



# Forensic audit of Non Performing Assets: navigating hidden threats

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# Key issues

In May 2015, the Reserve Bank of India (RBI) mandated the banks to use forensic audit as a preventive and investigative tool to detect frauds and deal with Red Flagged Accounts (RFAs) of corporate borrowings over INR50 crore.<sup>1</sup> After three years, the problem of NPAs has still remained acute in the case of large corporate loans. The introduction of beneficial ownership provisions in the Companies Act, 2013, Insolvency and Bankruptcy Code 2016 (e.g., section 29A), Bank's Know Your Client (KYC) and Anti-Money Laundering (AML) provisions, etc., also require application of forensic audit methods to identify the actual beneficiaries of funds disbursed in the banking sector.<sup>2</sup>

It is time to reflect how and if in the last three years, banks have effectively used forensic audit to reduce NPA losses, recover assets and improve governance. Accordingly, this document covers the various facets of forensic audits for banks as a tool to manage their NPAs, both for preventive and investigative purposes. While forensic audits can be used to

detect various types of frauds, this document focusses on corporate borrowal frauds and explores the following key issues:

1. Are the mandates for a forensic audit given in an independent and objective manner? Do they have the right scope of work?
2. Is the system of selection of forensic auditors such that only individuals/firms really equipped to conduct forensic audits in a professional manner get qualified for taking up such engagements?
3. Are forensic audit reports proving useful as preventive and investigative tools, and for recovery of a bank's assets which may have been diverted or siphoned off?
4. Are forensic audit proving useful for potential detailed investigation and prosecution by Law Enforcement Agencies (LEAs)?

If answers to some of the above questions are in the negative, then it has to be examined why forensic audits have failed and what remedial actions are called for.



1. RBI Circular number - RBI/2014-15/590 DBS.CO.CFMC.BC.No.007/23.04.001/2014-15. Appendix 1 for extracts from RBI's Circular  
2. This document covers various facets of forensic audits for Banks as a tool to manage their NPAs, both for preventive and investigative purposes. While forensic audits can be used to detect various types of frauds, this document focuses on the corporate borrowal frauds.



# Preliminary analysis

## Issue 1 – Scope deficiency and limitations in forensic audit mandates

The foremost issue is the lack of awareness of the nature of frauds and the relevant review period. The scope of forensic audit in most cases is limited only to the last two to four years period during which fraudulent transactions were actually suspected. Experienced investigators know that in case of large value frauds the preparation of frauds such as manipulation of financial statements commences much earlier – sometimes three to four years before the fraudulent transaction is actually suspected. The evidence for the motive behind the fraud normally lies in the period of preparation. If that period is not included in the scope of the forensic audit, the usefulness of the audit report is severely diminished.

The second area where the scope is not properly defined is by limiting forensic audit to the firm(s)/ companies where the fraudulent transactions may have been actually suspected. In most large value fraud cases, a number of group/related entities/persons acting in concert are also involved, some of which may be borrowers of other banks in other multiple banking arrangements. There is a need for all bankers to join hands in coordinating forensic audit on associated/related entities, even if the immediate loss of bank

funds has not yet surfaced in such entities under the same promoters.

Besides, there are several other ways (some of which are discussed later in this document) in which the scope of the forensic audit and its efficacy may be seriously impaired.

Thirdly, certain inherent limitations of forensic audits vis-à-vis LEAs may make less information available to a forensic accountant as compared to a government investigator. For instance, a forensic accountant cannot compel anybody to produce information, conduct searches, acquire communication and correspondences, acquire accounts and records of group/related parties, etc. Certain limitations can be overcome by incorporating a contractual clause that the accounts and records of the borrowing entity as well as its subsidiaries and related entities over which it has control or to which it has advanced funds be made available during forensic engagements.

Fourthly, sometimes, banks themselves also do not provide all transactional information and/or supporting documents. This should be insisted upon in the inter se contracts between consortium banks.

Fifthly, the scope of a forensic audit cannot ideally be defined upfront, as in most cases the upfront requirement is to first identify the possible red flags and get prima facie evidence to initiate a detailed forensic audit. Hence, a forensic audit for NPAs can be structured in two stages:

1. Preliminary investigative stage, initiated by the banks to get prima facie evidence of frauds in the borrowal accounts. This can help enable the bank/s to determine if the case is worthy of reporting to the RBI and LEAs as required by the RBI's Circular on fraud reporting. The standard (burden) of proof during this stage should be low because of the limited information during this phase
2. Detailed investigative stage, initiated during investigations by LEAs after the fraud has been reported under the RBI Circular. This stage may have access to additional information, as the LEAs have legal powers to call/obtain information and documents compared to the first stage, which is based more on voluntary (through contractual and statutory) co-operation.

## Issue 2 – Involvement of qualified forensic practitioners and industry experts

The second key issue is regarding the selection of equipped forensic auditors and industry experts by banks. Banks should ensure that only experienced, qualified and trained individuals/firms should qualify to conduct forensic audits in a professional manner. The selection criteria should include an assessment of their professional past experience, training, ability to gather technical evidence through data analytics, etc.

In a number of instances where forensic engagements have been ordered, the pre-qualification criteria for selection of forensic auditors either has not been defined or has been defined loosely. This approach of the decision makers may be primarily because of a lack of awareness of the skillsets of forensic engagement vis-à-vis financial statement or internal audits. There is a general misconception that any public accounting professional with experience of one or two minor fraud investigations can take up forensic audit involving thousands of crores of borrowings. This misconception can cause tremendous damage to the quality of work and consequent usefulness of forensic audit reports. The skill set required for forensic engagements and a comparison of forensic engagement with financial statement audit engagement are explained in Appendix 2.

The table in Appendix 2 highlights how significantly different a forensic engagement is from other financial statements audits. Unless these differences are

### Nature of forensic engagements in NPA situations

The forensic engagement for NPA situations **are quasi-criminal in nature and more complicated than those in civil cases** because of the possibility of findings being reported to LEAs (e.g., Central Bureau of Investigation (CBI)- Anti-Corruption Branch (ACB), CBI-Economic Offences Wing(EOW) or CBI- Bank Security and Fraud Cell (BSFC), Serious Fraud Investigations Office (SFIO), or State police, attracting staff accountability provisions (e.g., findings of malfeasance by the borrowers due to weak sanctioning or monitoring controls).

fully understood by the decision makers, an appropriate selection of forensic professionals is difficult. Ignoring these aspects constitutes a serious threat to the efficacy of forensic engagements.

### Issue 3 – Usefulness of forensic audit reports to banks

Reports which lack in quality and depth will have limited usefulness for the banks, and other stakeholders. However, the risk is that they may lead the banks to reach a wrong conclusion that there was no diversion or siphoning of funds or other frauds, when indeed there may have been some such acts.

Whether the forensic audit reports are proving useful as preventive and investigative tools for the recovery of bank assets (which may have been diverted/siphoned), is yet to be seen.

As a recommendation, the banking supervisors (e.g., RBI/ Department of Financial Services (DFS)) may undertake an analytical study of the usefulness of forensic audit reports. The study may analyse, for the last three years, the scope, the procedures undertaken, depth and breadth of work, as well as reports given by both professionally qualified firms having specialised forensic audit capacities and those given by firms with limited exposure to forensic practices and with limited or non-existent data analytics capacity. Based on this study, policy formulation and improvement can be made to arrive at guidelines for entrusting such engagements, and drafting the scope of forensic work. This study is extremely critical to ensure that a very useful preventive and investigative tool such as a forensic audit does not get discredited by lack of proper framework in entrusting forensic engagements. The challenge is that form does not prevail over the substance of forensic audit.

### Issue 4 – Usefulness of forensic audit reports to LEAs

Whether the forensic audit reports assist in detailed investigations and potential legal actions by LEAs is also yet to be established. However, analysis of various cases filed by the LEAs shows that they have not quoted the forensic audits, although they may have relied on some for initiating or investigating cases. This may increase with time as the RBI provisions are only three years old. Consistent with the recommendation for Issue number 3, a similar study may be undertaken.

# Detailed analysis

While forensic engagements can be a very valuable tool for detection and prevention of financial crimes, the lack of training and experience by various practitioners who perform forensic engagements, a lack of understanding of basic requirements by various stakeholders, and lack of co-operation by the bankers and borrowers have seriously threatened the quality and reliability of forensic engagements.

Many reports labelled as 'forensic' may have been prepared by practitioners without sufficient forensic experience in investigative methods, tools, and techniques, structured or unstructured training, or any on-the-job experience with another forensic accountant. The quality of such forensic reports vastly falls short of the high standards which courts or other adjudicating bodies require. **These factors not only significantly affect the appropriate outcome and mislead the users of such reports, but also significantly reduce the credibility, reliability and reputation of forensic engagements because the users will lose faith in the ability of forensic audits to detect frauds.**

Forensic engagements deployed by the banks in cases of corporate NPAs have banks, regulators (e.g., RBI, SEBI, etc.) and LEAs as its potential users. Therefore, it is critical that the work performed in forensic engagements be independent, objective, detail-oriented, high-quality with appropriate utilisation of appropriate forensic methods and tools. In the last three years is that in practice, the forensic engagements in NPAs have suffered from serious limitations and no conclusive results have been achieved in many instances. The limitations, which are imposed on forensic audits and have diminished the quality and reliability of forensic engagements, may be analysed in two parts:

## Part 1 – Avoidable limitations where resolution by banks and forensic accountants is possible

– these limitations arise due to controllable factors and significantly compromise the quality of forensic engagements. These limitations must be resolved

by shareholders to ensure that credible, reliable forensic engagements be performed.

## Part 2 – Unavoidable limitations where resolution by banks and forensic accountants is not possible

– these limitations arise due to uncontrollable factors such as legal or statutory restrictions which are beyond the ability or legal powers of banks and forensic accountants to resolve. However, it is experienced that a lot of banks and even regulators, LEAs, etc. do not fully understand these limitations and may have unreasonable expectations from forensic engagements.



## Key limitations and threats to forensic audits

### Avoidable limitations

1. The loan agreement does not contain a contractual clause that the business accounts of the borrowing entity as well as its subsidiaries and related entities over which it has control will be made available for third party audit (including forensic engagements)
2. No or limited access to accounts and records of the borrowing entity and its related entities who may have received funds from the borrowing entity (for example if a loan is taken by a Special Purpose Vehicle (SPV) entity who has passed it on to a group entity, the records of group entity are not accessible during the forensic engagement)
3. Sometimes banks do not provide transactional information in bank accounts or supporting documents

### Unavoidable limitations

4. No access to electronic information with borrowers. For example, various electronic data on servers and laptops of the borrower's owners and staff are not accessible to the forensic accountant to determine if they contain evidence of any wrongdoing such as diversion or siphoning off of funds;
5. No access to all other possible evidence because of lack of legal powers of search, seizure, etc. Such powers are available only to government agencies.



## Analysis of threats to forensic engagements at various stages

Threats to stifle the forensic audit, etc. can be analysed into four stages:

1. Forensic engagement initiation, selection and scoping, including independence and conflict of interest
2. Forensic engagement execution
3. Forensic engagement reporting.

### Forensic engagement initiation, selection and scoping

The primary threats during this stage may include lack of independence, conflicts of interest on both the forensic accountant and the banker, and limiting and restricting the scope to achieve the overall objectives (example

to determine whether there is diversion or siphoning off of funds)

1. Presently, in some banks, forensic engagements are initiated, awarded and overseen by the same bank officers who may have been associated with the sanctioning and monitoring credit facilities subject to forensic audit. They have an inherent conflict of interest as any adverse findings in forensic engagement may also raise questions on their sanctioning and monitoring of such facilities. This may lead to delay or avoiding forensic engagements altogether to restricting their scope. In certain cases, the bank functionaries may have prior knowledge of certain issues

such as accommodation of letters of credit (LCs) to make Special Mention Account (SMA) loans as standard. For example, if bank functionaries suspect or know that fake documents were submitted to the banks by borrowers to encash letters of credit, they would be reluctant for this to be detected through a forensic report;

2. Setting the budget too low for forensic engagements to the point that no credible forensic work is possible within the budgeted amount. For example, a bank had come out with maximum fee scale of INR500,000 for forensic engagement of loan exposures above INR1000 crore. Under-budgeted forensic audits or



commercial costs of well-equipped forensic specialist is a significant threat to scuttle investigations not only in the private sector, but also in the public sector.

Forensic specialists collect and review information for multiple years, and under-budgeting threatens credible forensic work. In certain cases, banks have budgeted amounts lower than those for annual financial statement audit for just one year, and this is clearly designed to scuttle the scope and findings of forensic reports. The constrained budget becomes even more important as forensic engagements usually have legal and quasi-legal implications and the work spans over several years even after the forensic reports go to the regulators and LEAs, and the forensic accountant may be called to provide more details, documents and court testimony when the investigative and prosecution process is ongoing (which can go on for several years).

3. Curtail the scope of forensic engagements to exclude key items – for example if the bulk of the disbursements (under the credit facilities) were made four years ago, then the scope of the forensic engagement may be only for the last two to three years, hence avoiding entirely the time when the borrowers may have siphoned off the funds.

### Forensic engagement execution

Factors during the execution phase that threaten the objectives of forensic engagements generally include:

1. Lack of subject matter expertise, data analytics professionals or investigation experts to adequately conceptualise fraud hypotheses and evaluate it
2. Withholding accounting and financial information by borrowers and not cooperating in the forensic engagement. As a forensic accountant does not have any powers of search and seizure, or to compel testimony, the forensic accountant may just disclaim the report without any implication such as declaration by an uncooperative borrower or wilful defaulter
3. Withholding accounting and financial information by banks – e.g., some consortium members and in some cases even the lead bankers do not provide all information available with them about the borrowers
4. Restricting physical inspection of assets (stocks, properties, etc.)
5. Manual sampling (rather than data analytics driven sampling) that could lead to missing out on specific fraudulent transactions or red flags
6. Having limited ability to corroborate red flags, evidence or events via direct or indirect evidence.
7. Creating other hurdles such as insistence on entering into Non-Disclosure Agreements (NDAs) with onerous terms. For example, a borrower attempting to obstruct a forensic engagement on the pretext of not having an NDA, which restricted the forensic practitioner to share any information with the bankers, but did not have any NDA with other service providers such as their financial statement

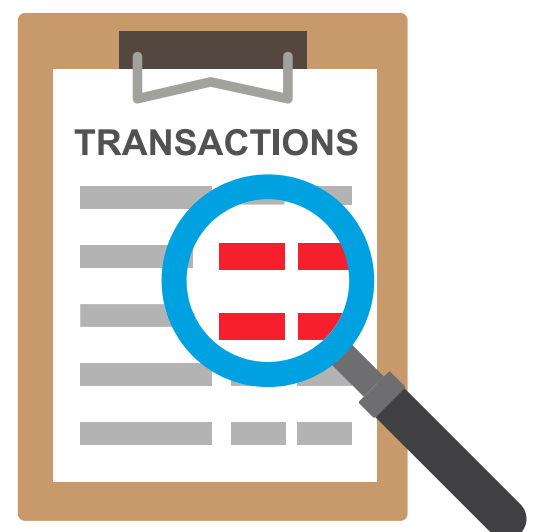
auditor, bank auditor, Techno Economic Viability (TEV) study consultants, credit consultants, etc.

8. Obstruction through spoliation of records, i.e., the destruction of records. What should the forensic accountant do if a bank functionary or borrower destroys real evidence?

### Forensic engagement reporting

Factors during the reporting phase that threaten the objectives of forensic engagements generally include:

1. Insistence by bank functionaries to change the findings and observations in the forensic reports to exclude items where they may be themselves implicated
2. Delay or avoid submitting the report of a forensic engagement to various authorities – e.g., RBI, CBI, etc.
3. Get a new forensic engagement with a different scope and discarding the previous report
4. Issue a report without requiring an evidence docket so that the case can stand the relevant tests later in detailed investigation or the adjudicating process.



# Key recommendations



# Appendix 1

## Key legislative and regulatory provisions requiring forensic audits

### RBI's circular on Framework for dealing with loan frauds (extracts) dated 7 May 2015:

- 1.0 **Objective of the framework:** In the context of increasing incidence of frauds in general and in loan portfolios in particular, objective of this framework is to direct the focus of banks on the aspects relating to prevention, early detection, prompt reporting to the RBI (for system level aggregation, monitoring and dissemination) and the investigative agencies (for instituting criminal proceedings against the fraudulent borrowers) and timely initiation of the staff accountability proceedings (for determining negligence or connivance, if any) while ensuring that the normal conduct of business of the banks and their risk taking ability is not adversely impacted and no new and onerous responsibilities are placed on the banks. ... The early detection of Fraud and the necessary corrective action are important to reduce the quantum of loss which the continuance of the Fraud may entail
- 3.1 At present the **detection of frauds takes an unusually long time.** Banks tend to report an account as fraud only when they exhaust the chances of further recovery. ... More importantly, it delays action against the unscrupulous borrowers by the law enforcement agencies which impact the recoverability aspects to a great degree and also increases the loss arising out of the fraud
- 5.1 RBI Master Circular DBS.CO.CFMC. BC.No.1/23.04.001/2014-15 dated July 01, 2014 on Frauds - Classification and Reporting (Para 3.2.4) provides that all the banks which have financed a borrower under Multiple Banking Arrangement (MBA) should take co-ordinated action, based on a commonly agreed strategy, for legal / criminal actions and the bank which classifies or declares a fraud should report the same to CFMC, RBI within the deadlines specified in the Master Circular on Frauds - Classification and Reporting cited above
- 5.3 The initial decision to classify any standard or NPA account as RFA or 'Fraud' will be at the individual bank level and it would be the responsibility of this bank to report the RFA or Fraud status of the account on the Central Repository of Information on Large (CRILC) platform so that other banks are alerted. Thereafter, within 15 days, the bank which has red flagged the account or detected the fraud would ask the consortium leader or the largest lender under MBA to convene a meeting of the Joint Lender's Forum (JLF) to discuss the issue. The meeting of the JLF so requisitioned must be convened within 15 days of such a request being received. In case there is a broad agreement, the account would be classified as a fraud; else based on the majority rule of agreement amongst banks with at least 60 per cent share in the total lending, **the account would be red flagged by all the banks and subjected to a forensic audit commissioned or initiated by the consortium leader or the largest lender under MBA.** All banks, as part of the consortium or multiple banking arrangement, would share the costs and provide the necessary support for such an investigation
- 5.4 The forensic audit must be completed within a maximum period of three months from the date of the JLF meeting authorising the audit. Within 15 days of the completion of the forensic audit, the JLF will reconvene and decide on the status of the account, either by consensus or the majority rule as specified above. In case the decision is to classify the account as a fraud, the RFA status would change to Fraud in all banks and reported to RBI and on the CRILC platform within a week of the said decision. Besides, **within 15 days of the RBI reporting, the bank commissioning/ initiating the forensic audit would lodge a complaint with the CBI on behalf of all banks in the consortium/MBA.**



# Appendix 2

## What is a forensic engagement? What skills are required of its practitioners? How is a forensic engagement different from a financial statement audit engagement?

### Forensic and forensic accounting defined

The Oxford dictionary defines forensic as (adjective) relating to or denoting the application of scientific methods and techniques to the investigation of crime, and (noun) scientific tests or techniques used in connection with the detection of crime.

The dictionary defines forensic accounting as (noun) the use of accounting skills to investigate fraud or embezzlement and to analyse financial information for use in legal proceedings.

Often, the mention of the word forensic draws reference to a criminal act, which is due to frequent usage of this term in public media in the context of (alleged or actual) criminal or quasi-criminal wrongdoings. However, the term is equally relevant to civil matters such as in financial disputes between two or more parties in arbitration, courts, administrative authority or other adjudicating bodies.

The key ingredients in the definitions of forensic accounting engagements are:

1. Professional accounting skills because the word accountant implies the skill to analyse accounting and financial information that may be acquired through education, training and experience
2. Existing or anticipated disputes, or allegations, concerns or risks of fraud

or other illegal or unethical conduct

3. Involvement of an adjudicating body, whether civil, criminal or administrative (e.g., court of law, arbitral tribunal, special investigative tribunal, independent court appointed committee/judge, etc.). Therefore, a forensic accountant is expected to possess a certain level of legal knowledge and skills to understand concepts such as court process, rules of evidence, admissibility, relevance, principles of natural justice, rules of interpretation, etc.
4. Court acceptable standard of work - a high standard of reliance is immediately established as to the quality of the work the forensic accountant must attain because his or her findings may be subject to a public scrutiny should the matter go to trial. Therefore, to deliver work that meets this standard, the forensic accountant must have adequate investigative skills and the sceptical and analytical mindset acquired through formal and structured academic, experience, training, etc.
5. The involvement of a forensic accountant traditionally has been in reactive situations, i.e., when some alleged act(s) may have already taken place. However, the work

of a forensic accountant in recent years has expanded and covers both (a) reactive, i.e., to confirm or refute the allegation, and (b) preventive, i.e., to mitigate such alleged or actual wrongdoing, e.g., further crime, damage or loss.

### Key skills required of its practitioners

The professional standards required for forensic engagements are not codified or prescribed in many countries including India. Some developed countries have codified principle-based guidance/standards for forensic practitioners, e.g., standard practices for investigative and forensic accounting engagements in Canada that explain professional accounting skills, investigative skills and investigative mindset as follows:

1. Professional accounting skills require the following sub-components:
  - a) an understanding of how business activity is documented, recorded, reported, managed and controlled; including the knowledge of prevalent accounting standards
  - b) the ability to identify, obtain, examine and evaluate relevant information
  - c) the ability to quantify the financial impact of actual or expected transactions or events;
  - d) the ability to perform and

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- interpret relevant analyses of information
- e) the ability to document and explain business information and the results of the financial analyses for decision-making purposes, and
  - f) the ability to render relevant and appropriate opinions and conclusions based on the findings and results of the work performed.
2. Investigative skills require the following sub-components:
- a) an understanding of the context within which the engagement is to be conducted (for example, the tribunal process, laws, regulations, contracts or policies relevant to the engagement)
  - b) the ability to identify, obtain, examine and assess information relevant to the engagement
  - c) the ability to analyse and compare various types and sources of information
  - d) an understanding of the types of information that would assist in establishing motivation, intent and bias
  - e) an understanding of the ways in which information could be fabricated or concealed; understanding patterns and red flags
  - f) an understanding that

- information collected and the work performed, including the work and information of others, may become subject to disclosure and be tendered as evidence, and
- g) the ability to document and present investigative findings and conclusions for decision making purposes.
3. An investigative mindset requires a sceptical attitude in the identification, pursuit, analysis and evaluation of information relevant to each engagement, contemplating that it may be biased, false and/or incomplete. This is applicable in identifying and assessing relevant issues, assessing the plausibility of the underlying assumptions, assessing substance over form, and developing hypotheses for the purpose of addressing the issues under investigation.

### Comparison of forensic accounting engagements with financial statement audit engagements

Forensic accounting is a specialised field within accountancy, and its practitioners should possess special investigative skills and mindset, gained through experience in human psychology, laws (e.g., civil, criminal, and administrative) and a variety of forensic methods and tools. Forensic engagements also use advanced data analytics tools to

identify fraud patterns; and forensic auditors are trained to provide expert testimony to the trier of fact. Experience shows that it takes at least five to six years of full time practice to learn the various concepts and nuances of a forensic accounting engagement.

Beyond the common professional accounting skills between both the financial statement auditors and forensic accountants, the two have vastly different experience and skillsets. At the strategic level, the differences include investigative skills and investigative mindsets, and at the operational level include the knowledge of key legal concepts, court procedures, evidence handling, clear identification of civil and criminal matters, a highly sceptical attitude, appearing as a witness in adjudicating body, etc. The objectives of the two types of engagements also vary significantly – the former is geared to give an opinion on overall financial statements based on materiality whereas the latter is concerned with only a line item or particular wrongdoing or violation, without consideration of the materiality of the overall financial statements. Overall, the scope of audit is broad and prima facie, but of the forensic engagement is narrow and deep.

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Area	Forensic accounting engagements	Financial statement audit engagements
Key skills	Public accounting skills, investigative skills and investigative mindset; evidence handling;	Public accounting skills;
Performance standards	Civil, criminal and administrative procedures; rules of evidence, etc.	Accounting and auditing standards
Objectives	To report facts and evidence about alleged fraud, wrongdoing or violation, without consideration of the materiality of the overall financial statements	To give an opinion on internal controls, and overall financial statements based on materiality as far as their compliance to accounting standards, presentation, disclosures, and not towards detection of all frauds
Scope of engagement	Scope is usually narrowly focused (limited to issues under investigation such as diversion, siphoning, etc.) but evidence must be deep, court acceptable standard	Scope is broad on overall financial statements and state of internal controls at the entity under audit
Period of coverage	Multiple years of accounting and financial data	Usually one year
Approach and methodology	forensic imaging of hard disks and server data, market intelligence, field enquiries, public domain checks, data analytics, analytical procedures, interviews, cross examination, etc.	Inspection, observation, inquiry and confirmation, computation and analytical review
Tools	Computer hard disk data extraction; data analytics;	Data analytical tools to a limited extent
Users of reports	Trier of facts (court, arbitral tribunal, etc.), administrative authority, or some such authority.	Shareholders, investors, board of directors, income tax authorities, etc.,
Expert testimony	Likely in some engagements	Not required or expected



# Appendix 3 | Forensic engagements of NPAs<sup>3</sup>

The RBI's circular puts an onus on bank functionaries for laxity in effective supervision over the operations in borrowal accounts rendering the advance difficult for recovery and resulting in financial loss to the bank.

From a strategic perspective, the frauds can be classified as Borrowal frauds and Non-borrowal frauds. The nature of manipulations can be broadly analysed into four main categories as set out below.

## Facets of borrowal frauds which generally become subject matter of forensic engagements:

### 1. Fraudulent financial statements to obtain credit facilities beyond the actual borrowing capacity by

- a. Inflating the net worth through the creation of false equity - Infusion of fake equity – e.g., bank funds are round tripped by promoters and then brought back in the borrowing entity and shown as promoter's equity
- b. Inflating turnover and purchases through false bills in the books and financial statement to avail credit facilities (e.g., from disclosed or undisclosed related parties)
- c. Inflating profitability
- d. Inflating receivables.

### 2. Fraudulent overstatement of primary and collateral securities

- a. Inflating value of stock/inventory in stock statement for drawing excess credit facilities (e.g., stock is overpriced in monthly reports to the banks and in financial statements)
- b. Inflating quantities of stocks/inventories in stock statement for drawing excess credit facilities
- c. Fraudulently removing pledged stocks/ disposing of hypothecated stocks without the bank's knowledge
- d. Pledging the same assets multiple times
- e. Various schemes to flagrantly cheat the lenders – showing stock lying in warehouses owned by friends and relatives as own stock to avail credit facilities against it.

### 3. Manipulations to divert or siphon off funds

- a. Round tripping funds to siphon off or divert funds
- b. Debtors are collected by related parties/ sister concerns and then written off by the borrowing entities
- c. Diversion of funds, lack of interest or criminal neglect on the part of borrowers, partners, etc., in adhering to financial discipline and managerial failure with mala fide intent leading to the unit becoming sick
- d. Collusion with suppliers/vendors to take inflated bills for material supplied, or where the material was never supplied to support payments
- e. Project financing – inflated cost of project costs to avail higher credit facilities. In some cases, the cost is inflated so high that the promoters don't need to contribute any funds and the entire investment is funded through borrowings. This is a major area as in several Public Private Partnership (PPP) projects, the Engineering, Procurement and Construction (EPC) contracts are given to related parties at inflated costs and the entire bank money is diverted to related parties as unsecured advances for construction.

### 4. Miscellaneous

- a. Accommodating credit facilities (e.g., letters of credits) given for ever-greening of loans
- b. Fraudulent discount of instruments or kite flying in clearing effects
- c. Non-fund based facilities are used to obtain funds through fictitious transactions with (disclosed or undisclosed) related parties.

3. While there are many types of bank frauds where the forensic engagements may be used to detect and prosecute, this paper focuses on large corporate borrowal frauds.

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