human limitations.

#### Scope for Future Work

The present study has been carried out to evaluate LFAR audit information as a tool for Managerial Control System. For future work, following subject areas can be considered:

- Importance of Long Form Audit Report and its implementation reality.
- Strategy to improve Managerial Control System in Indian Banking System.
- System security and customer security measures against frauds in increasing digitalization platforms in banking.

#### Analysis and Interpretation

For critical evaluation of Long Form Audit Report (LFAR) as a tool for Managerial Control System with reference to Indian Banking System, a questionnaire based survey of different bank branches has been conducted by the researcher, and Google Platform has also been used to get responses for the same.

#### Data Collection

The researcher collected primary data from senior managers and branch managers of different banks, from CA, CS and CMA, by means of questionnaire responses.

The Likert scale had a range of options from ‘Strongly Agree’ to ‘Strongly Disagree’. This gave respondents the ability to make fine distinctions between attitudes (Dundas, 2004). The questionnaire was structured so that general information was sought first before moving to questions that probed deeper aspects of Long Form Audit Report (LFAR). Here firstly, the responses collected from different respondents through questionnaire have been shown in following Tables.

**Assets**

• **For Cash:**

The questionnaire part I(1) having 5 questions related to cash assets management in bank branches, for which responses have been collected and analysed. These are given in Table 3,

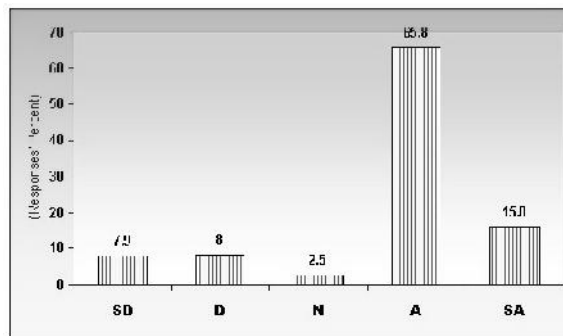
**Table 3: Responses in Percent**

S. No.	Detail	SD (1)	D (2)	N (3)	A (4)	SA (5)
1.	Is your bank branch often carry cash balances, which vary significantly from the limits fixed by the Controlling authorities of the Bank?	7.9	8.0	2.5	65.8	15.8
2.	In case of excess balances, have you report to the Controlling authorities promptly?	10.5	15.8	5.0	2.9	65.8
3.	Does the branch hold adequate insurance cover for cash on hand and cash-in-transit?	0	8.3	8.4	69.4	13.9
4.	Is cash maintained in effective joint custody of two or more Officials, as per the instructions of the controlling authorities of the Bank?	9	4.5	59.5	16.2	10.8
5.	Have the cash balances at the branch been checked at periodic intervals as per the procedure prescribed by the controlling authorities of the Bank?	0	5.6	11.1	72.2	11.1
	Average	5.48	8.44	17.30	45.30	23.48
	Std. Dev.	5.09	4.42	23.82	33.05	23.75
	C.V. (%)	92.83	52.31	137.67	72.96	101.14

Source: Author’s compiled primary data.

Here, SD = Strongly Disagree; D = Disagree; N = Neutral; A = Agree, and SA = Strongly Agree. Std. Dev. = Standard Deviation, C.V. = Coefficient of Variation.

The responses received for Part-I(1) of questionnaire as given in Table 4.2 shows that individually, for q.nos. 1, 3 and 5 i.e., 3 out of 5 questions have maximum responses of answer no. (4) i.e., ‘agreed’ whereas q.no. 2 has maximum responses for answer no. (5) i.e., ‘strongly agreed’ and q.no. 4 has maximum responses for answer no. (3) i.e., ‘neutral’. The highest average of total responses i.e., 45.30 percent received for answer no. (4) which means ‘agree’ for these five questions. It followed by ‘strongly agreed’ option which received 23.48 percent responses, then ‘neutral’ got 17.30 percent responses. Average ‘disagree’ and ‘strongly disagree’ responses were 8.44 percent and 5.48 percent respectively. In reply of the first question, ‘Is your bank branch often carry cash balances, which vary significantly from the limits fixed by the Controlling authorities of the Bank?’, 65.8 percent of total respondents were in favour of ‘agreed’ and 15.8 percent were ‘strongly agreed’, combining these responses, it is clear that more than 81 percent were agreed about variations occurred often from the cash limit fixed by controlling authorities. Only 8.0 percent respondents were disagreed and 7.9 percent were strongly disagreed whereas 2.5 percent remained neutral. From this response, it can be concluded that bank branches often carry cash balances, which vary significantly from the limits fixed by the Controlling authorities of the Bank.



**Fig. 1: Responses for Part-I, Q.No.1.**

### Conclusions

For Cash Assets, it can be concluded from the present study that:

- Bank branches often carry cash balances, which vary significantly from their respective limits fixed by bank authorities;
- In case of excess balances, they like to report to the controlling authorities promptly;
- Mostly, they having adequate insurance cover for cash on hand and cash-in-transit;
- It seems from responses that the instructions of the controlling authorities of the Bank about 'cash should maintained in effective joint custody of two or more Officials' is not obeyed strictly in bank branches; and
- Cash balances at bank branches have been checked at periodic intervals as per the procedure.

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