BANKS' NPA CONTROL THROUGH FORENSIC AUDIT

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Abstract: *Trust and confidence are the building blocks of a bank. But these trust and confidence are badly affected by the rising NPAs of banks. The NPA of public sector banks has increased fromRs.2, 05,054 crore in September 2015 to Rs.4, 00,000 crore in April 2016.In other words an increase of 100%approximately in just 8months. NPAs are basically the financially burdens to a bank. All this raises the concerns of the financial officers and the RBI. Due to the rising concern of NPAs the Reserve Bank of India issued a circular on May2015 in order to determine some of these bad assets as red flag assets and to order the forensic audit to curb the situation. This paper makes an attempt to discuss the meaning and present status of NPA; understanding the early warning signals for an account becoming NPA ; the meaning and evolution of Forensic Audit and to know Accounts for which forensic audit is applicable.*

Keywords: NPA, Forensic Audit, Loss, Banks

INTRODUCTION

Banks are built on trust and confidence. If a bank loses its trust, customers starts losing their confidence. In the present scenario it can be clearly seen that position of the banks is badly affected by the sharp increasing amount of the Non Performing Assets (NPAs). NPAs are basically the financially burdens to a bank. These are the loans from which banks are not earning any income. It affects the solvency position of these banks, their profitability, and liquidity and in turn leads to credit loss and overall losses to these banks. In the recent years the NPAs of the banks are on rise, specially the public sector banks. As to be noted that the NPA of public sector banks has increased fromRs.2,05,054 crore in September 2015 to Rs.4,00,000 crore in April 2016.In other words an increase of 100%approximately in just 8months. Due to the rising concern of NPAs the Reserve Bank of India issued a circular on May2015 in order to determine some of these bad assets as red flag assets and to order the forensic audit to curb the situation.

MEANING OF NPA

With effect from March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where;

i. Interest and /or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan,
ii. The account remains 'out of order' for a period of more than 90 days, in respect of an overdraft/ cash Credit (OD/CC),
iii. The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
iv. Interest and/ or installment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purpose, and
v. Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

The Non Performing Assets can be classified into the following three broad groups

a. Sub--Standard Assets
b. Doubtful Assets
c. Loss Assets

OBJECTIVES OF THE STUDY

- To know the meaning and present status of NPA
- To discuss the early warning signals for an account becoming NPA
- To discuss the meaning and evolution of Forensic Audit
- To know Accounts for which forensic audit Applicable

RESEARCH METHODOLOGY

This research paper is based on secondary data. The data for the paper has been collected from the published sources such as newspapers, magazines, articles and journals.

PRESENT STATUS OF NPAs

The present status of NPAs of the banks shows an increasing trend. As can be depicted from the table that the position of public sector banks are more serious than of the private sector banks. The NPA of public sector banks has increased fromRs.2, 05, 054 cr. in September 2015 to Rs.4, 00,000 cr. in April 2016. In other words there is a sharp increase of 100%approximately in just 8months.

All this raises the concerns of the financial officers and the RBI. Due to the rising concern of NPAs the Reserve Bank of India issued a circular on May2015 in order to determine some of these bad assets as red flag assets and to order the forensic audit to curb the situation.

	Public Sector Banks		**Private Sector Banks**	
Years	**Gross NPAs (%)**	**Net NPAs (%)**	**Gross NPAs (%)**	**Net NPAs (%)**
2001-02	**11.09**	5.82	**9.64**	5.73
2002-03	9.36	4.54	8.08	4.95
2003-04	7.80	3.00	5.85	2.80
2004-05	5.50	2.00	6.00	2.70
2005-06	3.60	1.30	4.40	1.70
2006-07	2.70	1.10	3.10	1.00
2007-08	2.20	1.00	2.30	0.70
2008-09	2.00	0.94	2.36	0.90
2009-10	2.20	1.09	2.32	0.82
2010-11	2.40	1.20	1.97	0.53
2011-12	3.30	1.70	1.80	0.60
2012-13	3.80	2.00	1.90	0.50
2013-14	4.70	2.70	1.90	0.70
2014-15	5.33	3.14	**2.05**	**0.81**

EARLY WARNING SIGNALS FOR AN ACCOUNT BECOMING NPA

On May 2015 RBI has issued some Early Warning signals, which should alert the bank officials about some wrongdoings in the loan accounts, which may turn out to be fraudulent

1. Default in payment to the banks/ sundry debtors and other statutory bodies, etc., bouncing of the high value cheques.
2. Tax Raids by authorities.
3. The borrower changes the scope of the project very frequently.
4. Inventory being Under insured or over insured
5. Invoices devoid of TAN and other details
6. Disputed title of the collateral securities
7. Wide variance between the standard cost and the costing of the installation cost project shown by the borrower
8. Outstanding loan amount are liquidated from the funds which comes from other banks.
9. Foreign bills remaining outstanding for long time.
10. Onerous clause in issue of BG/LC/standby letters of credit

11. In merchanting trade, import leg not revealed to the bank
12. Borrower avoiding godown inspection for flimsy reasons.
13. Delay observed in payment of outstanding dues
14. To avail finance from the branch situated far away from the unit.
15. Claims not acknowledged as debt high
16. Frequent invocation of BGs and devolvement of LCs
17. Funding of the interest by sanctioning additional facilities
18. Several loans are taken on the same collateral
19. vital documents Concealment
20. Floating front / associate companies by investing borrowed money
21. stake of promoter / director reduced
22. the key personnel resigned in huge numbers and frequent changes in the management takes place
23. Unbilled revenue increases substantially year after year.
24. Large outstanding are shown in the form of large number of transactions with inter-connected companies.
25. Turnover growth is not as much higher as movements in inventory are shown.
26. Significant changes in receivables are shown higher than the growth in turnover and/or increase in ageing of the receivables.
27. Current assets increases disproportionately.
28. Significant increase in working capital borrowing as percentage of turnover.
29. Critical issues are highlighted in the audit report.
30. Increases in Fixed Assets have shown, without corresponding increase in turnover.
31. Borrowings Increases, despite huge cash and cash equivalents in the borrower's balance sheet.
32. Liabilities appearing in ROC search report, not reported by the borrower in its annual report.
33. Substantial transactions are reported with related party.
34. Material discrepancies in the annual report.
35. The annual report contains significant inconsistencies (between various sections).

36. Poor disclosure of materially adverse information and no qualification by the statutory auditors.
37. Accounting period or accounting policies are changed frequently.
38. General purpose loans are requested frequently.
39. Account is frequently moved from one bank to another.
40. Frequent ad hoc sanctions.
41. Sales proceeds are not routed through bank.
42. LCs issued for local trade / related party transactions
43. RTGS of very High values paid to unrelated parties.
44. Heavy cash withdrawal in loan accounts.
45. Original bills not submitted.

FORENSIC AUDIT

Forensic Audit can also be termed as a scientific process in which the financial information is firstly gathered then analysed and finally presented in a proper document that can be used as a test of time in the courts. It is a powerful instrument to curb the rising frauds. Forensic Auditing assists an organization in following two ways

- Investigative Accounting
- Litigation Support

Investigative Accounting It deals with the investigation of criminal matters relating to employee theft, securities fraud, insurance fraud etc. and also includes provisions and suggestions regarding possible courses of action.

Litigation Support It involves the quantification of the amount of economic damages and also providing accounting assistance in litigation matters.

EVOLUTION OF FORENSIC ACCOUNTING

In 19th century the need for Forensic accounting was first realized as an accountant was required to testify at a hearing of bankruptcy in the year 1817. It becomes more known in 1824 after the announcement made by a Scottish accountant that he expertise in legal accounting. Worldwide Sherlock Holmes is considered as first Forensic accountant. However, a significant contribution made by the Indian historic persons like Kautilya, Birbal and Tenaliram can never be ignored. During the ancient Mauryan Times Kautilya was the first person to mention the famous forty ways of embezzlement in the form of a his famous book known as Kautilya arthashastra . The research is triggered in India with a great speed and Pradeep A kunoor who heads Journal of Forensic accounting in India pioneers the topic and has done a good research about the contribution of Kautilya in Forensic accounting. Pradeep have called Kautilya back in to the 21st Century and have started the series of virtual conversations between the computer and Kautilya. This virtual conversation revealed that almost all the major failures in USA Incorporates were the extended versions of what Kautilya said few thousand years before. Hardly any change in their numbers can be seen. Indian Forensic Accountant Manual contains all this virtual conversation between Kautilya and the computer of the present age. Birbal, a great scholar of the time of King Akbar used various tricks to investigate various frauds. These work as the Litmus test to the Fraud examiners even of recent times. Birbal's stories are mostly applied by the Gem of Indian Fraud Examiners, ChetanDalal, to the investigation of the frauds. In various articles published in BCAS Journal ChetanDalal has explained how Birbal's trap and Birbal's Litmus test approaches are significantly used while investigating the accounting frauds.Another one, the third scholar in the above field, is Tenaliram who emphasized on the techniques of investigations to detect the root of fraud and the perpetrators.

ACCOUNTS FOR WHICH FORENSIC AUDIT APPLICABLE

RBI also suggested that the forensic audit is not to be done only for the name sake but also answer the questions relating to what, when who and how an account becomes an NPA.

Common types of frauds for which banks can order forensic audit are:

1. Unauthorised withdrawals
2. Unauthorised transfer of funds from customer accounts
3. Theft of physical assets
4. Unauthorised use of collaterals
5. Loan to non-existent borrowers
6. Loan with kickbacks
7. Pledging of collateral more than once
8. False credit information
9. Bad loan swapping
10. Reciprocal loan arrangements
11. Money Transfer (Wire) Fraud

12. ATM Fraud
13. Letter of Credit (LC) Fraud
14. Cheque Fraud
15. Credit card fraud
16. Cyber frauds
17. NPAs

CONCLUSION

The tremendous increase in the number and amount of NPAs has raised the tension of the financial sector. Due to this the Reserve Bank of India has issued guidelines to declare the forensic audit for those accounts which are suspected to be bad. RBI also issued the early warning signals to detect some of the accounts before they become totally bad. All these steps will surely be proved to become a helping hand to curb the existins situation of the NPAs.

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