

FORENSIC REVIEW UNDER THE INSOLVENCY AND BANKRUPTCY CODE



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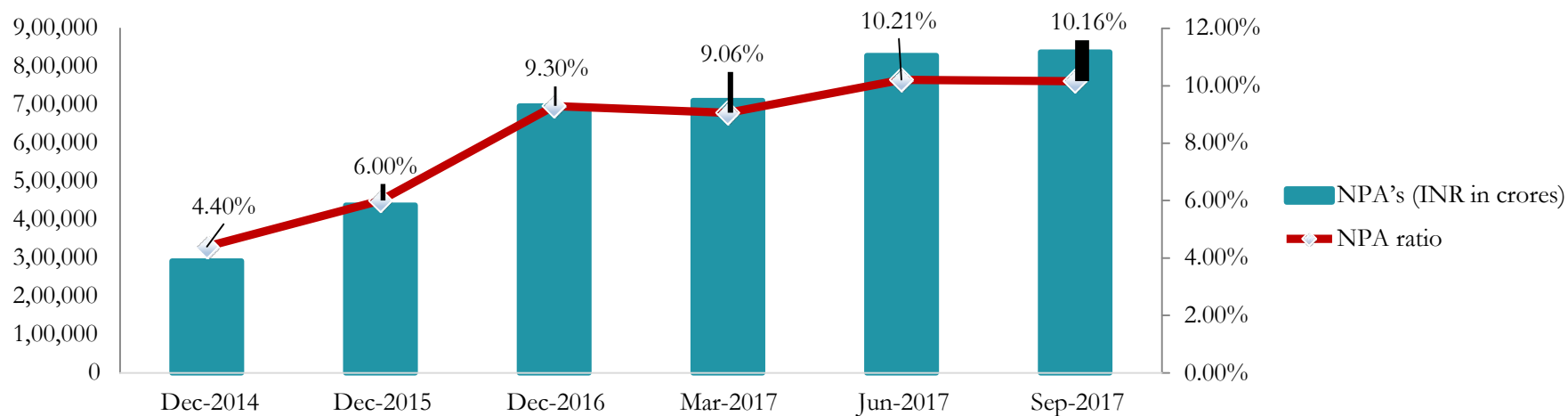
INTRODUCTION

NPA SCALE – INDIA

Increase in Non Performing Assets

- Non- Performing Assets (NPA) accounts and some of the contemporary issues around our banking sector have come to dominate our news rooms and court rooms in the recent past.
- In the recent past, there has been a steep rise in NPAs. This situation is set to worsen over the time period, to curb this situation there is a need for investigation as to why this situation is deteriorating.

Increasing trend of NPA in India (INR. in crores)



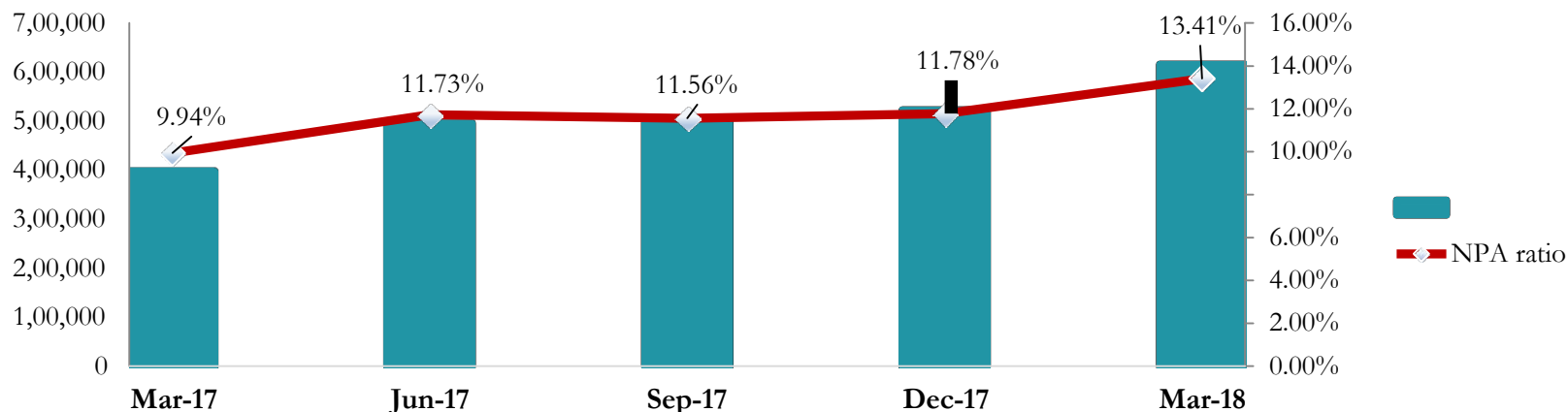
- It is to be noted that the NPA in September 2017 amounted to INR 8.38 lakh crores and the NPA ratio is 10.16% which is way above the global average of 4%.
- NPA increased from INR 2.92 lakh crores to INR 8.29 lakh crores i.e. by 184% just in a span of 2.5 years only and its ratio has gone up from 4.40% to 10.16%. This situation is set to worsen over the time period.

Source : Care Ratings Report

NPA SCALE – INDIA

Increasing trend of NPA's in 14 Public Sector Banks in India.

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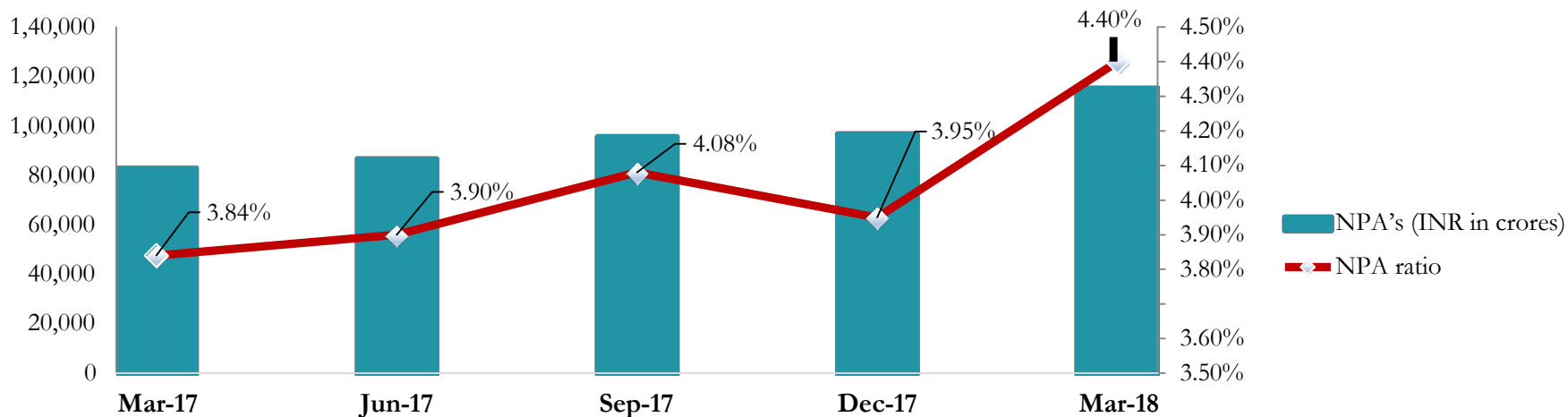


- It is to be noted that the NPA in March 2017 amounted to INR 3.98 lakh crores and the NPA ratio is 9.94% which is way above the global average of 4%.
- NPA increased from INR 3.98 lakh crores to INR 6.16 lakh crores i.e. by 54.45% just in a span of 1 year only and its ratio has gone up from 9.94% to 13.41%.

Source : Care Ratings Report of FY 2017-18

NPA SCALE – INDIA

Increasing trend of NPA's in 12 Private Sector Banks in India.



- It is to be noted that the NPA in March 2017 amounted to INR 82.98 thousand crores and the NPA ratio is 3.84%.
- NPA increased from INR 82,981 thousand crores to INR 1.15 crores i.e. by 38.52% in 1 year and its ratio has gone up from 3.84% to 4.40%.

Source : Care Ratings Report of FY 2017-18

NPA SCALE – INDIA

The NPA ratios for individual banks as of March 2018 are provided in the table below:

1. 12 banks had Gross NPA ratio of above 10% and all are in the public sector.
2. 5 banks had a ratio of less than 2% and 5 between 2-5%. All of them are private banks.
3. The balance 4 had a ratio of above 5% of which 2 are in the private sector and 2 in public

Sr. no.	Name of the Bank	NPA Ratio
1	IndusInd Bank Ltd.	1.17
2	Yes Bank Ltd.	1.28
3	HDFC Bank Ltd.	1.3
4	RBL Bank Ltd.	1.4
5	DCB Bank Ltd.	1.79
6	Kotak Bank	2.22
7	Federal Bank Ltd	3
8	IDFC Bank Ltd.	3.31
9	South Indian Bank	3.59
10	The Karnataka Bank	4.92
11	Vijaya Bank	6.34
12	Axis Bank Ltd.	6.77
13	Indian Bank	7.37
14	ICICI Bank Ltd.	8.84
15	State Bank Of India	10.91
16	Punjab & Sind Bank	11.19
17	Syndicate Bank	11.53

Sr. No.	Name of the Bank	NPA Ratio
18	Canara Bank	11.84
19	Union Bank Of India	15.73
20	Allahabad Bank	15.96
21	Oriental Bank	17.63
22	Punjab National Bank	18.38
23	Bank Of Maharashtra	19.48
24	Central Bank Of India	21.48
25	Dena Bank	22.04
26	UCO Bank	24.64

Source : Care Ratings Report of FY 2017-18

NPA SCALE – GLOBAL

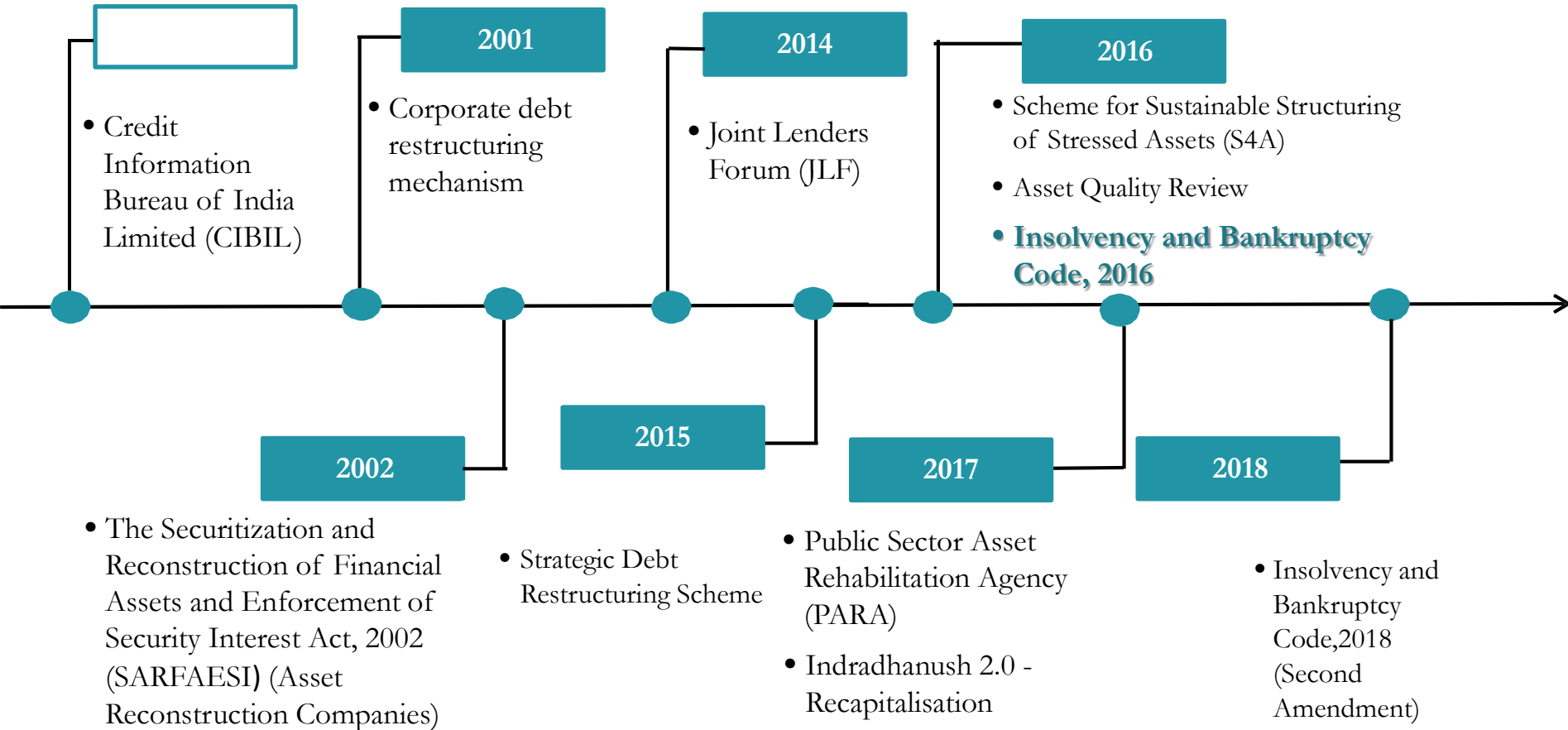
- According to World Bank Statistics for the period ended June-2017 following are the percentages of NPA's across Indian boundaries.



- Considering the above, the global average works out to be roughly around 4%.
- If we study globally in past in many developed countries this ratio is on a decline on account of measures undertaken by their governments which has proved to be effective.
- It is noteworthy that in the early 2000's this issue was more severe in China than in India.

Source: World Bank Statistics

MEASURES TAKEN BY THE GOVERNMENT



DEALING WITH NPAs

Regulatory & other tools

The Companies Act, 2013

Securities and Exchange Board of India Act, 1992

The Whistle blower Protection Bill, 2011

SARFAESI Act, 2002

The Benami Transactions (Prohibition) Amendment Act, 2016

Insolvency and Bankruptcy Code, 2016

Prevention of Money Laundering Act, 2002

Forensic Audit, fraud detection & investigation

Steps to reduce NPAs

Strengthening the internal control system

Whistle blowing mechanisms

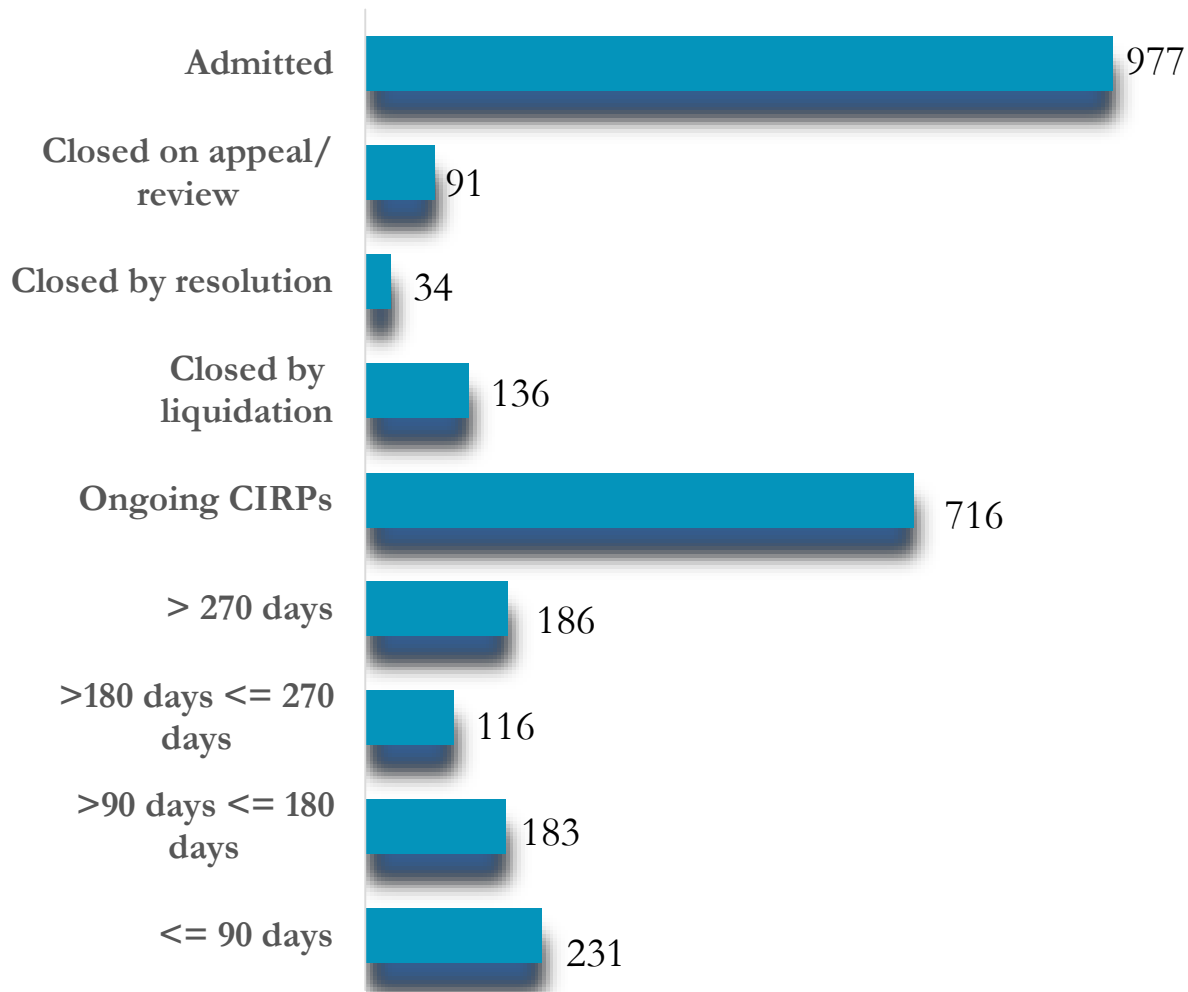
Background Check of promoters

KYCC (Know Your Customer's Customer) and KYCV (Know Your Customer's Vendor)

Due diligence of asset quality provided as collateral

Monitoring of end use of funds disbursed

STATUS OF CASES UNDER CIRP



Source: IBBI/ Business standard dated September 19, 2018

FRAUD FACTS AND PROVISIONS UNDER IBC

- Resolutions professionals (RPs) handling various corporate insolvency resolution programs under the insolvency and bankruptcy framework have reported a large number of fraudulent transactions. These transactions, reported in over 110 Companies under the resolution, are worth over INR. 40,000 crore
- The numbers showed that frauds, which include shipping of funds, transactions with related parties and fictitious persons, were widespread in cases that have been referred to National Company Law Tribunals (NCLT) across the country
- Of the big 12 cases that were reflected to NCLT by the Reserve Bank of India (RBI) last year, fraud has been reported under atleast 10.
- Under the provisions of IBC, the RP is required to file an application for Fraudulent cases under section 66 of the Act to the Adjudicating Authority, which is the respective NCLT.
- The code provides RP the power under section 20 to appoint accountants, legal or other professional to perform his obligations under the code. In several cases RPs have appointed Forensic Auditors.
- In the event of failure of insolvency professional to act on such dubious transactions, the Creditor can also file the application with adjudicating authority.

Source: Economic Times dated 30 September, 2018(Finance fraud cases)

FORENSIC SERVICES UNDER IBC

I] Assistance in finding irregularities under sections 43 to 66 of the IBC, 2016

II] Detailed forensic audit

III] Background check of potential bidders

IV] Hostile forensic due diligence review on competitive bidders

I] ASSISTANCE IN FINDING IRREGULARITIES UNDER SECTIONS 43 TO 72 OF THE IBC, 2016

Sections of the Code	Subject Matter	Approach
Sections 43 & 44	Preferential transactions	<ul style="list-style-type: none"> • Analysis of nature of related party transactions and their impact on the financial statements • Verification whether payments / receipts have been done in accordance with the transaction • Impact of any offset journal entries that may have been passed and its impact • Investigation of preferential transactions (not at arms length) between entities that have taken place in the following manner: <ul style="list-style-type: none"> ○ In case of related parties – two years prior to the date of insolvency ○ In any other case – one year prior to the date of insolvency • Examination of transfer of property / assets/ interest to the benefit of a particular creditor / beneficiary in the presence of an existing debt/ liability such that the creditor is in a beneficial position at the time of distribution of assets • Genuineness of the nature of funds / loans given / received from parties • Authenticity of the claims made by related party creditors • Supporting the legal team in making applications to the Adjudicating Authority
Sections 45 to 49	Undervalued Transactions	<ul style="list-style-type: none"> • Evaluation of transactions that have occurred which are significantly less than the value of consideration. • Benchmarking such transactions carried out by the company with peer companies (similar industry) to comment on whether they were carried out at arm's length • Review of transfer pricing orders • Quantification and nature of such transactions • Supporting the legal team in making applications to the Adjudicating Authority

I] ASSISTANCE IN FINDING IRREGULARITIES UNDER SECTIONS 43 TO 72 OF THE IBC, 2016

Sections of the Code	Subject Matter	Approach
Section 50	Extortionate credit transactions	<ul style="list-style-type: none"> • Ascertaining the nature of receipts of any financial or operational debt during the period within two years preceding the insolvency commencement date • Terms & conditions of such debt (interest rate, repayment terms, security interest etc.) and determine if the same is exorbitant in nature • Whether the parties who provided the loan are genuine parties or are in effect related parties?
Section 66	Fraudulent and wrongful trading	<ul style="list-style-type: none"> • Observation of any apparent fraudulent activity by analyzing the financial statements and other supporting documentation • Identification of areas where fraudulent transactions may have occurred • Analyzing additional data based on the findings
We also assist in finding evidences relating to Chapter VII – Offences and Penalties described as under:		
Section 68	Concealment of Property	<ul style="list-style-type: none"> • Obtaining any evidence / information of concealment of any property in the books of the Corporate Debtor, by any officer. • Investigation of any fraudulent activity by any officer (e.g. by making false entries into the books of accounts, manipulation, alteration of accounts, etc.)
Section 69	Transactions defrauding creditors	<ul style="list-style-type: none"> • Evaluating transfer of any gift / charge conspired in execution of an order against the property of the corporate debtor. • Concealment or removal of any part of property of corporate debtor without any satisfactory order for payment of money received against the corporate debtor.
Section 72	Wilful and material omissions	<ul style="list-style-type: none"> • Ascertaining that there is no omission of any wilful and material information relating to the affairs of the corporate debtor.

IJ ASSISTANCE IN FINDING IRREGULARITIES UNDER SECTIONS 43 TO 72 OF THE IBC, 2016

Sections of the Code	Subject Matter	Approach
Other Aspects		<ul style="list-style-type: none">• Detailed analysis of annual financial trends of the company and comment on probable suspicious areas of manipulation, if any• Excessive provisioning / write offs / losses which are not in the ordinary course of business and are unusual in nature• Background check of major customers and vendors of the company to establish if they are the front companies of the promoter• Non-recurring expenditure incurred by the company• Evaluating whether revenue is booked as per the applicable GAAP• Non- moving creditors & debtors• Analytical review of international subsidiaries and associate companies• Exceptional items to the statement of profit and loss

II] DETAILED FORENSIC AUDIT

Given below is our approach while conducting forensic audit :



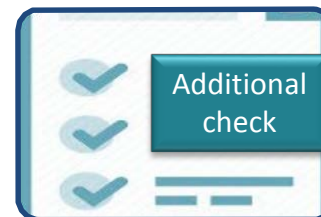
- Gathering basic information about the background of the Corporate Debtor / other concerns.
- Understanding the facts.



- Obtaining information through extensive public domain research; shareholding, promoter details, KMP etc. of the Corporate Debtor/ other concerns.
- Studying various aspects of the financials.
- Evaluation of Bank statements to understand the nature & fund flow of transactions.



- Data analysis
- Analysis of contracts and identification of critical terms.
- Assessment of genuineness of creditors.
- Risk Assessment in key areas of operations & asset misappropriation
- Analysis of preferential transactions with related parties & others / International subsidiaries



- Additional information gathering based on social media search.
- Relationship assessment of creditors and Corporate Debtor/ other concerns.
- Transaction testing and verification of supporting documentation.
- Fund diversion from Corporate Debtor to any other business



- Reporting of the recoverable amount from the Corporate Debtor.
- Reporting any material findings with regards to the outcome of the project.
- Initiate proceedings, if any.

QUESTIONS ADDRESSED IN A FORENSIC AUDIT

Is this business in existence?

Are KMP/ officers involved in criminal acts?

Is the turnover genuine?

Are contingent liabilities disclosed?

Are the assets in existence?

Is the inventory valuation inflated?

Has anyone ever filed a complaint against them?

How and who financed their expansion?

Are they involved in any legal dispute?

Are they complying with laws & regulations?

Have they defaulted on loan repayments in the past?

Are there any entities affiliated to this business?

Are they financially secure?



III] BACKGROUND CHECK OF POTENTIAL BIDDERS

Following are the primary requirements / eligibility criteria for bidders as per Section 29A of The Insolvency and Bankruptcy Code (Amendment) Act, 2017 which would fall in our scope for the purpose of verification:

- Ensuring that the bidder **is not an undischarged insolvent**
- Ascertaining whether he **is a willful defaulter** (within the guidelines of the Banking Regulations Act, 1949).
- Determining whether such entity is **prohibited / debarred from trading in the securities market, by the Securities and Exchange Board of India**
- Examining that such person is not connected /exercises **any influence over the corporate debtor** or is not an entity to whom, preferential transactions, undervalued transactions, extortionate credit transactions or fraudulent transaction have taken place
- Ensuring that the bidder **is not disqualified under the Companies Act, 2013**
- Examining whether any person who is a promoter of a corporate debtor who is in the management / control **and whose account is classified an NPA for more than one year**
- Whether he is **convicted of any offence** during the past years
- Any entity referred in the points above, any connected persons, any related parties of the connected persons , any person acting in concert with the above, shall be ineligible to bid.

To enable us carry out detailed investigation of the above, we follow a **three - pronged** approach to compile facts & perceptions:



III] BACKGROUND CHECK OF POTENTIAL BIDDERS

I] Public Domain Research

- Examining the **background of potential bidders, their family & social background**
- To check the **creditworthiness** of the bidders
- Comment on their **business networks and connections**
- Any **negative comments/ news** about the bidders?
- Analyzing **transactions** with respect to any **bids in the past**

II] On-site Field Investigation

- On field investigation to obtain information about the potential bidders

III] Interviews / Reference Checks

- Conducting interviews of acquaintances of the bidder and obtaining details of the bidder
- Discreet interviews of professional / social acquaintances of such persons are carried out

IV] HOSTILE FORENSIC DUE DILIGENCE REVIEW ON COMPETITIVE BIDDERS

With a view to understand the reasons for non-repayment /low recoveries of borrowed funds, a detailed hostile forensic financial due diligence is required to be carried out :



THANK YOU!!

FOR PATIENT HEARING

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