# Fraud Detection during Bank Branch Audit

Pointing & Hunting FRAUDS

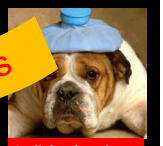
Internet: nptbanking.blogspot.com
Youtube: nptbanking channel
Email: nitant.trilokekar@gmail.com

March 2023

## Number of audits over the years

1. Statutory Audit
2. Revenue Audit (Income and Exp. Audit)
3. Inspection
4. Snap Audit
5. RBI Audit
6. Foreign
7. Conc dit (Fall out of big bull operation)
8. Semi annual audit of big branches
9. Information Systems audit

Yet there are frauds



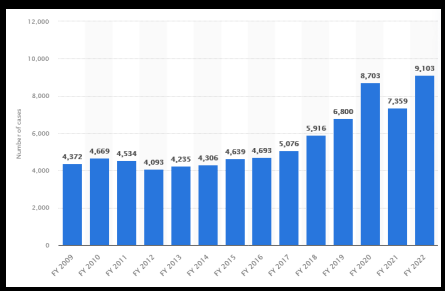
Audit burdened Branch manager

2

Bank audit is like
Riding a bike
Except that bike is on fire
You are on fire
Everything is on fire

3

## Bank fraud cases 2009-2022




4

## Some statistics (RBI)

- 9,103 cases involving Rs 1,85,644 crore
- 98 per cent were of advances
- Time lag between the date of occurrence of frauds and their detection by banks and FIs was 24 months. (Minimum 2 statutory audits)
- Larger frauds of Rs 100 crore and above — the average lag was 63 months. (Minimum 5 Statutory Audits)

5

**Banks lose Rs 1.6 crore every hour to cheating, forgery**

The State Bank of India lost the most — Rs 5,743 crore — accounting for 15 per cent of money lost by PSBs.

**India saw 229 banking frauds per day in FY21,**
**less than 1% amount recovered**

**India saw 83,638 cases of banking frauds in FY21, involving Rs 1.38 lakh crore. Of this, only Rs 1,031.31 crore has been recovered so far.**

6

## Cash Verification

7

## Insider perpetuated: Market financing by Cashier

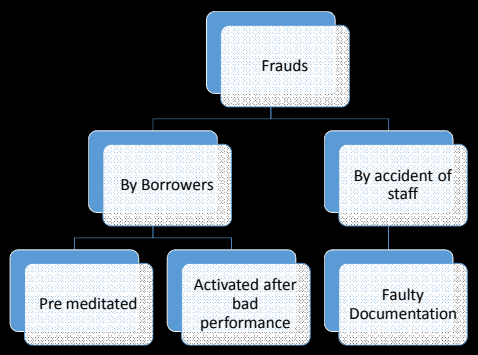
Cashier takes charge at start of day. Hands over cash without entry to 'friend' waiting in queue.

'Friend' rushes to market to purchase goods at cash discount to sell

'Friend' returns the cash before end of day. Usually last person to enter branch.

8

## Frauds in Advances




9

## Frauds by stage of advance PRE-SANCTION

- Pre-sanction
  - Eligibility of subsidized loans
  - Wrong facts in evaluation note
  - Ignorant of track record of NPA in other branches/Banks (Remedy is under implementation)
  - Value of asset to be financed
    - Property
    - Gold
- False KYC

**Accident or connivance?**

10

## Frauds by stage of advance SANCTION & DOCUMENTS

- Sanction beyond discretion power
  - Sanctioning authority
  - Excess Exposure to category of borrower (credit policy)
  - Excess exposure to group (credit policy)
- Documents not filled in properly
  - Ignorant staff
  - Critical misinformation / non information
- Wrong Document taken

11

## Approach to detect Frauds during Audit

F Find the Red Flags

R Review the Red flag transactions

A Analyse them for abnormality

U Understanding shared with Mgmt.

D Document your findings

S Statutorily report them

12

## Post Sanction

- Non fulfillment of critical terms of security or collateral
- Substitution of collateral approved by level lower than sanctioning authority
- End use of funds not monitored or knowingly diverted

**Accident or connivance?**

13

## Laser target your audit process by department of Advance

- Consortium Advance
- Bullet Loan
- Working Capital – Cash Credit
- Temporary Advance
- NEW advances Jan to March

14

## What should be your philosophy to detect fraud?

Set a thief to catch a thief ?

The thief is the artist. The policeman is only a critic…

Oscar Wilde

15

## Consortium NPAs

| | |
|---|---|
| **Bhushan Steel Ltd** | **Rs 44,478** crore. |
| **Lanco Infratech** | **Rs 44,364** crore. |
| **Essar Steel Ltd**: | **Rs 37,284** crore. |
| **Bhushan Power & Steel Ltd** | **Rs 37,248** crore. |
| **Alok Industries** | **Rs 22,075** crore. |
| **PNB Diamond Fraud** | **Rs 11,400** crore. |
| **Amtek Auto** | **Rs 14,074** crore |
| **Monnet Ispat and Energy Ltd** | **Rs 12,115** crore. |
| **Electrosteel Steels** | **Rs 12,115** crore. |
| **Kingfisher** | **Rs 10,000** Crore. |
| **Era Infra Engineering** | **Rs 10,065** Crore. |
| **Jaypee Infratech** | **Rs 9,635** crore |
| **Jyoti Structures** | **Rs 5,165** crore |

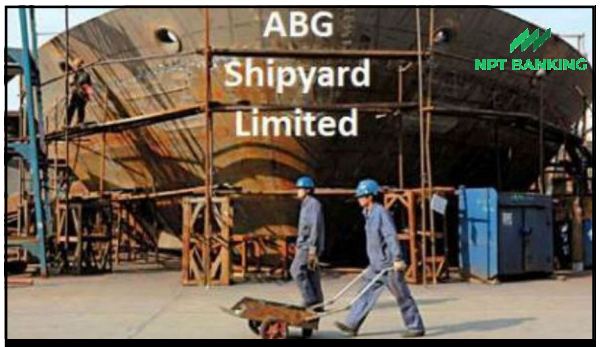
NPT BANKING

Auditing consortium advance tough when you are not the Principal Banker

NPT BANKING

Predicting problems in Consortium Advances

When you are NOT sitting with Principal Banker but with Member Bank




Rs. 22,842 crores

## Consortium Advance

(especially when you are sitting in **member** Bank branch not the lead Bank)

- Consortium vs Multiple Banking
- Terms of sanction
- Quality of monitoring
  - Meetings as decided
  - Minutes of meeting
  - Issues discussed in meeting
  - Interest and installment servicing
  - Last visit by your Bank
  - Stock statement, Audited financial statements

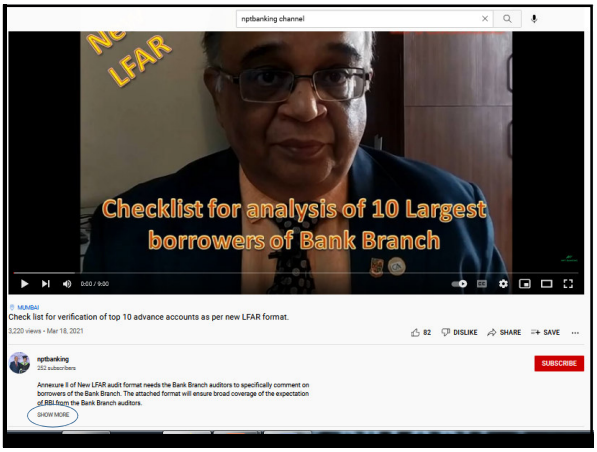
18

## Your Commandment to follow since last year

Thou shalt **not** submit any Bank Branch audit Report without

1. MOC
2. Qualification
3. Fraud Reporting

19

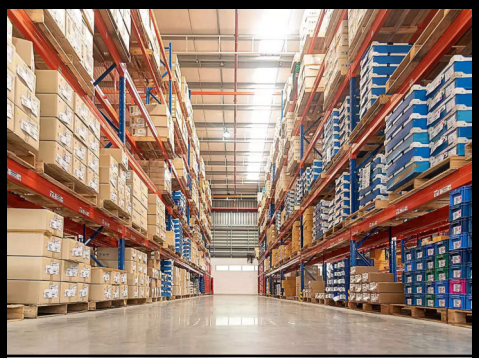


## Misunderstanding cleared of bullet loan

- Lend and forget. Monitoring not necessary
- Bullet loans are long periods only
- Bullet loan vs Bridge loan
- Bullet loan vs education loan
- Bullet loan and prudential norms

21

## Cash Credit



## WC ag drs and stock

- WCTL is not the same as WC
- WC is a perpetual exposure
- Select sample scientifically for your working notes
- Last few inspection reports
- Frequency of cheques returned
- OD against clearing/Cheque purchase frequency
- Number of times TOD granted / Over limit

23

## NPA Manipulation – Temporary Advance

- Usually for Working Capital Advances exceeding limit nearly upto 90 days.
- Temporary advance period to cross year end.
- Repeated Temporary advance (Limit?)
- Seasonal Advance Abused/misunderstood
- Advance to Associate units to fund the loans
- Manager's discretion of 10% above S.L.

24

Credit Entry

## Non Funded entry

- CC account brought within limit
  - Bill Discount etc. Careful on export finance.
  - Transfer from another account (market borrowing usually same branch)

Suggested measures to spot the Red Flags

- CC Accounts overdrawn more than 80 days (Panic period starts here)
- ***Casual*** Bill Discount (no formal sanction)
- All transfers to other account are not frauds. Some are part of process (next Slide)

25

NPA Manipulation

## New Advance or Transfer to New Account

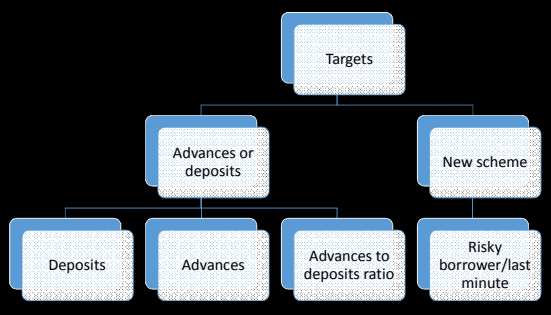
- Dual Objective Achieved
  - New loans of higher amounts achieve target
  - Old loans are closed without NPA Increase
  - Details available on youtube also
- Case resulting in closure of Bank and Auditor absconding

Suggested measures to spot the Red Flags

- Ratio analysis
- New borrowal accounts have to be analysed.
- Check all – don't forget Bills purchased/discounted, LC issued, Letter of Understanding etc.
- New accounts opened by transfer from old account

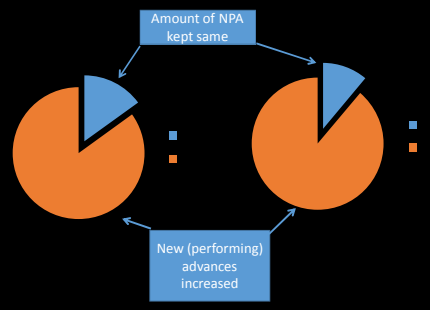
26

Window Dressing: Target achievement




27

## NPA Ratio manipulation




28

## Window Dressing - Target achievement of Advances

- Hurriedly given advances
- Priority sector categorization loophole
  - Agriculture advance in metro cities
- March disbursements are usually congenital NPA
- Gold Loan

29

## Window Dressing - Target achievement of Advances – New Scheme

- Subsidised schemes of Govt.
- Incomplete Circular/guidelines
- Loan Melas of the past
- Non existing well (20 point programme scheme)
- Triparte agreements needed but not made
  - Truck Advances (Siddhi Vinayak Logistics)
  - Cobbler scam

Ineligible lending
Affordability of installment

Priority sector seduction

30

Karisma Kapur unveils the Logo for Siddhivinayak Logistics31

SVLL company has placed an order for 120 luxury buses from Swedish commercial vehicle maker Scania

1. Costs 2.3 crore rupees
2. Interiors designed by Dilip Chabbria, an automotive designer and the owner of design firm DC Design.
3. Customization means that the bus can accommodate only 31 passengers.
4. Own pantry and crew, who will serve passengers refreshments during the course of the journey.

32

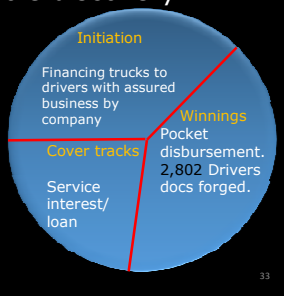
## The cycle of Siddhivinayak Logistics Bank of Maharashtra scam

- Initiation/Loophole discovery
- Winnings
- Cover tracks

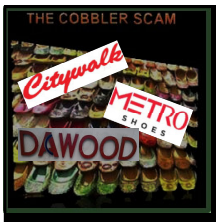
Perpetual motion trigger

Target Achievement Priority Sector Advance

Borrower intention: Low cost loan with same advantage




33




Location : Mumbai

Year of unearth: 1995

Damage : USD 600 million (Rs 1,000+crore)

Exploitation of : scheme that was floated by the Government of India meant to benefit the poor cobblers of Mumbai.
Modus Operandi : Float Several bogus societies of cobblers.

King pins: Saddrudin Daya, former sheriff of Mumbai and owner of Dawood Shoes, Rafique Tejani, owner of Metro Shoes, Kishore Signapurkar, proprietor of Milano Shoes, and Abu Asim Azmi, president of Samajwadi Party's Mumbai unit and partner in Citywalk Shoes.
Officials of : Maharashtra State Finance Corporation, Citibank, Bank of Oman, Dena Bank, Development Credit Bank, Saraswat Co-operative Bank, and Bank of Bahrain and Kuwait.

**Ceiling of Disruption**: Octroi Department – excessive concessions
*In 1995, Sudhir Thakre, the joint registrar of the Cooperative Society for Mumbai division, ordered a survey of the registered societies.*

34

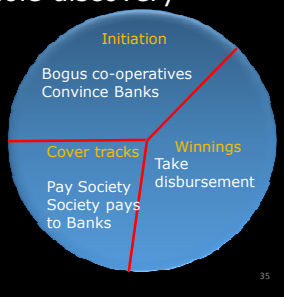
## The cycle of cobbler scam

- Initiation/Loophole discovery
- Winnings
- Cover tracks

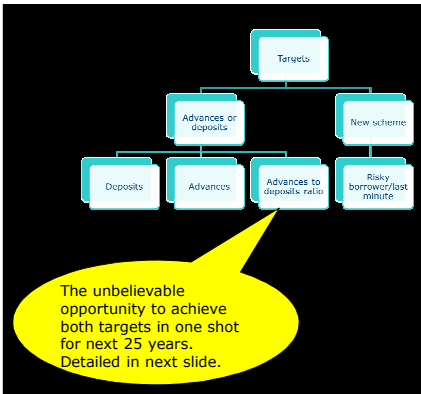
Perpetual motion trigger

Greed

Disruption: High value of repeated Octroi exemption (Value ceiling)




35




36

## Ordinary situation

- Residential Branch just outside the city-you commute. One transaction regarding Devolvement of Letter of credit catches your eye. Some Banks have a different ledger called 'ADVANCE BILL' Ledger. BUT it is adjusted by margin provided by the customer.

Suggested measures to spot the Red Flags

While inspecting outstanding Letters of Credit, this issue can be found.

Letters of Credit unsupported by sanctioned borrowing facility is rare.

37

## Explanation given by the Bank

- LC was issued against 100% Cash Margin
- It was helpful in reaching target of both deposits and advances
- Advance was parked in the br al case with the help of regional threat that seniors are involv
- On due date payment, cash margin was used so 'WHAT OUR PROBLEM?'

FODDER SCAM

38

## Gathering Evidence

- Verify the inspection Report of importer. (there will be none)
- Sanction of the Regional Manager/Head Office
- Legal validity for the Branch to issue the Letter of Credit. (Branch license of FE dealing – Category B branch atleast)
- Action taken by branch after the devolvement of LC. (Did they contact the person? Did an officer go to the premises of address given by the person?)
- You may try to go to the address given by the person with the Branch official.

Accident or connivance?

39

## Features of the Fraud

- New party.
- Status of importer not verified. No pre-sanction inspection.
- Financial Papers not collected due to cash margin.
- Address given in fraudulent.

40

## Export Credit -1

- Export Credit is short term working capital given to exporter to
  - Help Production
  - Help give credit to overseas buyer
- Banking Products
- Pre shipment – Packing Credit
- Post shipment – FBC, FBN etc.

41

## Export Credit -2

- Packing credit is settled by FBC/FBN/FBP. This is a legitimate transfer entry.
- Reality of confusion
  - Day one – FBC request
  - Day four – FBP request
  - Alternative to get Currency conversion benefit, product of 'Rupee Advance against FBC'. (Only against FBC)

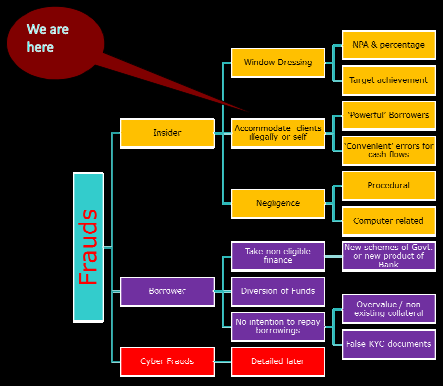
42

## Case of huge revenue loss on Rupee advance against FBC

- Charges of Collection
  - Commission
  - Postage/Courier
  - Correspondent Bank charges

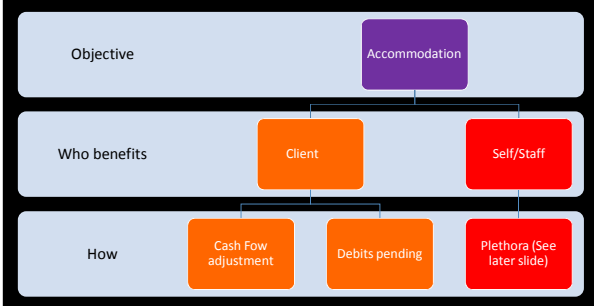
- Argument of Bank why commission was not collected (average bill Rs. 20 lacs)
- Loss estimated Rs. 2 crores p.a. at one branch in 1989
- Mostly casual bill collection

43




44

## Insider perpetuated: Accommodation of client or self




45

## Accommodation of Clients- Cash Flow adjustment

- School Fees mixed with wine shop
- Facility granted on reverse of Cheque
- Cheque recd in clearing referred to drawer
- Letter of Understanding (Nirav Modi)
- Dummy associate borrowers

46

## 3rd party software

- Treasury, other HO software
- Salary/HR applications
- FE / Dealer applications
- ATM
- Foreign Exchange

- Links are usually by TXT
- Direct database links are safer and more dangerous

Weakness Is Exploited

47

48