AUDIT IN CBS ENVIRONMENT AND FRAUD DETECTION

CA. NITANT P. TRILOKEKAR

2019

Bank Branch audit in CBS Environment

by CA Nitant Trilokekar

1. Bank Branch Audit in Core Banking System (CBS) Environment

Most of the Banks have moved to CBS environment. What was earlier the prerogative of the Private Sector Bank and large public sector Banks, is filtered down to the large co-operative Banks, District level co-operative Banks and small co-operative Banks. Sometimes mere payment/clearing system of the clearing house becomes a trigger move to a CBS environment to ensure that the clearing house electronic transfer automatically reaches the accountholder. All persons exposed to the branch like its depositors, borrowers and the auditors are affected by this. Information Technology implications should not be seen only in isolation to report under Jalani Committee recommendations since technology is all pervasive affecting the Branch Auditor's opinion in most critical manner.

2. Core Banking defined

Instead of a server at each branch, there is one server for all the branches. The server is kept in a place called the Data Centre (DC). In case of failure of this server/site, there is a Backup site and if the site is in another location (another city) preferably in a different seismic zone, it is called the Disaster Recovery Centre (DRC). It is not uncommon to see the DRC to be located in a different continent in case of multinational Banks. A lot of care is therefore taken at the Data Centre but that not being in the scope of the Branch Auditor, it is not a subject matter of discussion here. Traditionally, the networking was by way of leased lines as the primary network. In case this network failed, the other back-up network was dial up Integrated Services Digital Network (ISDN) where the connection was automatically dialed up. Later other modes such as wireless (Radio frequency), VSAT (Very Small Aperture Terminal) and VPN (Virtual Private Network over the Internet), Cloud, came into popularity.

3. Branch Statutory Auditor and System Auditor of DC and branch

The Branch auditor is not expected to be a technical expert to understand the system or the software. But it is a fact that most of the Banking operations are done through the computer. Since the CBS is the neurological network of the Bank, the branch auditor can ill afford to ignore the existence of the system. On the contrary, if the auditor is able to use the system, he/she will be able to improve his/her own efficiency. If the Branch has been subjected to a Systems audit, the Branch Auditor can peruse the report to gain insight. He must ensure that any reliance of this report is only as per the policy of Institute of Chartered Accountants of India (ICAI) on dependence of work of an expert, because some system audits are known to be executed by non Chartered Accountant (CA) firms.

A Branch Auditor may be complacent at his own peril if he mistakes presence of computer or the brand of the application software for accuracy and the desired results since the following issues have been noted:

1. **Final Accounts may not be representative of the Books of Accounts**:
   An unbelievable alarming statement is unfortunately true. This issue would fall more into the realm of fundamental duty of the auditor. This issue is often neglected, as the statutory auditor dives into the matters of Borrower classification and items of Long Form Audit Report (LFAR). Once this issue is revealed post audit, it would be quite difficult for any auditor to defend himself. This complex situation can be simplified on the basis of the plausible reasons, also being areas branch auditor should concentrate:

   a. **When all departments are not computerized**:
      When some departments are not computerized, the vouchers are manually fed into the core system. Such departments may range from Lockers to Treasury and Foreign Exchange. In such

cases, the vouchers are entered at the end of the day. If any of the day's vouchers are not entered resulting in a compensating error, no-one is wiser since the trial balance tallies.

b. When most departments are computerized but by different applications:
This is not an uncommon situation. But, different applications does not always mean problem. How the different applications feed their data into the core system is the crux of the issue. System Auditors are better placed in the evaluation of such matters. Reference to the System Audit report therefore is recommended. Sometimes, the communication between the application and the core system is affected preventing entry upload. No warning is given even though it should be there. The books of that department show a figure quite different from that shown in the General Ledger leading to the crucial situation of Final Accounts not being in agreement with the Books of Accounts.

c. When new channels like Automated Teller Machine (ATM) are added:
New channels linked recently are sometimes not tested substantially. An example of ATM itself will clear the point. In any Bank, the books are closed for the day and re-opened almost immediately. Day closure is done any time from 5 pm to 10 pm. Assume that a customer has withdrawn cash on 31st of March at 7 pm when the books were closed at 5pm. This withdrawal is shown on April 2. If you had verified the cash at 5 pm on March 31 even of the ATM you would find such a situation as correct. But when the posting is done on April 2, there is implication on revenue since the savings accounts are paid interest on daily basis. The customer gains interest of 2 days in this situation and more during long Bank holidays. If the application has interest calculation on 'as of' basis then perhaps the interest loss will not occur.

2. Borrower Health Classification:

Accurate classification of health of the borrowers of the branch has become the most important aspect of statutory Branch audit. This has serious implications on the Balance sheet of the Bank in terms of provisioning. Many application systems have a special routine or report or even separate software which does the work of classification of borrowers. Blind acceptance of such report will tantamount to non-performance by the Branch Auditor. It is preferable for the Branch auditor to test the system. What the system skips for classification of non-performing accounts (NPA) or what is incorrectly classified as NPA is of concern to the Branch auditor. Branch Auditor will thus have to sample test the system to assure him the accuracy of the classification as detailed below:

- Compare the previous year NPA list with current. Identify and seek reasons why the upgraded accounts are upgraded and whether the reasons are justified as per rules permitted by the regulatory authority Reserve Bank of India (RBI).

- Take the report from CBS system (as opposed to the Borrower classification system which is a different application in some Banks) which gives indications of nonperforming accounts in form of a few combination of reports like:

    - List of loan accounts in arrears – if the report permits, get those accounts where more than 2 installments are in arrears. (since 3 installments in arrears is defined as NPA) This will permit you to study the borderline cases and identify some which the system may not have downgraded.

    - The above report does not include Cash Credit (CC) and Overdraft (OD) accounts. This is because these accounts are continuous and there is no concept of 'installment'. What most systems will report will be CC and OD accounts which are overdrawn. Branch auditor will be able to identify the accounts which are overdrawn as on March 31 and a scrutiny of the accounts will confirm the date from which these accounts were 'continuously' overdrawn. If this period exceeds 90 days then the account needs to be classified as NPA. A check on classification of accounts to confirm such accounts are classified as non-performing will be adequate. A random check of earlier months will help isolate cases where accounts are continuously overdrawn but brought in order artificially for the year end.

- Report of accounts not renewed / reviewed for more than a year is one of the statements to be submitted in LFAR. This list helps confirm whether these accounts are included in the NPA list.

- Report of stock statements in arrears: A report of Stock/Debtors statements not submitted to the Bank for a period exceeding a user specified number of months should be generated and reviewed. If you specify the period of three months which is the trigger to downgrade the borrower's account, this will be a ready list to validate the NPA list of the branch.

- Report on overdue Bills Purchased and Bills discounted: This is another powerful report for verification of classification. The importance of this report is that while the other facility of the borrower may be in order, this department may be accidentally ignored. Since one NPA account forces all facilities to the borrower to be downgraded, this oft-ignored feature should be emphasised by the Branch Auditor.

Intervention of the Bank's Data Centre and their professionals to make a customized query is not always needed.

3. Risk Classification:

Risk classification of accounts has direct bearing on the risk based Capital Adequacy of the Bank. There is often a misunderstanding that the Branch or Branch audit will not have impact on the Risk Based Capital adequacy because it will be done at the Head office and checked by the Main Auditor. It is mere logistics that the Main Auditor will not have intimate knowledge of the various accounts of the Branch. Even under Core Banking, if we were to assume full data availability, the sheer number of accounts make the task difficult today. The auditor of this note does subscribe to an advanced application to help achieve this but such software is yet to be designed. Therefore the Branch auditor needs to ensure that the accounts risk classification even of the Savings and the Current account are done to his satisfaction. RISK CLASSIFICATION NEED NOT BE AUTOMATIC. THERE ARE MANY MANUAL ACTIONS STILL PREVAILENT.

Risk classification also has impact on KYC (Know Your Customer) norms. KYS has become a very sensitive point even with the RBI Auditors stressing on it. KYC ACTIONS ARE OUTSIDE THE CORE BANKING SYSTEM BUT UPDATION IS IN THE SYSTEM.

For Risk Management, RBI directions state that banks should have a risk based approach which includes categorizing customers as **low, medium and high risk category**, based on the assessment and risk perception. This is called the Anti-Money Laundering Standards (AML) risk assessment. It has to be noted that banks do not inform customers about their risk categorization.

Risk categorization should be undertaken based on parameters such as

- Customer's identity
- Social/financial status

- Nature of business activity
- Information about the clients' business and their location etc.

The directions also state that while considering customer's identity, the ability to confirm identity documents through online or other services offered by issuing authorities may also be factored in like in the case of identifiable documents like PAN, Aadhaar etc.

The directions also mention that the information collected from different categories of customers relating to the perceived risk, is non-intrusive and the same should be specified in the KYC policy.

Periodic review of Risk Categorization

The RBI directions also state that Banks will undertake on-going due diligence of customers to ensure that their transactions are consistent with their knowledge about the customers, customers' business and risk profile; and the source of funds.

For eg. the following activities should be monitored by the banks.

- Large and complex transactions including RTGS transactions, and those with unusual patterns, inconsistent with the normal and expected activity of the customer, which have no apparent economic rationale or legitimate purpose.
- Transactions which exceed the thresholds prescribed for specific categories of accounts.
- High account turnover inconsistent with the size of the balance maintained.
- Deposit of third party cheques, drafts, etc. in the existing and newly opened accounts followed by cash withdrawals for large amounts.

The extent of such monitoring should be aligned with the risk category of the customer which means that high risk accounts have to be subjected to more intensified monitoring. A periodic review of risk categorization is also stated in the RBI directions (at least once in six months). The RBI directions specifically state the example of transactions of marketing firms, especially accounts of Multi-level Marketing (MLM) companies where a large number of cheque books are sought by the company and/or multiple small deposits (generally in cash) across the country in one bank account and/or where a large number of cheques are issued bearing similar amounts/dates.

Periodic Updating of KYC based on Risk Categorization

The RBI directions on KYC clearly mention that the periodicity of KYC updating should be based on the risk profile of the customer. Periodic updating of KYC should be carried out

- At least once in every two years for high risk customers
- Once in every eight years for medium risk customers
- Once in every ten years for low risk customers

The periodic updating is also subject to the following conditions.

- Fresh proofs of identity and address shall not be sought at the time of periodic updating, from customers who are categorized as 'low risk', when there is no change in status with respect to their identities and addresses and a self-certification to that effect is obtained.
- A certified copy of the proof of address forwarded by 'low risk' customers through mail/post, etc., in case of change of address shall be acceptable.
- Physical presence of low risk customer at the time of periodic updating shall not be insisted.

4. Anti Money Laundering (AML) Application and its accurate representation

The Branch Auditor is the last sentinel to protect the Bank from abuse of this aspect. As the governing body - The Reserve Bank has amply reminded by issuance of various circulars, the Statutory Auditor needs to cover this aspect. Most CBS Banks have resorted to software application for AML reporting. This software application may be from the CBS application provider or a third party software. Whatever be the case, the common feature of concern is that this module or application is an 'afterthought' as the AML guidelines came in force more than two decades after CBS. The fundamental feature of this module/application is that it 'reads' data from CBS and processes it for its report. This feature of 'reading' is important because many Banks boast NIL cases. This is usually because of 'mapping' error. This module looks at the wrong places and comes back with no cases to report which is misconstrued as NIL returns. Auditor can also scrutinise the 'white listing' of cases where the branch is better suited to remove the cases of suspicious transactions based on some rules of deposit and withdrawal which are also specified by The Reserve Bank of India. The reasons for not considering the transaction as suspicious is within the realm of the branch, by identifying Retail cash business of account holder like petrol service station or grocer etc. The classification rules are set normally at the Data Centre which the Branch Auditor need not concern with. But the reasons and replies definitely are of his concern to ensure these are logical and do not undermine the objectives of AML. Low AML training of Bank staff emphasizes the intervention of the Branch Auditor for AML audit.

5. Revenue Accuracy assurance:

When most Banks, even the co-operative Banks have evolved to CBS, a topic of discussion like Revenue leakages seems prima facié redundant because the involved computer servers are the latest generation of machines having fourteen floating decimal point! Perhaps one may have to reconcile time period of this discussion being that of transitory to the destination of perfection, until which, we shall have to recognize the feature of imperfection, thus adjusting our audit plan to the inevitable verification of revenue accuracy even in the presence of the formidable machines and their magnificent chips. If one were to attempt a classification of the revenue errors, one might see a range of errors with severity to make most of us lose sleep or re-calculate every computer print. Analysis will show that **operational or user error is the major cause** and in very few cases, the software coding may be the cause of the error.

- **Interest is not levied on a particular product of the Bank**: eg Advance against Mutual Funds. All advances made under the new product will suffer the same fate. Since interest and all charges run are executed at the Data Centre, if one account is skipped, all accounts will be skipped at least for the branch. The source of the error is most likely at the time new product is set up by the Data Centre. Mapping of the account (technical jargon) may not be done to the interest procedure. This means that the interest or charges procedure which is activated manually by the Data Centre does not have this product in its list.

- **Non responsiveness of rate to increase of PLR/TLPLR/ WCPLR etc.** When the rate sanctioned for an account are linked to Prime lending rates - PLR (say 1% over PLR) then the intention & expectation is that any change in the PLR will change the rates of ALL such accounts. Some accounts or group of accounts do not respond to the changes in the rates leading to under/over recovery of interest. Two possible reasons causing such a situation may be:
    - The user has not opened the account correctly in the interest section.

- Account converted from legacy system may not carry the PLR link feature of the new system. Ideally, this should have been detected under conversion audit and corrected.

- **Installment holiday miscalculates the total Equal Monthly installments (EMI):** Where the borrower is eligible for EMI holiday (eg. housing loan under construction or education loan) and the calculation of EMI is done manually there is a possibility of over or under recovery. Under recovery in such cases lead to 'self caused' NPA's. It is also not uncommon to note over-recovery where the loan accounts reach credit balances. This is usually a manual error caused by lackadaisical supervision at the time of account opening which is the time of EMI calculation.

- **Error in varying interest rate in a single advance account:** OD against Bank's own fixed deposits may not always be right. eg. 12% upto Rs. 2 lacs & 14% between 2 lacs to 4 lacs. Since the manual calculation is a simple procedure, one expects it to be in the software with ease. Reality however dictates its success contingent on the caliber of the programmers. A sample audit will be in good stead. Under or over recovery is the result. Normally, the borrower would be the first to object in case of over recovery.

4. In conclusion

One hopes to reach the level of perfection until which this transitory phase shall be the irony of our audit activity where we have to re-check on our Rs. 200 calculator whether the Rs. 20 lac computer has done its calculation correctly! In conclusion, though computers deliver accurate results, it is only because of a combination of user accuracy with that of the programmer. Auditors may be able to manage with the right reports of the system itself and a bit of sample testing to perform their given task.

Frauds in Banking Sector

By CA. Nitant P. Trilokekar

Bank Audit in India is a risk-revenue mixed assignment. Bank Branch allotment is widespread and with decent fees. Yet it is fraught with risk. Work of about 30 staff in a Bank branch done over the full year has to be signed in three to four days. Then the auditor holds his breath for a year hoping no fraud surfaces. This is downright embarrassing for him as well as the whole profession. Perhaps increased discussion on Frauds in Banking sector will increase alertness of all Bank Auditors raising the quality bar of Bank branch audits. This article is one such attempt.

Frauds in the economy involve Banks directly or indirectly. Some of those which shake up the confidence of people are:

- Money Laundering
- Debit/Credit card fraud
- Fake Demat accounts
- Frauds emanating from bribery for loans
- Know Your Customer (KYC) Violations (Benami Accounts)

All of the above cannot be covered in the limited space of this booklet but we can start off on some topics.

Money is the trading commodity of any Bank. With so much cash floating in the Bank, like cash balances in Bank safes as well as in 'near cash' like drafts and payorders, staff, or customers or persons walking in branches may sometimes feel tempted to pick up what is not theirs. Computers have added complexity to the detection and tracing of perpetrator of the crime since handwriting is minimal in compterised environment. As computerisation becomes widespread, the frauds are also computer based in response to the environment.

The Banking frauds can be classified from the angle of the perpetrator as:

1. Insider
2. Outsider

When the employees of the Bank commit the fraud, they are the 'Insider' category. Many laypersons have this strong view that frauds in Banking sector are impossible without involvement of insider. However this is not always the case.

Fraud by outsider is without the involvement of any insider is also possible. The intention is just to exploit weakness of the Banking system for self-gain.

From the angle of technology classification they can be classified as:

1. Manual frauds converted to computer based
2. New category of frauds – back door of technology exploited.

Approach to fraud detection

When the appointment is that of statutory audit, it would be unjustified to recommend an approach that diverts you from your primary objective of statutory audit. The tactic is to notice frauds during your planned work for statutory audit or at least notice the RED FLAGS and walk the extra mile. When you notice something out of the ordinary, it is a red flag. Red flag does not always mean fraud. It is just an alert to you for further investigation. For example, if the Credit Manager was on long leave, who did the authorisations and was it under direction of the Regional/ Head office? An acronym has been developed for fraud detection.

F	Find the RED flags	When you notice anything out of the ordinary like heavy cheque purchase and even return of cheques of same person it is a red flag.
R	Review RED flagged transactions	Review of red flagged transactions is to confirm it is not a one time and legitimate one. It can be one time yet non legitimate.
A	Analyse them for abnormality	The study should specifically answer what is abnormal about them from point of security, risk, violation of statute or management policy and procedure. (please include Accounting standards)
U	Understanding may be shared with Management	It will be in good stead to discuss with the Branch Manager to ensure there is no misunderstanding on your part. If you feel he is likely to stall you then this step may be skipped.
D	Document your findings	Try to keep with you all evidence possible. Screen shots, relevant copies of policy or statute which is violated, even photocopies/scans etc. of instruments to support your argument.
S	Statutorily report them	Reporting such Frauds needs to be in writing and not at an informal level. Resist the argument to present it under a separate letter with a single copy only to one person. In a statutory audit it should find a way in the official report only.

Although the suggested approach may initially seem formidable, over time it will be second nature and auditors will not even be aware that they are doing this unconsciously. Some cases discussed here will demonstrate how the above approach can be implemented.

Cases of fraud discussed here are based on real cases. Some have had huge publicity while some may be reported much earlier. As this article is targeted in a publication dedicated for auditors, it will be value added to also discuss specific approaches to <u>detect</u> each case in the limited time of audit. Each case is independent from the other. Audit tips are given in each case to minimize the detection time. CBS (Core Banking Software) environment is assumed which is a reality as well as a little bit of computer usage by the auditor restricted to spreadsheet though audit tools are also available but normally not permitted.

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Case 1

Fraud title	New Scheme exploitation
Perpetrator Category	Outsider
Technology complexity	Non CBS
Objective	Self-gain

Any new scheme announced by either the Government or any Bank defines opportunity for the exploiter. He bases the opportunity on the hastiness of the scheme launch. It is announced by the Minister or Prime Minister or Bank Chairman in a public meeting and all scurry to define features and perhaps documentation. Let us take the example of housing loan.

In India, Housing loan was given for decades only by the Institution Housing Finance Development Corporation (HDFC). When the Bank's started giving finance for housing, amongst various features they specified the margin. Each Bank vied with each other for loans by specifying lower margin. One such Bank announced what others announced i.e. 20%. In other words the Bank would finance 80% of value of the house. Knowing this, one prospect walked in with a proposal for a house of Rs. 10 crores. It was for a new house purchase under construction. He proved to the Banks for his source of margin of 2 crores as well as ability to repay installments.

Warning signs ignored: A person rolling in crores would reflect his wealth in his personality. He would travel in large cars and if housing finance was needed, he would apply to his own Banker and not walk into a Bank as a new customer.

What transpired after payment of just one installment was that the Builder's agreement was false although the stamps paid as fees were genuine. The copy of return of Income was also false. Also false was the document of his source of Rs. 2 crores.

Audit tips: New customer formality (KYC) was missing. When the customer is new or walk in, more care should be taken. No-one comes without any previous Banker from whom a credit opinion should be asked in confidence usually. Additionally, a visit by the banker to the borrower premises either home or office would be sufficient to confirm the financial status of the Borrower. Auditor can peruse the inspection report in the file. Visit to the builder would also have confirmed the price as well as the viability of the building construction (project). A borrower who is to move into a house of Rs. 10 crores (a price of that time of case) will rarely move from a very small house unless the increase in source of income is transparent and shared with the Bank.

Case 2

Fraud title	Dormant account fraud
Perpetrator Category	Insider
Technology complexity	CBS (relative low complexity)
Objective	Self-gain

This is a case of old wine in new bottle. This fraud was prevalent in the pre-computerisation period not just CBS stage. In this fraud, accounts which are classified as 'dormant' ***and*** have sizable balance in them are defrauded. Accounts normally go through two stages of non-operation. The first stage is 'non operative' accounts where no operation other than system related vouchers such as interest or charges are passed in the account for a period of six month. Three to seven years after that depending on the Bank's policy and RBI direction, such accounts are classified as 'dormant'. Although the majority do not have balance other than nominal, some have sizable balance in them. These accounts though rare, exist. The account holder may have moved to new premises, or got transferred or plumb forgot the existence of the account. Banks and most software systems are sensitive to these accounts. Once they are classified as non-operative or dormant, operations in the account other than system generated entries are not permitted. Entries are permitted under authorization of the Branch Manager only or senior officer in case of large branches. This is also to ensure interview of account holder by the accountant to understand the reasons for low action of the account. The fraud is done by either transfer of funds to own account or dummy account or straight withdrawal.

The difficult situation was just mentioned that the account needs to be converted from non-operative to operative and this is to be done only under authorisation of Branch Manager. Does that mean that without active involvement of the Branch Manager? This is not always imply so. So***, how does the staff get the password of the Manager?*** He need not get so. By design or my accident the power of his own password may be erroneously given to the level of a manager due to which the account may be made 'live'.

Another bypass of control is when any person has authority to the database. Information Technology maintenance persons have access to the database or a poor security control will permit easy access. When the application controls are by passed, it is easy to transfer the balances to another account without leaving an audit trail. The perpetuator will also have his personal account in one of the branches which is a natural feature. Such frauds are difficult to discover until complaint from the real account holder is received. Prevention is better than cure. Restricted access to database is a better alternative.

Audit tips: The study of audit trail would be helpful to check those accounts made live from dormant. However the reality of presentation of audit trail hits us when we inspect one. It is lengthy and all small events are shown with old value to new value. This source is no longer reliable to point out red flag transactions. **One suggested short cut is isolate all accounts made live this year**. You can do this by accessing list of accounts which were dormant last year as well as end of this year. Insert this data in spreadsheet, use vlook up to identify those whose status was dormant last year but are not in the dormant list this year. These are red flag transactions. Examine these accounts especially the voucher just after conversion of status of the accounts from non-operative/dormant to ‘live’. This will feed you to a trail in case there is a fraud of this type. If the software application has a report of date of conversion to ‘live’ status then the spreadsheet alternative need not be taken.

Case 3

Fraud title	Window dressing
Perpetrator Category	Bank Officials
Technology complexity	CBS (Low)
Objective	Suppress true NPA (non performing account) status

Unlike other frauds, this one does not have the direct nexus to personal gratification. It is done for the ‘collective’ gain of the Branch. The aim is to suppress NPA status of few accounts so that lower Provisions are needed. Internally, the Region to which the Branch belongs will thus have lower statistics. With this ‘larger’ objective in mind such dubious tactics are employed. If not detected, the auditor is placed later in a precarious position of such window dressing when detected later.

The modus operandi used is to manipulate status of the NPA accounts to Performing status whether or not specialized software application is used to determine NPA status. Just before the year end, you will notice the loan account closed and another loan given to the same party for amount equivalent to the outstanding of the old account. Since the old account is closed, even if the status of NPA was accorded to it anytime during the year this account is of no consequence either to the NPA software or anyone as this account ceases to exist at the end of the year. Analysis of such an account is thus easily skipped under the *misunderstanding* of 100% recovery when in reality, it is not.

Audit tips

The auditor has various alternatives to seek and verify such account in a minimum period of time. The audit action here is, Select target accounts – examine them – conclude on window dressing. Initially we shall see the section of selection.

1. Selection of target accounts.

Ask for list of loan accounts closed between February and March. If such a list is not forthcoming then alternative action is mentioned below. If such a report is obtained from the system it is comfortable to get list of broad target accounts. Examine the closure entry and if it is equal to the last / average installment then this is not in your select list at this stage. Accounts closed either by transfer to any other account (smart manipulators do not use this option) or by payment of amounts sizably more than one installment usually nearing three installments or above are in your select target.

a. In case the ready report of list of accounts closed in specified period is unavailable you can still obtain it using the CBS and without involving programmers at the Data Centre of the Bank (getting their involvement is next to impossible). A jotting list is sin qua non of any Indian Banking system since the manual days. This lists the balance of a particular department say Loans or Savings on a particular day. In manual days this was done every Friday to tally with the manually maintained General Ledger. Such Jotting can be printed at any frequency today. Assuming you have numerous loan accounts such a list of mere account number, name and amount will run into dozens of pages.

For just two month analysis you need to print jotting for end of February and March end. Then you need to compare old closed accounts and new loan accounts.

b. New accounts are easy to identify since account numbers higher than the last one of February are the new accounts.
c. Closed account identification however is time consuming for a higher load if done manually. Again, you can insert this data in excel and identify accounts existing in February but not in March. These are target accounts. As amounts are also mentioned, you can take the ABC analysis route to identify those which have been closed with more than one installment. In addition, newly opened accounts in March with same name are also to be selected.
d. A note of caution that mere closure of old account and opening of new immediately need not mean window dressing. It has to be examined case to case. For example two housing loans are sometimes not permitted based on income assessment. For this, one is closed and a new one is opened.
e. Two months are suggested here because the Banks normally struggle to get the account in order around January even though the NPA date is the date on which the account has dropped to NPA status. If the auditor feels the Bank ensures this half early then same exercise can be repeated for August September.

2. Analyse the accounts & Conclude on window dressing

   How the account is closed and the amount of closure are red flags.

   a. Accounts are rarely blatantly transferred to new loan accounts. Yet this has to be ruled out. Such accounts need to be analysed if a new loan is given and earlier loan account merged as per the sanctioning authority. It should sound logical to the auditor.
   b. Cash/Cheques used for settlement are to show legitimate closure of account. If this is a case of window dressing then the borrower seeks a temporary source for a few days about a week to fifteen days after which a new loan account is granted. This is definitely window dressing.
   c. Names of new accounts sometimes may not be the same as the old one. This is to throw the auditor off track. You are aware that a person can have many proprietorship accounts. If a new loan is taken in another proprietorship account it will not show up as a red flag. Banks need to identify the name of the proprietor in the Loan account since the proprietary firm does not have independent legal status. If the name of the proprietor is not mentioned then the PAN number of the borrower will be the same and the documents of the new loan will show who the proprietor is.
   d. If the names are changed to that of family member then also the surnames would be the same in areas where surnames are prevalent.
   e. In case the borrower manipulates through private limited companies then here too, the hard work of finding common directors can be resorted to.

Case 4

Fraud title	Money Laundering/Benami/KYC
Perpetrator Category	Outsider
Technology complexity	High – fake documents
Objective	Suppress identity and evade tax

Tax evasion in India is a sore feature. While the Government has taken steps and enactments, the translation into action at ground zero remains to be patrolled by many of us. KYC being a non-financial nature it is not given due attention by the Bank auditor. A fake KYC has potential to germinate into large frauds without recourse to the perpetrator. Digital technology has eased the copy and manipulation of documents. Editing software permits manipulation of names and addresses to create an edifice of falsehood. Education certificates, address proofs, income-tax returns, proof of residence and other documents can easily be manipulated. Unless there is some third party or an objective/direct source of confirmation the web of lies will expose the Bank to astronomical levels. These levels are either borrowings from the same Bank or transactions done through the Bank for the economic benefits of the perpetuator like Demat Accounts (Benami).

Audit tips: Whenever wholesale account opening is encountered by any Bank, it needs to be supported by sufficient staff and Standard Operating Procedure (SOP) for KYC Compliance. KYC of depositors and Borrowers need not be accorded differential priority as yesterday's depositor may be tomorrow's borrower. Yet the golden rule is that KYC of non-depositors needs to be more strictly done. System of KYC needs to be examined and also whether it is being followed. Under the garb of convenience, some Banks send their representatives to the house or place of business of potential clients. Their visit also confirms the address of the account holder and as photograph it taken by the Bank official there is no question of fake photo submission. Even if there is no personal visit, accounts need to be opened by the personal visit by the account holders including Directors of companies at least once. This is a guaranteed implemented procedure if the Bank is shooting the photographs on their camera only and not accepting submitted photos.

When Income Tax PAN Number is available, the Bank can verify on-line through say CIBIL where all other details can also be corroborated.

Case 5

Fraud title	Accommodation Bills
Perpetrator Category	Outsider
Technology complexity	High – fake documents
Objective	Use cheap Banking finance for non-sanctioned transactions

Banking finance encourages contribution to the country's Gross Domestic Product. Bank finance is encouraged to be given at low rates to contributors to the economy. Borrowers get encouraged wrongly to use cheaper finance for other non-official activities. We normally see this for vendor bill purchase. Whenever goods are purchased either for manufacture or trade, the borrower needs more credit period than that offered by the vendor for reasons of cash flow or manufacturing/sale cycle. The bank steps in by providing finance specifically for the documented transaction. The borrower has to prove all aspects of the transaction. Proofs are provided by documents. The bank should be able to conclude that order is placed on the vendor, goods are dispatched, goods are received, insured in transit etc. Thus, purchase order, sale invoice, lorry receipt (LR) or bill of lading, good received note, insurance policy etc. proves that this transaction existed. At the time of sanction the bank must have approved a list of vendors approved for bills discounted. In genuine cases such documents are normal and easy to produce.

If the transactions do not exist yet Bills are discounted then such bills are termed as 'Accommodation Bills'. But the documents need to be submitted as a formality. As mentioned before, technology of today offers easy way out for reproduction of documents.

Audit tips: Some stark signs are as follows:

1. Bills are of round amounts. The net amount of actual transactions rarely are in round figures. If all the bills are in round figures then it is a red flag. You need to be cautious to realise ***that all red flags are not fraud***.
2. Supporting documents are neat and clean. Take the example of Invoice. If it is not folded to fit into an envelope does it mean that a 10 X 12 inch envelope was used? This may be so in overseas trade though even there it is rare. Then the Lorry (Truck/surface transport) receipt. It may be clean in case of Vendor bill purchased. But in case Debtor bill purchased where the borrower claims to have delivered goods to his customer, he has to submit accepted lorry receipt (LR). This lorry receipt has travelled with the truck from the factory to the customer taking days and lot of handling. This soils the paper to a large extent. So if this LR is clean, your red flag should be fluttering! Even here were have noted the office staff to rub the receipt on used carbon paper to show grease and dust with the aim to avoid such notice by the auditor or the Banker where accommodation is taken without his knowledge.
3. Single vendor: Unless the Bank has sanctioned Bill Purchase/ discount of only one approved vendor you will agree that few concerns have a single vendor. Such a vendor is likely to be an 'accommodating' friend. So if all the bills are drawn by one party only, your red flag starts fluttering. If you note the sanction of facility is to more than one vendor then you are heading for an investigation. Normally, the Banker himself would question only one vendor unless it is a monopoly item or some other technical reason. To avoid pre-sanction objections and hard questions he would add a list just to divert attention but after sanction use his accommodating

friend only.

Case 6

Fraud title	Fraudulent Overdraft against Fixed Deposits Receipts (FDR)
Perpetrator Category	Outsider
Technology complexity	High – fake documents
Objective	Siphoning money

Giving money against fixed deposit is the safest form of Bank Lending. This is oft quoted by Bankers. The logic is simple. The money offered as security is already with the Bank in the form of fixed deposit. Lending against this is done with a margin of 20%. Also, the rate of interest charged is 2% over the fixed deposit. In case the borrower does not pay, when the fixed deposit matures, the money is appropriated against the outstanding. Furthermore, such advances against the Bank's own FDR are outside the purview of Non-performing Asset (NPA) classification. This makes scrutiny of such account easy to miss.

Normally the FDRs are of the borrower i.e. name on the FDR is the same as that of the borrower. In few genuine cases it is not the same. When the partners submit their personal FDR for the funds to be borrowed by the firm or when parents submit the FDRs in their name as security to finance business of their children "to enforce discipline". When the FDR does not bear the same name as that of the borrower, it is termed as 3rd party receipt.

In such a fraud, the Bank assumes security of the FDR exists when it does not. FDRs are genuine but the aspect of their submission as security is not. In such cases 'bulk' deposits are brought in through middlemen. The word bulk refers to amounts exceeding Rs.100 crores. Middlemen drive a barter bargain with the Bank Managers- deposits for lending. Once the deposits are transferred, the receipts are handed over to the middleman who convinces the Bank that he takes it as agent. Deposits are usually of large corporations especially public authorities or Public Limited companies. The Bank also does not have much say in the KYC as the middleman encourages secrecy otherwise the deposits will move to other Banks. Now after the transfer is made and deposit receipts are handed to the middleman he expectedly comes with the letter to permit the Bank to give overdraft against a third party not related to the depositor (not an associate company or subsidiary). Since this was part of the barter with the Bank by the middleman, the overdraft is given. Only when either no servicing is done or the depositor company complains non receipt of deposit receipts, the fraud is understood.

Audit tips:

1. Sudden spike in any ratio of the Bank needs to be investigated. (Use the term 'study' as the term 'investigation' has more sinister annotation in Banking industry) Even spike in profit which others may applaud should be studied critically by the auditor. Ratio analysis is an easy pointer to problem areas but undervalued by many. In the present case, the annual

figure compared to earlier would have shown jump in profit, deposits and advances. The bulk deposit and bulk advance would be easily traced and the story revealed before circumstances and newspapers revealed the story.

2. Unrelated third party deposits need to be supported by special document and not merely by a letter from the company.
3. The document needs to be supported by certified resolution copy.
4. If all the documents are in place then a balance certification from the depositor and lender should be demanded to be sent directly to the auditor. This will be the ultimate proof of authenticity of the transaction.

Conclusion

Discovery of frauds is often misunderstood as labour intensive or time consuming process. Society looks to the industry of auditors to unearth frauds in their regular work. As the clients have benefitted from computers it is logical that the auditors too benefit from them. Computer Aided Audit Tools (CAAT) are useful. One day, auditors will be permitted to use them. Until then a via media has to be reckoned with. Generating reports through the system and dovetailing them into spreadsheet for future analysis like Ratio analysis saves the auditor lots of time yet points to the stark red flags. The given examples though few, are based on real frauds that have occurred in Indian Banking history. This should spur you in your next Bank audit assignment.

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