



# **Cases in Bank Fraud (Unit 9 & 24 – Module 1) Part 2**

**DFA**

March 04, 2022

**Arijit Chakraborty**

# EWS for Banks

- ◆ **Presence of EWS** = lead to banks ear-marking an account as Red Flag Account (RFA) = mean that there is suspicion of fraudulent activity.
- ◆ EWS is a trigger for launching investigation into an RFA. The threshold for EWS is set at Rs500 million or more at the level of the bank irrespective of solo lending or consortium lending arrangement.
- ◆ All accounts beyond Rs. 500 million will be monitored by banks for EWS.
- ◆ Once an account is classified as RFA or Fraud, banks to report same to CRILC (Central Repository of Information on Large Credits) along with the dates on which account was classified as RFA or Fraud.

# Fraud Monitoring hierarchy

- ◆ Banks are required to set up Fraud Monitoring Group (FMG) and also designate an officer to undertake EWS monitoring on an on-going basis.
- ◆ The designated officer reports to FMG, FMG shall report of all accounts classified as EWS, together with the decision to classify them as RFA or otherwise to CMD/ CEO every month.
- ◆ A report on the RFA accounts may be put up to the Special Committee of the Board for monitoring and follow-up of Frauds (SCBF) providing, inter alia, a synopsis of the remedial action taken together with their current status.

# Fraud monitoring – 3 Tier

- ◆ Framework requires Banks to have Risk Management Group (RMG) of the Bank shall carry out the following, for the purpose of early detection of fraud:
- ◆ a. **At the pre-sanction level** – The RMG shall be responsible for collecting information on the potential borrower which could be as an input by the sanctioning authority.
- ◆ b. **At disbursement stage** – The RMG shall ensure that at the disbursement stage there is focus on adherence to terms and conditions of sanction. Where there is a dilution of the terms and conditions, such dilution should be subject to the review of the RMG.
- ◆ c. **Annual review** – In addition the continuous monitoring of the account, Banks should also be vigilant from the fraud perspective while reviewing annual accounts.
- ◆ The framework requires the Banks to comment on the aspects of diversion of funds in an account, adequacy of stock vis-a-vis stock statements, stress in group accounts, etc.
- ◆ RMG should also track market developments relating to the major clients of the Banks and report the same to the credit office
- ◆ Employees should be motivated to report any kind of fraudulent activity through the whistle blower mechanism of the Bank to the FMG. The FMG may seek necessary clarifications from the concerned employee and accordingly take action.
- ◆ In the course of audit, auditors may come across several instances of fraudulent activities in the account.
- ◆ The auditors shall report the same to the top management and if necessary to the Audit Committee of the Board (ACB) for prompt redressal.

# EWS for Banks

## ◆ A. Operation of Accounts

- ◆ 1. Bouncing of high value cheques
- ◆ 2. Foreign bills remaining outstanding with the bank for a long time and tendency for bills to remain overdue.
- ◆ 3 Delay observed in payment of outstanding dues
- ◆ 4 Frequent invocation of BGs and devolvement of LCs
- ◆ 5 Under insured or over insured inventory
- ◆ 6 Invoices devoid of TAN and other details
- ◆ 7 Funding of the interest by sanctioning additional facilities
- ◆ 8 Frequent request for general purpose loans.
- ◆ 9 Frequent ad hoc sanctions
- ◆ 10 Heavy cash withdrawal in loan accounts
- ◆ 11 Significant increase in working capital borrowing as percentage of turnover



## ◆ B. Concealment or Falsification of documents, Fund diversion

1. Concealment of certain vital documents like master agreement, insurance coverage
2. Frequent change in accounting period and/or accounting policies
3. Substantial increase in unbilled revenue year after year
4. Material discrepancies in the annual report
5. Poor disclosure of materially adverse information and no qualification by the statutory auditors
6. High value RTGS payment to unrelated parties
7. Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet
8. Not routing of sales proceeds through consortium / member bank/ lenders to the company





## ◆ C. Issues in Primary/Collateral Security

1. Dispute on title of collateral securities
2. Request received from the borrower to postpone the inspection of the godown for flimsy reasons
3. Exclusive collateral charged to a number of lenders without NOC of existing charge holders
4. Critical issues highlighted in the stock audit report
5. Liabilities appearing in ROC search report, not reported by the borrower in its annual report
6. Non- production of original bills for verification upon request.
7. Significant movements in inventory/ receivables, disproportionately differing vis-a-vis change in turnover and/or increase in ageing of the receivables
8. Increase in Fixed Assets, without corresponding increase in long term sources (when project is implemented)
9. Costing of the project which is in wide variance with standard cost of installation of the project

# PMC Bank fraud case - 2019

## CASE FILE

**Sept  
19**

PMC Bank MD confesses to fraud in a meeting with RBI

**Sept  
21**

MD documents details in a letter to central bank

**Sept  
23**

RBI appoints administrator and suspends board

**Sept  
24**

RBI allows PMC Bank customers to withdraw up to ₹1,000 per account

**Sept  
25**

Withdrawal limit raised to ₹10,000 per account

**Sept  
30**

EOW registers FIR against PMC Bank officials, HDIL entities & promoters

**Oct  
3**

RBI lifts withdrawal limit to ₹25,000 per account



# RBI penalty on Axis Bank & IOB, SEBI action - HDFC Bank

- ◆ RBI slapped a monetary penalty of Rs 2 crore on **Indian Overseas Bank** for **non-compliance of KYC norms** after fraud detected in one of its branches.
- ◆ **Axis Bank** : RBI penalty of Rs 3 Cr for **non-compliance of income recognition and asset classification (IRAC) norms**, assessment of NPA which warranted a monetary penalty.  
**Axis Bank** , under burden of legacy infrastructure loans, reported divergence of Rs 5633 crore for FY17 & Rs 9480 crore for FY16.
- ◆ **SEBI show cause on Yes Bank & Axis Bank – 2017 for NPA under-reporting by Rs 13,500 cr**

## Insider Trading

- ◆ SEBI to HDFC Bank to intensify controls, HFDC Bank to report in 3 months t
- ◆ Q1 results leaked in whatsapp before official results declared
- ◆ Leaked – PAT Rs 3,900 cr, NNPA = 1.25 %
- ◆ Similar insider trading charges levied on Axis Bank

- ◆ NBFC Liquidity & solvency issue
- ◆ Govt removed management
- ◆ ID resigned, Mr Uday Kotak made Chairman
- ◆ Role of credit rating agencies, auditors, ID under scanner
- ◆ Case o loan round tripping,
- ◆ Lending without collateral
- ◆ RPT

# ABGSL - Allegation & Report

- ◆ Fraud detected = forensic audit that EY conducted in January 2019, from April 2012 to July 2017. It found that the fraud had taken place during this period as per the FIR.
- ◆ **Allegation & Report**
- ◆ *“The fraud was conducted through diversion of funds, misappropriation, criminal breach of trust, to illegally gain at the cost of the bank’s funds.” - SBI ( in its complaint)*
- ◆ The forensic audit — based on the ledgers of One Ocean Shipping Private Ltd (OOSPL) and ABG Engineering and Construction (ABG EC) Ltd— noted that money was transferred to another company called PFS Shipping India Ltd. which adjusted receivables to ABGSL.
- ◆ Transfer entities show that in previous years ABGSL had transferred funds to OOSPL and ABG EC.
- ◆ The money borrowed from banks was used to repay loans and pay for other expenses of group companies, as well as for letters of credit.
- ◆ There are indications of properties being purchased by related or linked parties from funds provided by ABGSL.
- ◆ CBI = no delay in filing the FIR. The various complex transactions were being looked into. The investigation is on.

# Forensic Audit Report by EY

- ◆ EY = key prosecution witness in the probe against ABG Shipyard, booked by CBI for allegedly duping banks of over ₹22,482 crore,
- ◆ EY conducted a forensic audit of ABG Shipyard and submitted its report in January 2019 to a consortium of 28 banks allegedly defrauded by the Surat-based ship builder
- ◆ The agency asked SBI Mumbai to furnish a list of witnesses. The bank, in its fresh complaint in September 2020, suggested EY and the general manager of its Mumbai branch as prosecution witnesses in the case.
- ◆ Audit report will be examined and officials who conducted the audit may be quizzed by CBI.

***The audit report will also be examined to ascertain if it missed any lapses, the people said. "Depending on evidence and the role of those involved, the agency will decide who will be prosecuted and who will be made a witness,"***

In its audit report, reproduced in CBI's FIR, EY has highlighted "potential circular transactions," violations of corporate debt restructuring (CDR) offered by banks in 2014 and "potential diversion" of funds by ABG Shipyard.

# CVC Review – Bank Frauds

- ◆ The rising trend in Bank frauds has been a cause of concern at all levels.
- ◆ **Central Vigilance Commission** has undertaken a review and analysis of top 100 Banks Frauds, as on 31.03.2017.
- ◆ The analysis mainly focused on
  - ❖ *Modus- operandi;*
  - ❖ *Amount involved;*
  - ❖ *Type of lending viz. Consortium/ Multiple/Individual;*
  - ❖ *anomalies observed;*
  - ❖ *loopholes that facilitated perpetration of concerned fraud and*
  - ❖ *systemic improvements required to plug the loopholes in the system & procedures, etc.*
- ◆ The findings have been **shared with RBI and Deptt. of Financial Services, (Ministry of Finance).**

## Role of ISS & Forensic Auditors

- Fraud Diagnostic Review – banks
- Forensic Audits
- Conduct Business, Assets & Share Valuation
- Carry out Due Diligence Study for Business Restructuring
- Credit Audit & Monitoring of Accounts
- IS Audit
- Audit of IFC



1. CBS covers which of the following

- a) Deposits, Advances
- b) Bills & Remittances
- c) General Ledger
- d) **All of the above**

2. CBS software resides

- a.**always resides in a central application server located in DC**
- b.in the branch
- c.in the RBI
- d.in a database server

3. Which of the following statements is true ?

- (A) Creative Accounting and Book- keeping are synonymous
- (B) Book-cooking and Accounting are complementary to each other
- (C) **Accounting starts from where Book-keeping ends**
- (D) Both (B) and (C)

4. Which of the following is not a function of IT& BCP department in CBS

- a. Proper delegation of tasks
- b. Functions incompatibility
- c. Segregation of duties
- d. Internal audit**

5. VaR model in a bank deals with

- (A) revenue accounting / interest income
- (B) NPA analysis
- (C) Risk Management**
- (D) payroll accounting

6. Fraud, in a bank relates to ( maximum impact)-

- (A) Inventories
- (B) Fixed assets
- (C) **Credit / Advances**
- (D) LC & BG

7. Which review consists the first step in forensic audit of CBS branches to check / detect frauds

- a) System log review
- b) **Review of Antifraud & IT Security policy**
- c) Database control
- d) Network weakness assessment Report

8. CORE of CBS means

- a) Computerized Offline Review Environment
- b) Computerized Online Re-Engineering
- c) **Centralized Online Real-time Electronic**
- d) Controlled Online Review Ecosystem

- 9. In Finacle CBS which code is used to check Account details
  - a.ACCII
  - b.ACI**
  - c.Account Enquiry Code
  - d.ANC
- 10. In Finacle CBS , which code is used to see Loans & Advances Overdue - to check PNPA
  - a.LO
  - b.LAO
  - c.LAOPI**
  - d.LP
- 11. In Finacle CBS, which exception report is used to check NPA position
  - a.NPARPT**
  - b.NA Report
  - c.Loss Asset Report
  - d.Sub Standard Asset Report