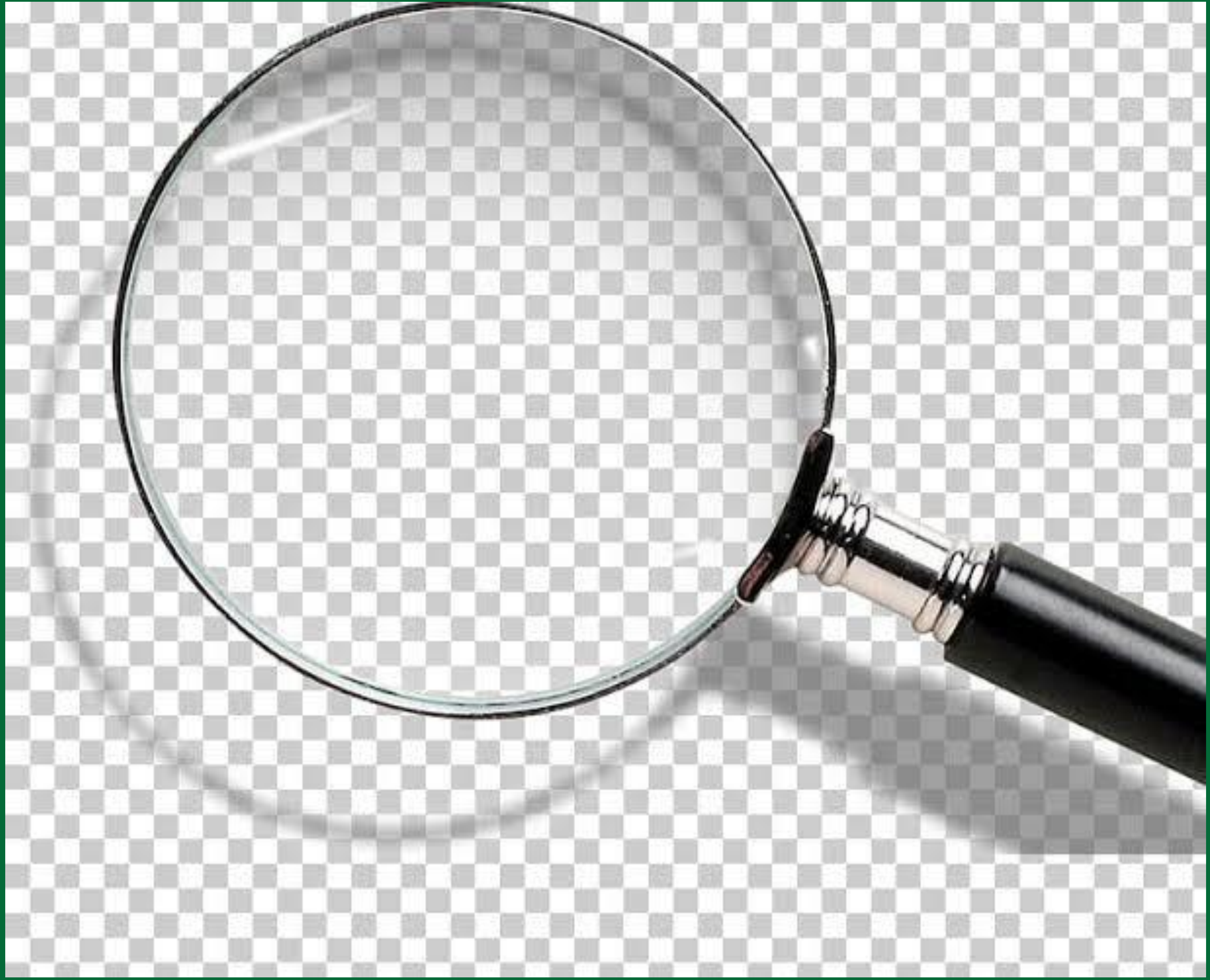

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A Forensic Approach

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India LLP

“Behind every great fortune, there is a crime”

– Quote by Lord Balzac, taken from *The Godfather*

- The term “forensic investigation” generally refers to the use of science or technology in the investigation and establishment of facts.

- Simply put - “A practice of lawfully establishing evidence and facts to be presented in a court”

What is fraud?

Definition

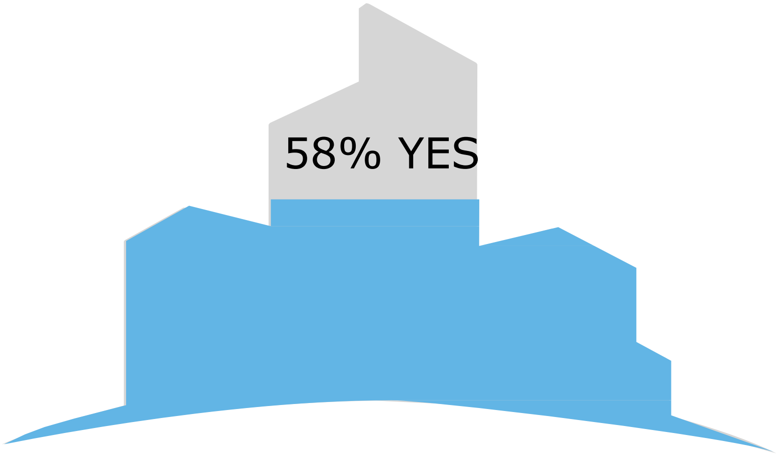
Includes any act or omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner with an intent to deceive, to gain undue advantage from or to injure the interests of the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

Key findings on the current state of corporate fraud

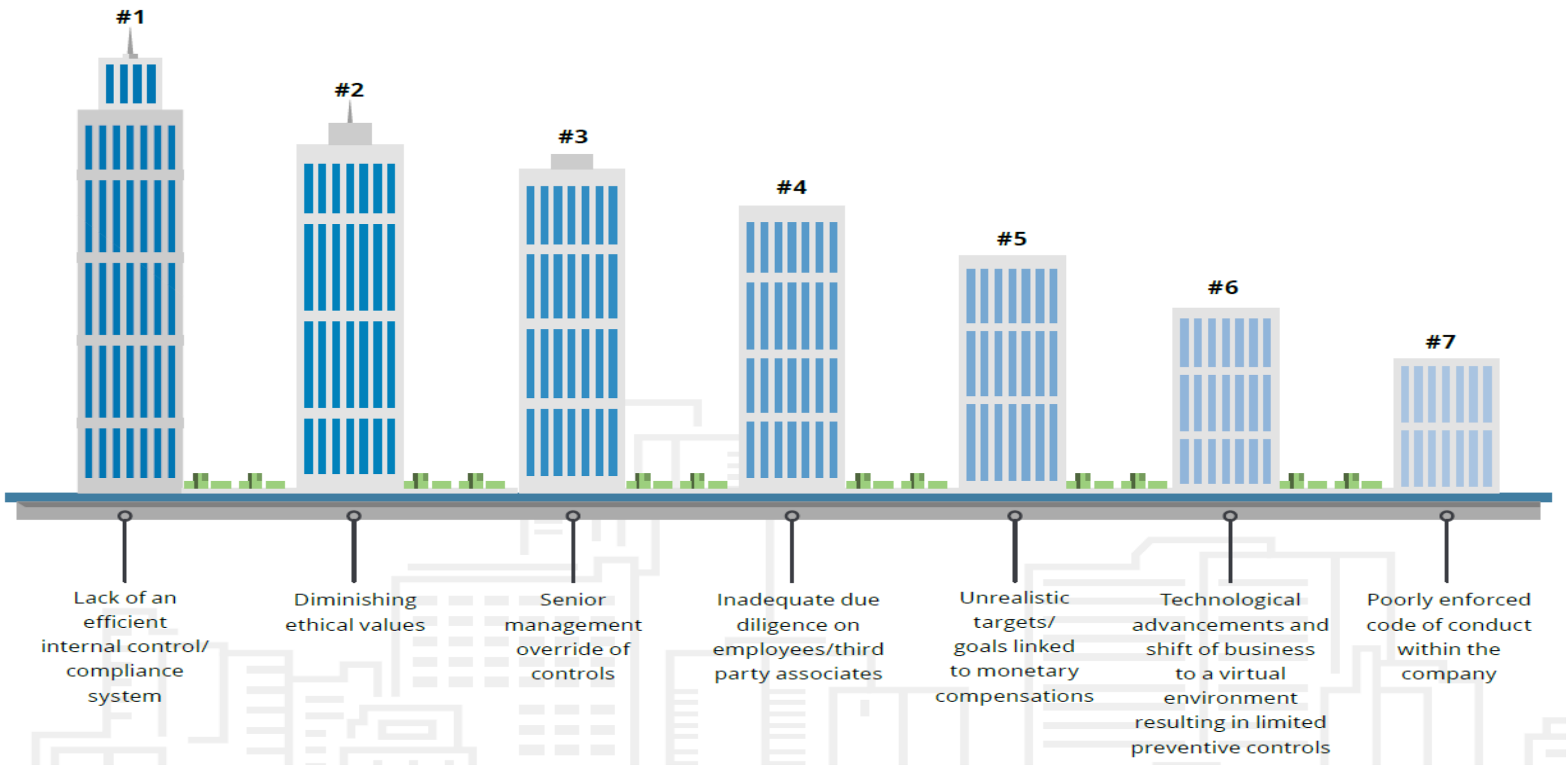
Current state of corporate fraud

Key findings from the Survey :

About 58% of survey respondents believe that incidents of fraud will rise in the next two years.

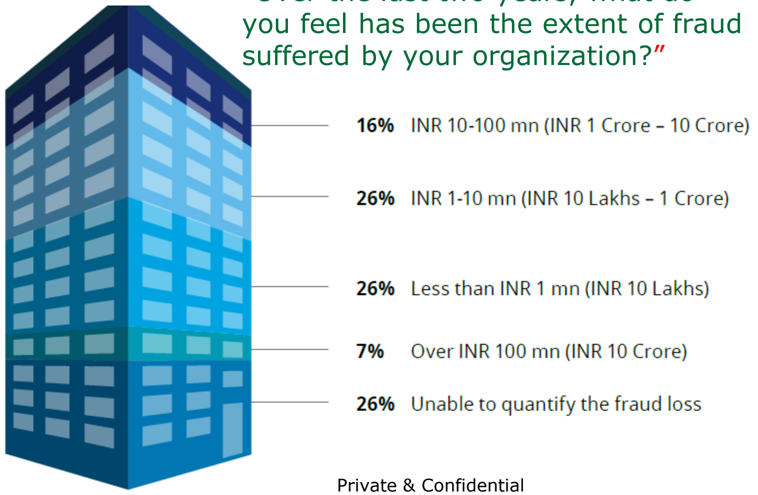


Top reasons being:



About 49% of respondents indicated losing more than INR 10 Lakhs (INR 1 Million) in fraud losses in the recent past. A little more than a quarter of respondents indicated that they were unable to quantify their fraud loss.

"Over the last two years, what do you feel has been the extent of fraud suffered by your organization?"



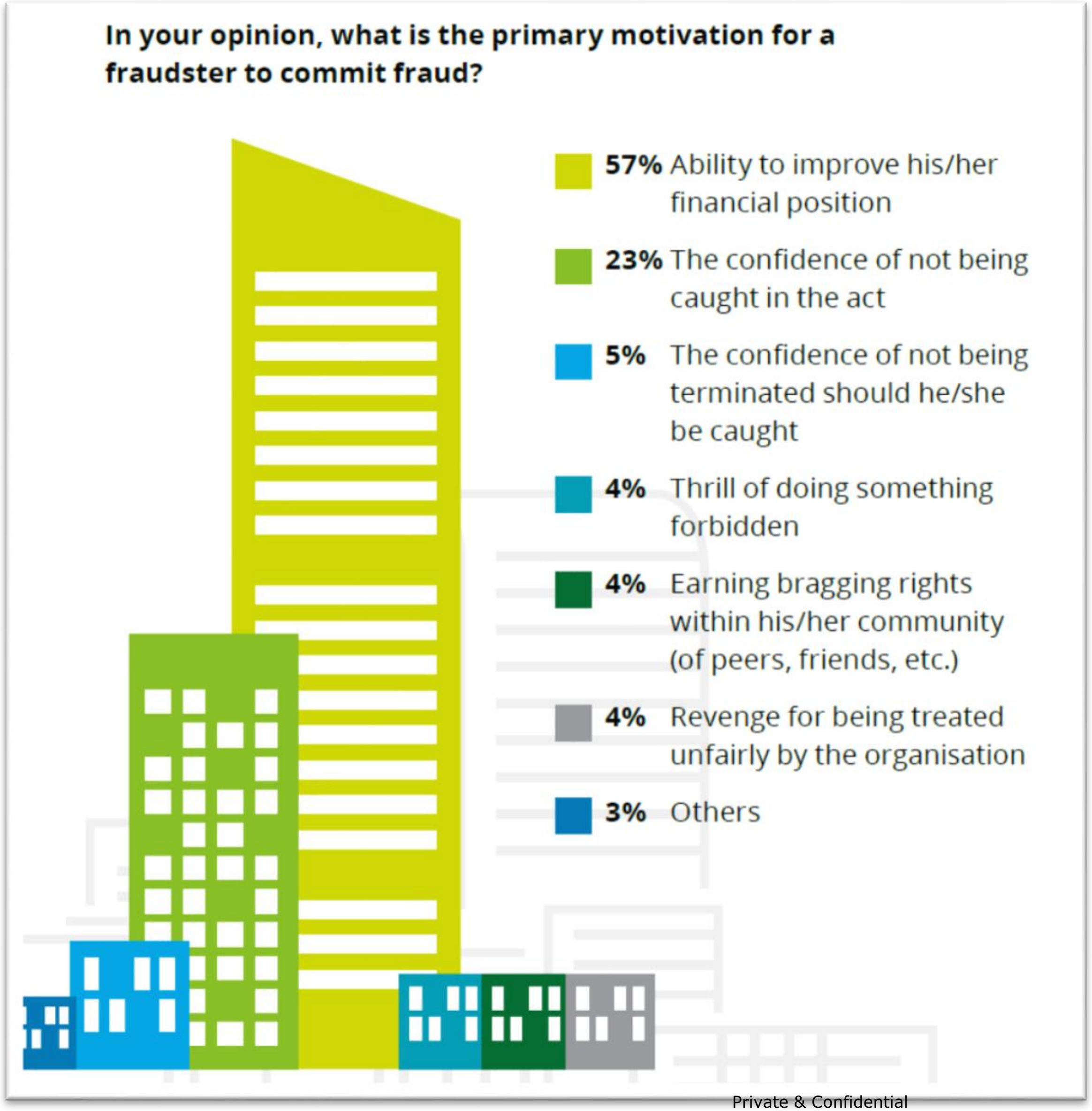
Source : Deloitte India Fraud Survey 2018

Who is a fraudster?

- Junior and Middle Management were more likely to commit artifice with primary motivation being to improve their financial position to which 57% agreed on and other being the conviction of not getting caught by 23%.

- Majority of respondents (64%) believe that suspicious traits in employees can be identified early on and dealt with appropriately to prevent fraud.

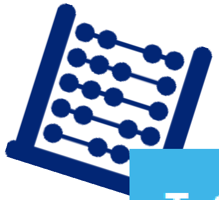
Source: Deloitte India Fraud Survey 2018



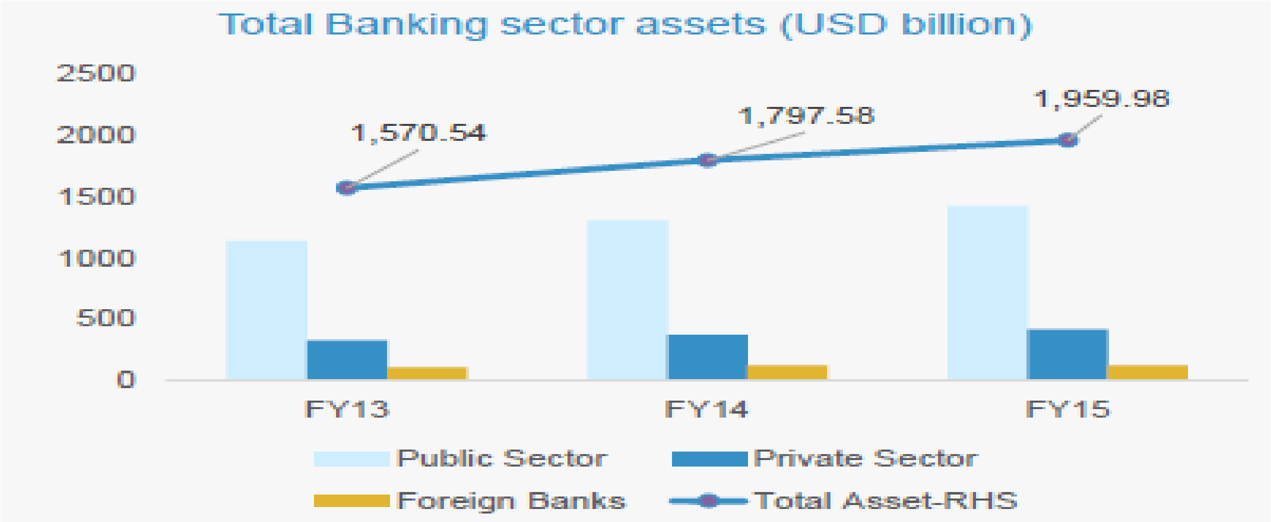
Current Scenario Banking Industry

Banking sector in India

The banking industry in India has the potential to become the fifth largest banking industry in the world by 2020 and third largest by 2025



Total banking assets in India is expected to cross US$ 28.5 trillion in FY25.



- The Indian banking sector is fragmented, with 46 commercial banks jostling for business with dozens of foreign banks as well as rural and co-operative lenders. State banks control 80 percent of the market, leaving relatively small shares for private rivals.
- Total banking sector credit is anticipated to grow at a CAGR of 18.1 per cent to reach US$ 2.4 trillion by 2017. The total banking assets in India touched US$ 1.96 trillion in FY15 and are anticipated to cross US$ 28.5 trillion in FY25.

Source: IBEF

India Banking Fraud Survey, Edition III

What is happening – A difficult environment for Banks

	2012	2015	2018
Fraud is on the rise and continues to rise rapidly than expected	**93%** Of this, 64% of respondents believed fraud had increased by upto 10% over the previous years	**93%** Of this, 76% of respondents believed fraud had increased by upto 20% over the previous years	**84%** Of this, close to 40% of respondents believe fraud has increased over 20% in the last two years
Despite issues identified in earlier surveys, the root cause responsible for the increase in fraud appears to be the same and not adequately addressed	• Lack of oversight by the line manager or senior management on deviations from existing processes • Business pressure to meet targets • Difficulty in business scenario	• Lack of oversight by the line manager or senior management on deviations from existing processes • Business pressure to meet targets • Lack of forensic analytics tools to identify potential red flags across different processes	• New technology/ digital channels that make fraud detection difficult • Lack of forensic analytics tools to identify potential red flags across different processes • Business pressure to meet targets
There appears to be a slight improvement in the ability to detect frauds (using technology), however issues still remain	• Internal audit/ legal/ compliance • Anonymous complaint by an external party • Through an internal whistleblower complaint	• Through a customer complaint • During routine account audit/reconciliation • Through an internal whistleblower complaint	• During routine account audit/internal audit/ reconciliation • Through a customer complaint • Through an internal whistleblower complaint/ through internal automated data analysis or transaction monitoring software

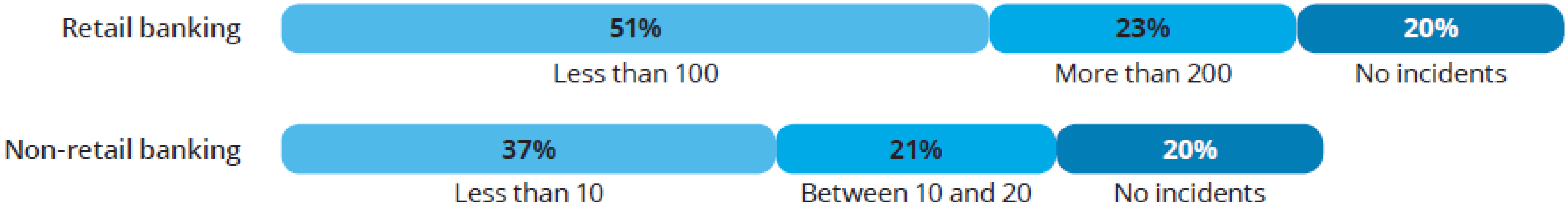
India Banking Fraud Survey, Edition III

A closer look - Fraud is on the rise and continues to rise more rapidly than expected

84% respondents indicated that there has been an increase in fraud incidents in the banking industry in the last two years

Of this, close to 40% of respondents believe fraud has increased over 20% in the last two years

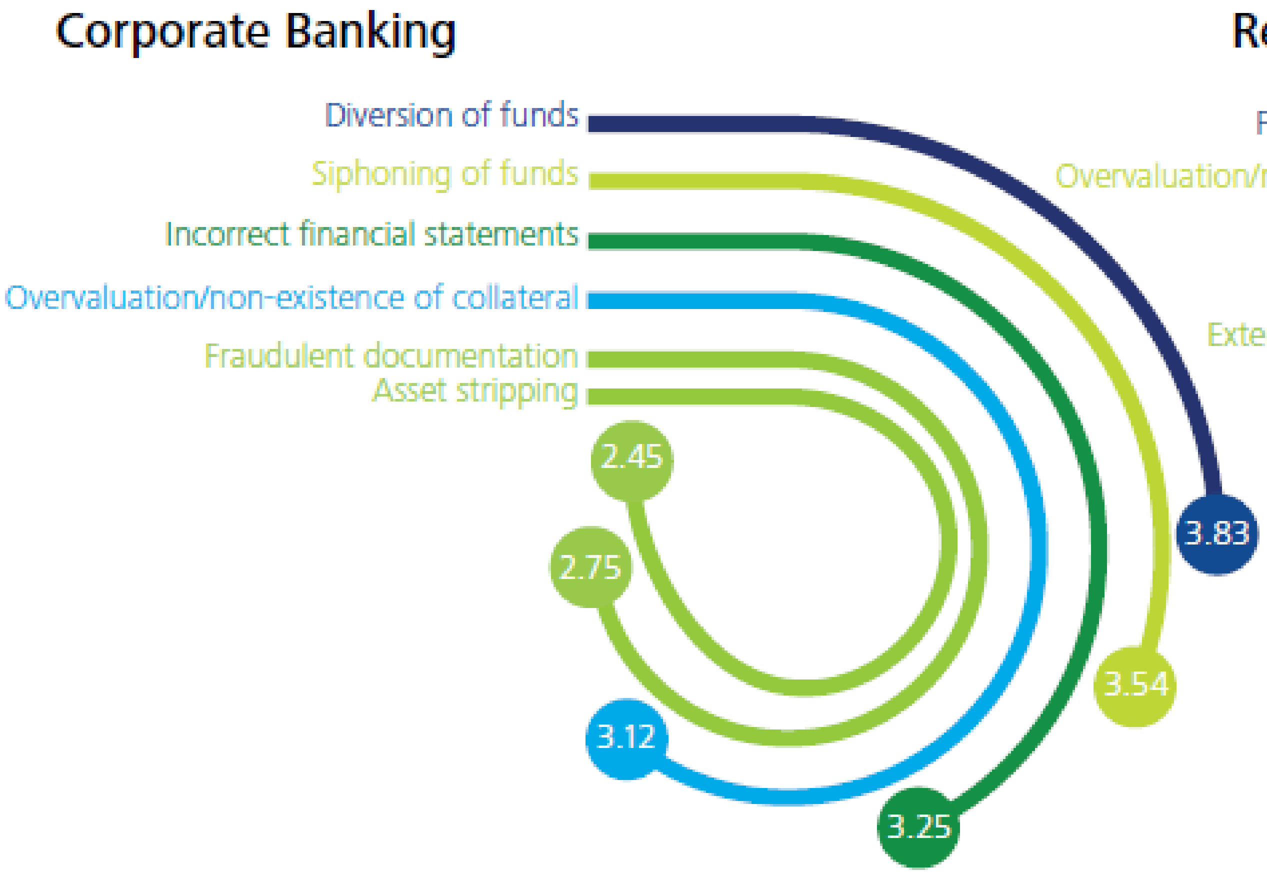
Fraud incidents encountered in the last two years

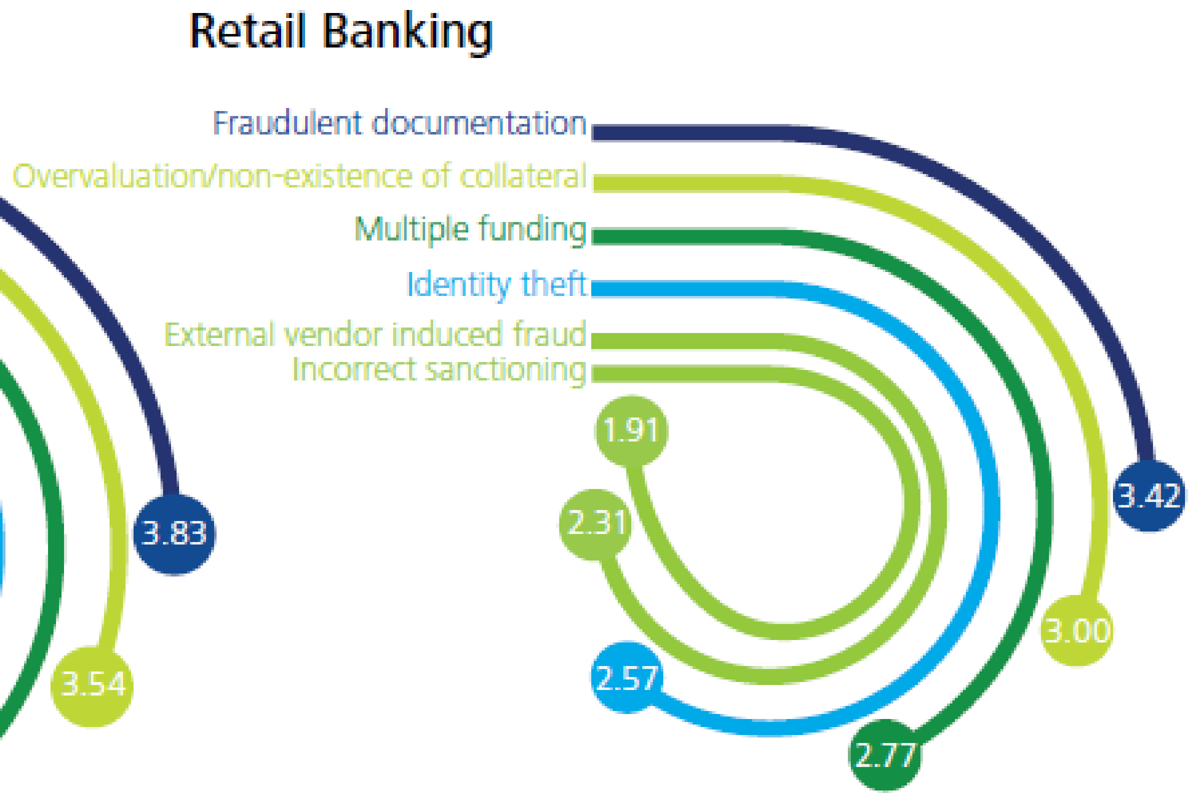


Note: The top three responses have been highlighted

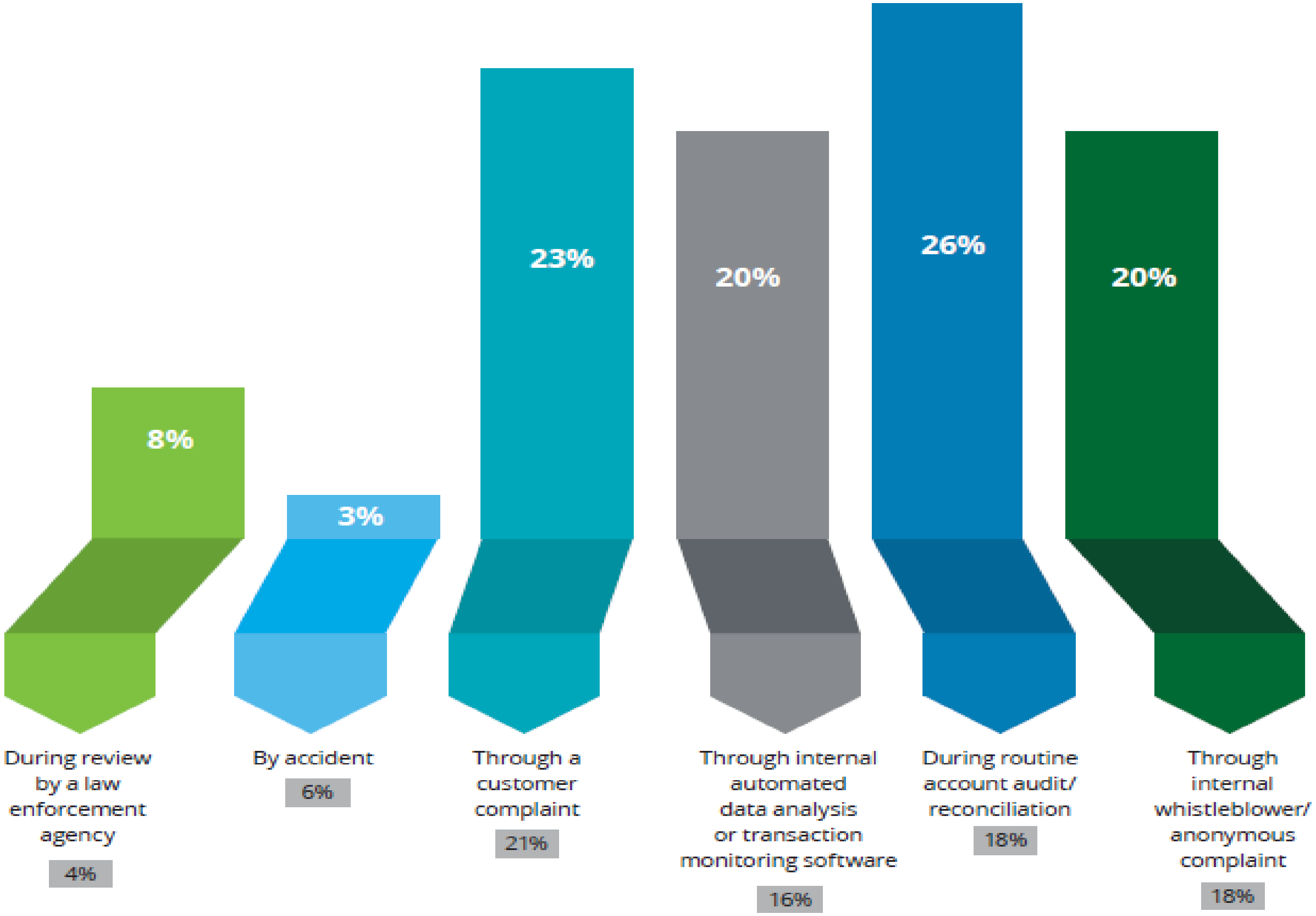
Where is it happening (India Banking Fraud Survey, Edition III)

Retail banking is most prone to fraud followed by corporate and priority sector





India Banking Fraud Survey, Edition III
Unearthing fraud

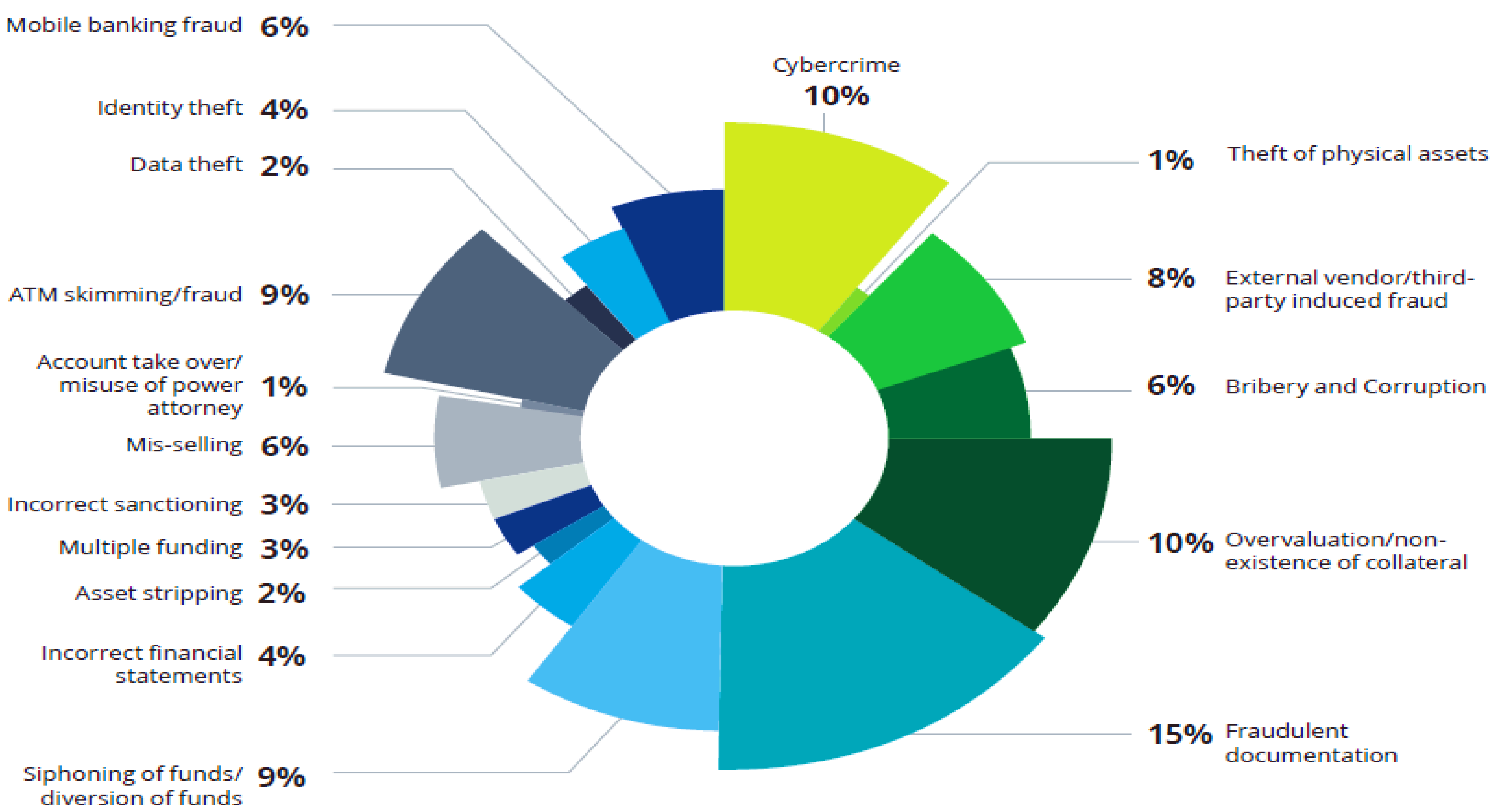


Around 30 percent of our survey respondents have indicated that it took them 6-24 months to detect fraud

Note: Statistics in grey are from Edition II

India Banking Fraud Survey, Edition III

Types of frauds experienced in the last two years

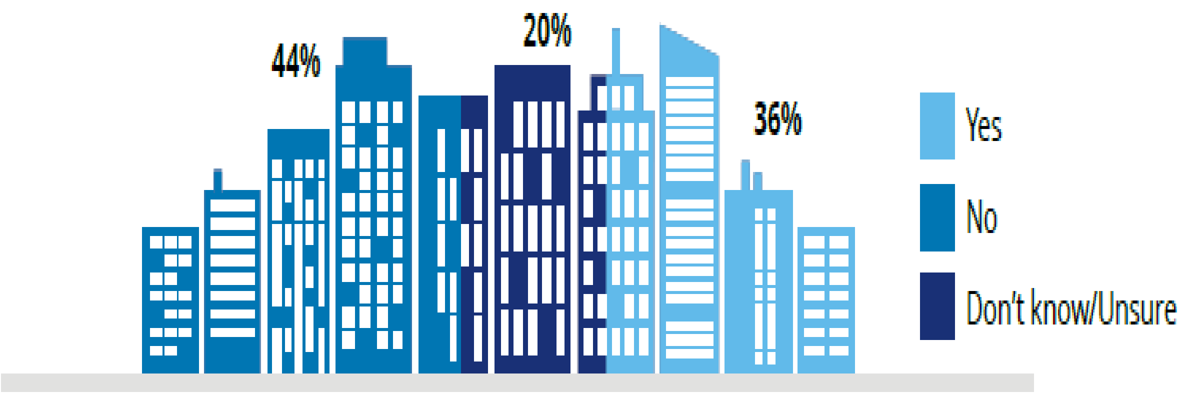


Is the organization adequately equipped to tackle fraud ?

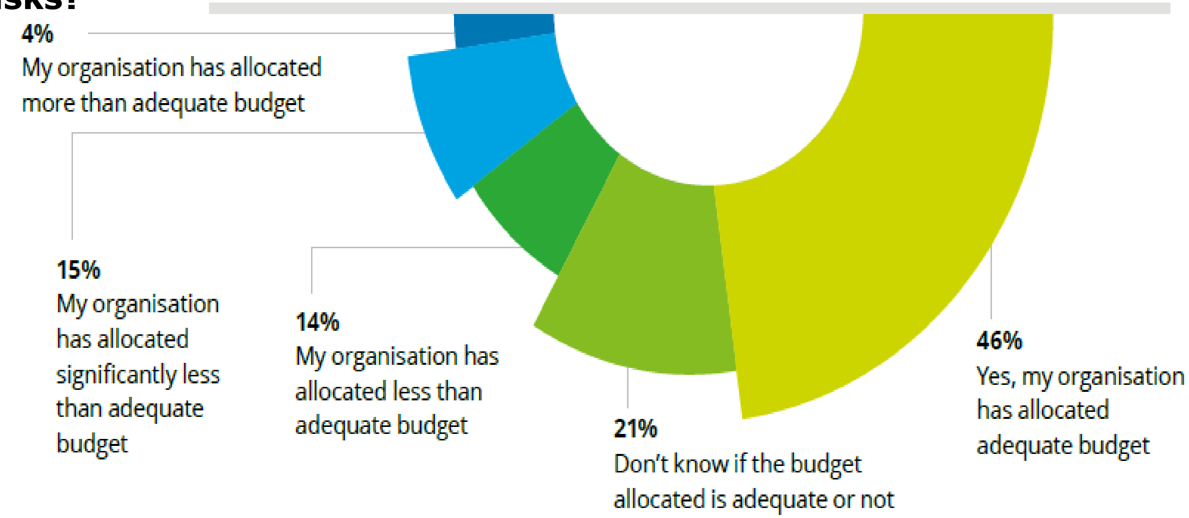
50% respondents believed that their organization had allocated adequate budget but felt the need for commitment from business community.

- There is a rising confidence in the organizations' abilities to manage fraud.
- There is greater sensitivity to the reputational damage that fraud, misconduct and non – compliance can cause.
- Cognizance that fraud can result not only through unethical values but also systematic loopholes and limited overrides.

In your opinion, do you think there is enough commitment from the business community at large to address fraud?

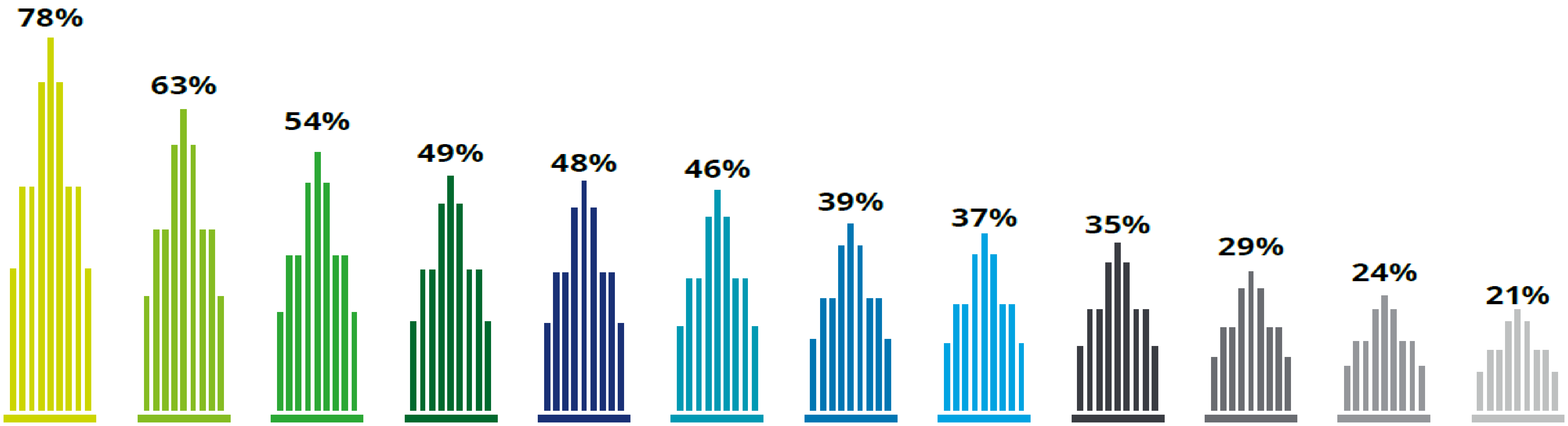


Do you believe your organisation has allocated adequate budget and resources to deal with fraud-related risks?



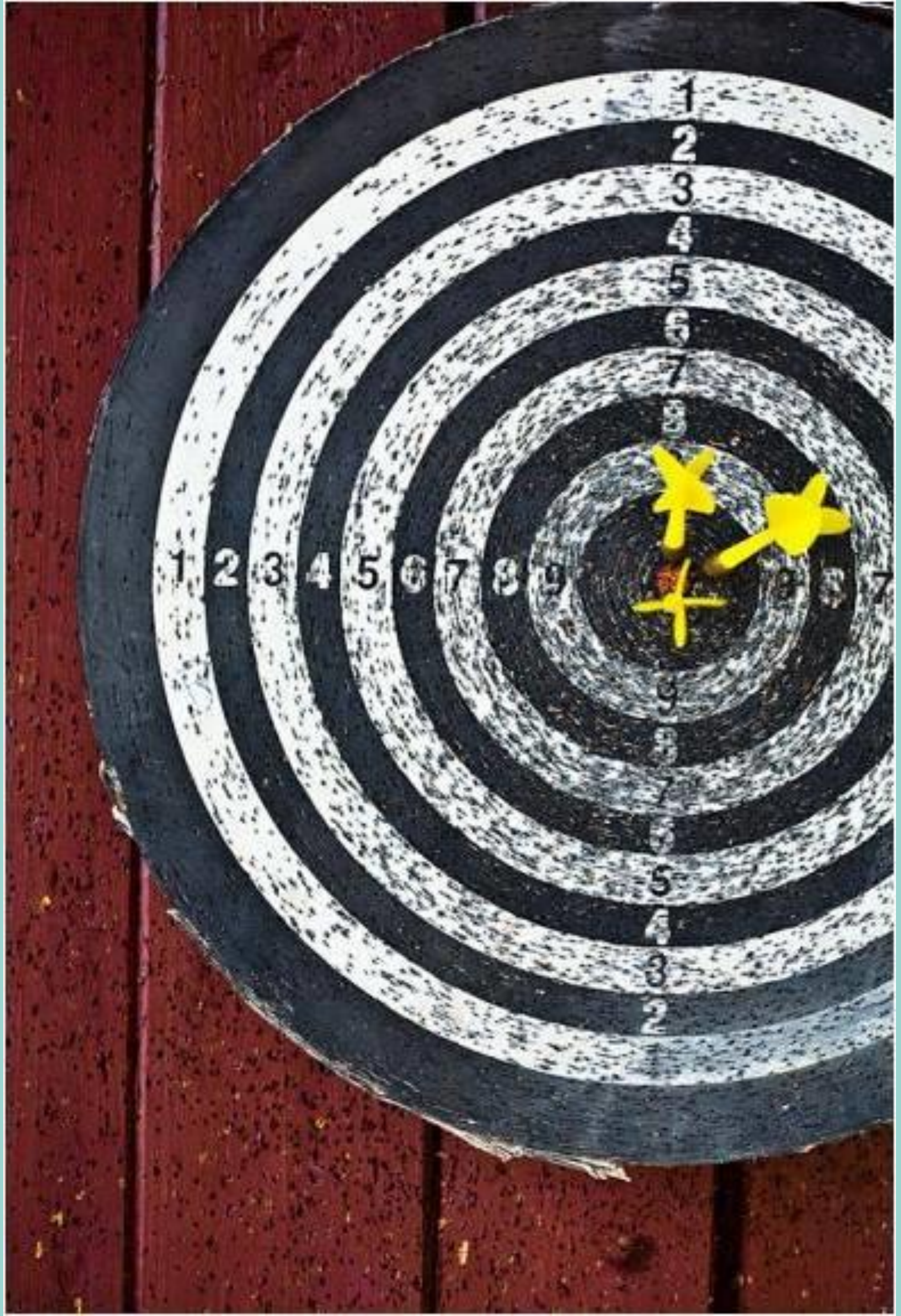
Source : Deloitte India Fraud Survey 2018

What measures does your organization adopt to prevent incidents of fraud?



- Institute periodic Internal Audit
- Take serious action in case of incidents of fraud and use such instances to set an example within the organisation to prevent future frauds
- We have independent auditors who conduct periodic audits
- Effective tone at the top, followed by implementing policies for fraud and consequence management, code of conduct, etc.
- Periodic declarations from employees/management on compliance with laws and regulations
- Conduct general fraud awareness trainings/workshops for all employees
- Periodic communication to employees on fraud and its repercussions
- Conducting an ongoing due diligence check (Third party/Senior Management/Business associate, etc.)
- Fraud risk assessment/monitoring of fraud control frameworks—either manually or using technology such as fraud analytics and fraud management systems
- Dedicated training programs for select teams/individuals to address frauds to which organisations are generally most susceptible, such as bribery and corruption, conflict of interest, procurement fraud, etc.
- Engage third party forensic experts to assess our fraud risk management frameworks at least once a year
- Dedicated fraud prevention unit that researches new frauds and communicates them to the fraud risk management teams

Investigation Strategy



Forensic Audit

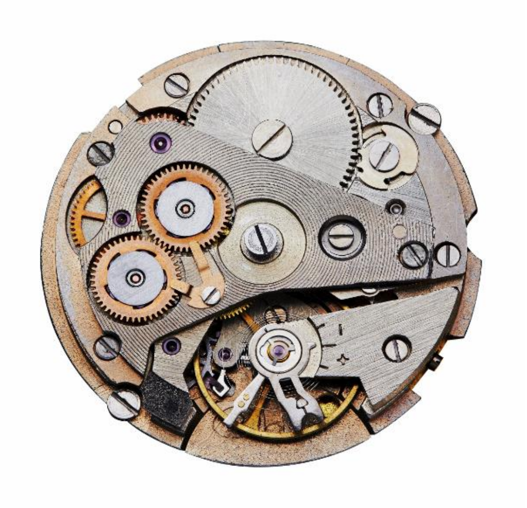
Forensic Auditing is a new concept that comprises three key ingredients

- Forensic Audit thinking
  - ❑ In other words “thinking forensically”
- Forensic Audit procedures
  - ❑ Both proactive and reactive
- Appropriate use of forensic technology, data analysis and business intelligence

How do you look beyond the obvious?

People
(Skill set/
Experience)

+



Process
(Investigation
Methodologies)

+

Technology
(Forensic
Tools)

Investigations take their own course…

However, investigators introduce as much science, method and systematic flow in running them seamlessly…

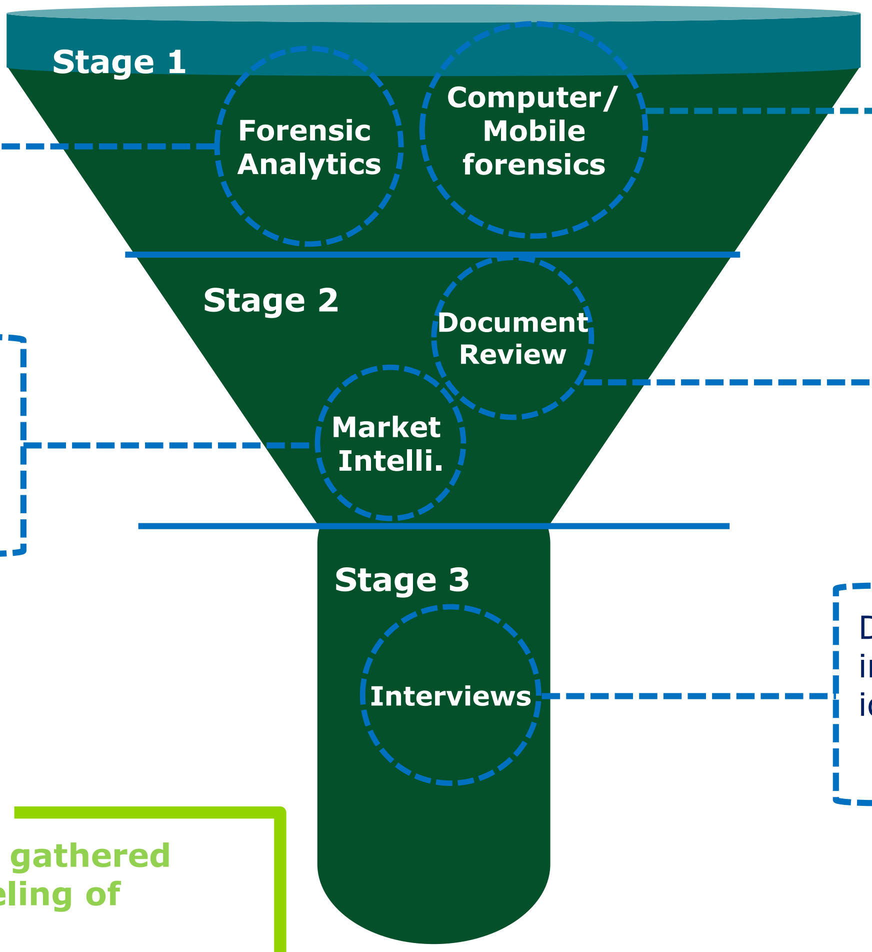
Investigation procedures are refined as modus operandi and evidence commence to unravel…

Investigation methodology

Investigation methodology needs to bring together the synergies of forensic technology and business intelligence gathering along with more traditional techniques of conducting interviews and reviewing books and records.

Getting to the heart of the matter

Methods of gathering evidence



Query-based review of large sets of data to compare trends over time or to identify red flags

Computer-assisted audit techniques to find digital evidence stored in the computer

Conduct market/ field visits to gather hearsay information on suspects

Review of physical documentation, conduct reconciliations and validity check

Discussions and interviews with identified employees

Evidences are gathered through funneling of information.

Case Study 1

Case Study 1

Background

Desi Bank is a large commercial bank in India having branches across the country with Head office located at 201 Min Tini road, Mumbai. Bank provides range of products and services to Retail and Corporate customers.

VXON Trading Pvt. Ltd ("Borrower") availed credit facilities from a consortium of 24 banks (Led by Desi Bank). The borrower, based out of Surat, is a star trading house engaged in import and export of edible oil and agricultural produce. The Borrower had several sister concerns owned by the same promoter group and subsidiaries which were in the similar line of business and had purchase and sale transactions with them.

The nature of facilities provided were CC, OD, LCs, TL, STL, EPC, Bill discounting and bank guarantees. The total exposure sanction limit of the Borrower as on 31-March-2015 was INR 600 crores fund based and INR 400 crores non-fund based facilities. The Borrower's financials showed high jump in its revenues and balance sheet size over the last three financial years.

The Borrower's account with the banks has been showing sign of stress since last 8 months with irregular payments, devolved LC and outstanding bills. The level and quality of stocks & debtors (primary security) had depleted considerably in the last quarter of the financial year 2014-2015. Keeping long standing relationship with the Borrower and good track record, the banks have been intermittently sanctioning short term adhoc limits to the Borrower both within and outside consortium limits.

The recent interactions with the promoters indicated diversification in lucrative areas of precious stones as the global market for edible oil and agricultural produce was under pressure and depleting margins.

Which areas you think should be of focus to identify any red flags / indications of diversion of funds and anomalies in the account?

Issue Identification

- Two years prior to becoming NPA the customer was a highly respected and sought after customer by banks.
- Shareholding of promoters reduced substantially in a period of 2.5 years.
- The Banks increased the limits substantially based on growth projection from borrower.
- During the last year the facilities provided to the borrower turned NPA with all the banks.
- Preliminary analysis of the financial statements indicated that requirement of working capital for the export and domestic sales of the Borrower were only 35% of the Actual funding by the banks.

Analysis

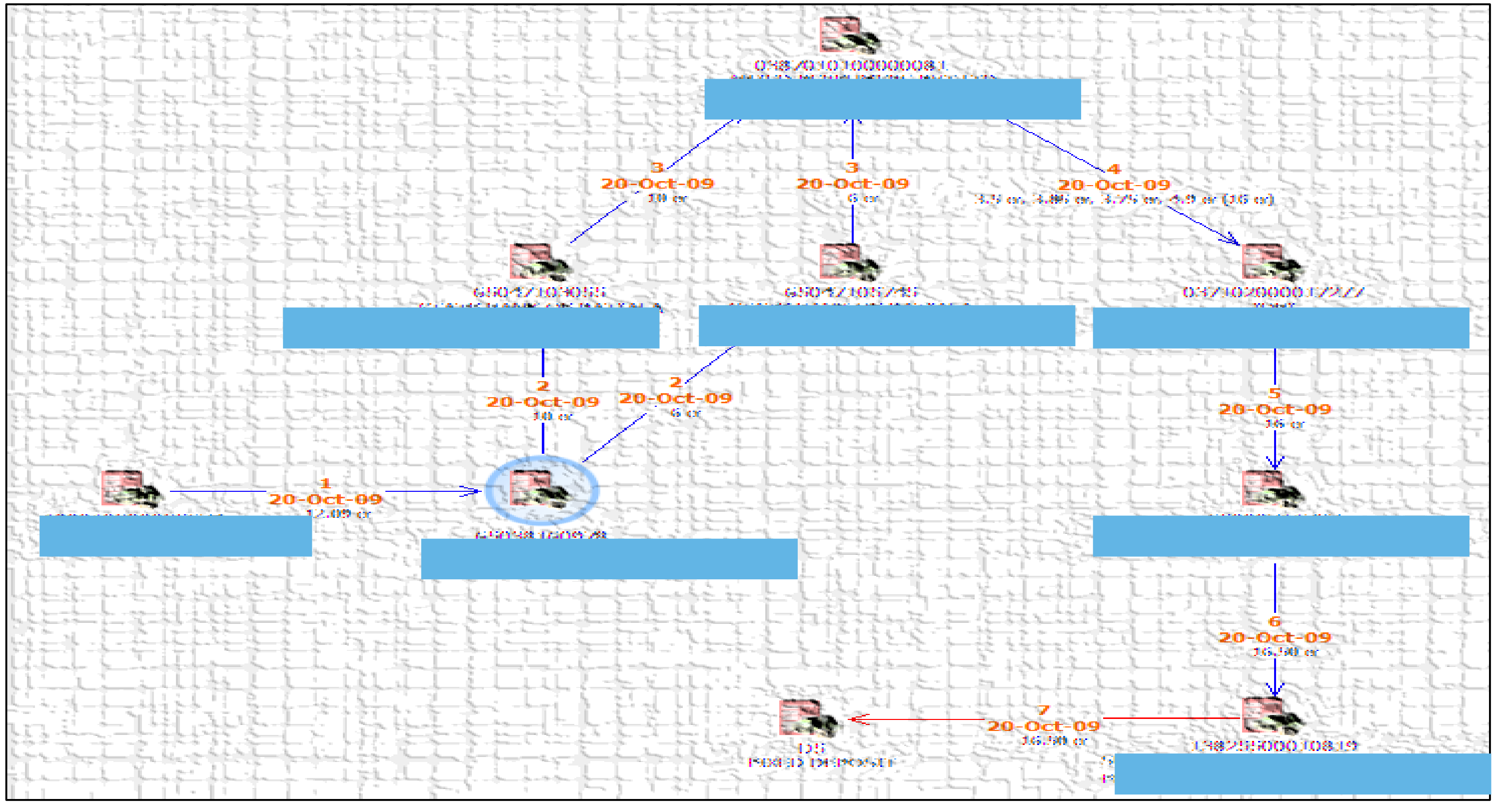
- Analysed and compared Pre-shipment credit and the Post-shipment credit availed to understand the purposes for which the funds were disbursed vis-a-vis utilized.
- Comparison of Purchase Contracts submitted by borrower against more than 300 EPC disbursements to 20+ Banks to identify duplicate Purchase Contracts.
- Analysed Proforma Invoices and Commercial Invoices submitted by Borrower for nearly 700 LCs to identify duplicates.
- Analysed and compared dates of opening of nearly 700 LCs with 20+ Consortium Banks and respective negotiating dates and the location of Vendors and the negotiating banks to identify same day transactions.
- Analysed more than 100+ bank accounts with thousands of bank transactions to check sanction of facilities exceeding approval authority and Temporary Overdraft availed by Borrower without appropriate approvals.
- Analyzed diversion of export credit disbursements during the covered period of 2.5 years for 20+ Banks.
- For each disbursement of EPC made, subsequent debits and withdrawals were identified for the end use of the disbursement.
- The information of payee and payee’s bank were identified from the copies of cleared cheques/vouchers and statements of account made available by the Banks.
- In case of transfers to borrower’s accounts with other Banks, we identified subsequent debits and withdrawals aggregating to at least 90% of the value of such transfers from the bank statements provided by the concerned banks.
- Background checks for parties to identify their line of business for the purpose of assessing genuineness of the business transactions of Borrowers and usage of funds disbursed by Banks.

Key Findings

- ❑ Facilities availed from consortium banks on same Export orders
- ❑ Fake transport lists for movements of goods under inland LCs
- ❑ Same Invoices used for opening multiple LCs
- ❑ Usage of Accommodations bills with the help of related parties
- ❑ EPC and Exports bills settled through domestic bank transfers.
- ❑ Adhoc facilities used to settle over dues to avoid NPA Classification
- ❑ Multiple relationships with banks outside the consortium arrangement
- ❑ Diversion of funds in the wind mills and precious stones business without informing banks
- ❑ Inwards and outward remittances not commensurate with exports and imports
- ❑ Forged deliveries of material from suppliers to warehouse

Key Findings

- Diversion of Loan funds to associate entities for investment purpose



Case Study 2

Background

A consortium of 24 banks had financed M/s. ABC Trading Limited ("Borrower") & its associate companies for a period of 10 years from 2004 to 2013. The Borrower was engaged in agri-business (trading) and perfumery business (manufacturing).

The total credit limit sanctioned to the Borrower in 2012-13 was about INR 2000 crores as compared to INR 200 crores in 2004-05. The enhancement in the credit limit over the period was backed by the increasing turnover of the Borrower.

In 2012, the Borrower had defaulted on the loan repayments and the account was declared as NPA. The total credit facilities outstanding as on June 30, 2012 was about INR 2,200 crores with the consortium banks. The underlying collateral for the credit facility provided by the Borrower was about INR 40 crores.
There were questions raised regarding the genuineness of export transactions of the Borrower and export finance facilities availed from the consortium of banks. Further, there were allegations that the Borrower had diverted funds on a large scale and had indulged in fraudulent activities. Furthermore, it was alleged that the working capital funds were diverted to the Borrower's associate entity and various other accounts including current accounts of its promoters.

What would be your areas of focus for identifying anomalies and red flags in the accounts of the Borrower basis the information available with the banks?

Issue Identification

- To trace the money trail and end use of funds (Step 1)
- Identify undisclosed bank accounts, if any (Step 2)
- Diversion of loan funds to its associates/subsidiaries (Step 3)
- Genuineness of transactions with third parties (debtors/creditors)
- Review of inward/outward foreign remittances and related documentation

ANALYSIS PERFORMED

1) **Bank Account Statements and Financial records of Borrower**

- Compared the bank account transactions with the Audited Financial Statements of Borrower.
- Analysis of sources and utilization of funds disbursed by bank.
- Analysis of financial records like debtors aging reports, financial statements, stock statements, stock audit reports etc.
- Selected transactions of the party to whom highest amount of foreign net payments and receipts were made from Borrower’s bank account, to test check the underlying documentation pertaining to the remittances made to this entity.

2) **Public Domain searches / Field Inquiries**

- Background search in the public domain and field enquiries were made on selected parties to ensure the existence and continuance of the business and identify the line of business and relationship, if any with Borrower or its promoters.

KEY FINDINGS

- Around 41% of payments transferred were to other accounts of Borrower and its associate entities and 44% of receipts were from the other accounts of Borrower and its associate entities.
- Payments of over INR 1000 crores made to entities which did not exist or owners of which were prime accused in other scam or were penalized by regulator for siphoning off funds.
- Payments of over INR 300 crores were made to parties appearing as debtors, some of which did not exist and/or status of sales tax registration of these entities was cancelled.
- Receipts of over INR 700 crores from entities which did not exist and / or status of sales tax registration of these entities was cancelled.
- Identified foreign outward remittances aggregating to more than INR 300 crores to associate entities and foreign inward remittances of around INR 30 crores from associate entities.
- Identified diversion of funds to entities in real estate and share trading through promoters accounts

Common directors in a few companies appearing in the debtor’s list.

Case Study 3

Background

Kamal Bank is a large commercial bank in India having branches across the country with Head office located at Bengaluru. The bank provides range of products and services to Retail and Corporate customers. XYZ Ltd. (“the Borrower”), a BSE/NSE listed company, is a large global company, with presence across UK, India, Singapore, Middle East, Hong Kong, Africa and the Caribbean. Kamal Bank has had relationship with the Borrower since 2010.

In 2013-14, the Borrower was plagued by decrease in sales revenue, very high overdue trade receivables and payables, salary arrears and arrears of statutory dues, over dues (interest and repayment of borrowings) of banks, financial institutions and finance lease obligations. The Borrower’s market capitalization also witnessed a drastic fall, impacting the fund raising exercise of the Borrower. The Borrower was able to complete only one tranche of fund raising USD 50 million out of a total expected raise of USD 150 million. Liquidity was further squeezed by the slowdown in its US business. About 80 per cent of the Borrower’s business is US-linked and 10 per cent each from India and the UK.

The Borrower has been transferring funds to its overseas subsidiaries as investments in equity and preference shares. Such investments were made out of the receipts from exports receivables. Additionally, the Borrower’s overseas branches have been transferring funds to its overseas subsidiaries.

The periodic receivables statements provided by the Borrower showed a decrease in certain debtors on account of realization of sales dues. However, the bank statements have not been depicting equal amounts of receipts from such debtors. As per the 6 monthly financial statements for F.Y. 2013-14 made available to the bank, advances to creditors of INR 49 crores was written off. Further, there have been inconsistencies in the debtors aging reports provided to the bank.

What would be your key areas of focus in the process of identification of red flags / anomalies in the account of the Borrower?

Analysis

Bank Account Statements and Financial records

- Compared the bank account transactions with the Audited Financial Statements of Borrower.
- Analysis of sources and utilization of funds disbursed by bank.
- Analysis of financial records like Debtors Aging reports, Financial statements, stock statements, stock audit reports etc.
- Analysis included identifying trend and patterns in the transactions in the various records. Additionally, we performed analysis of available financial records vis-a-via bank account statements.
- Attempted to determine the nature of payments based on description/narration as available in the bank account statement and based on information provided by Banks. For e.g., Letter of Credit (LC), Bills payment, Remittances etc.

Key Findings

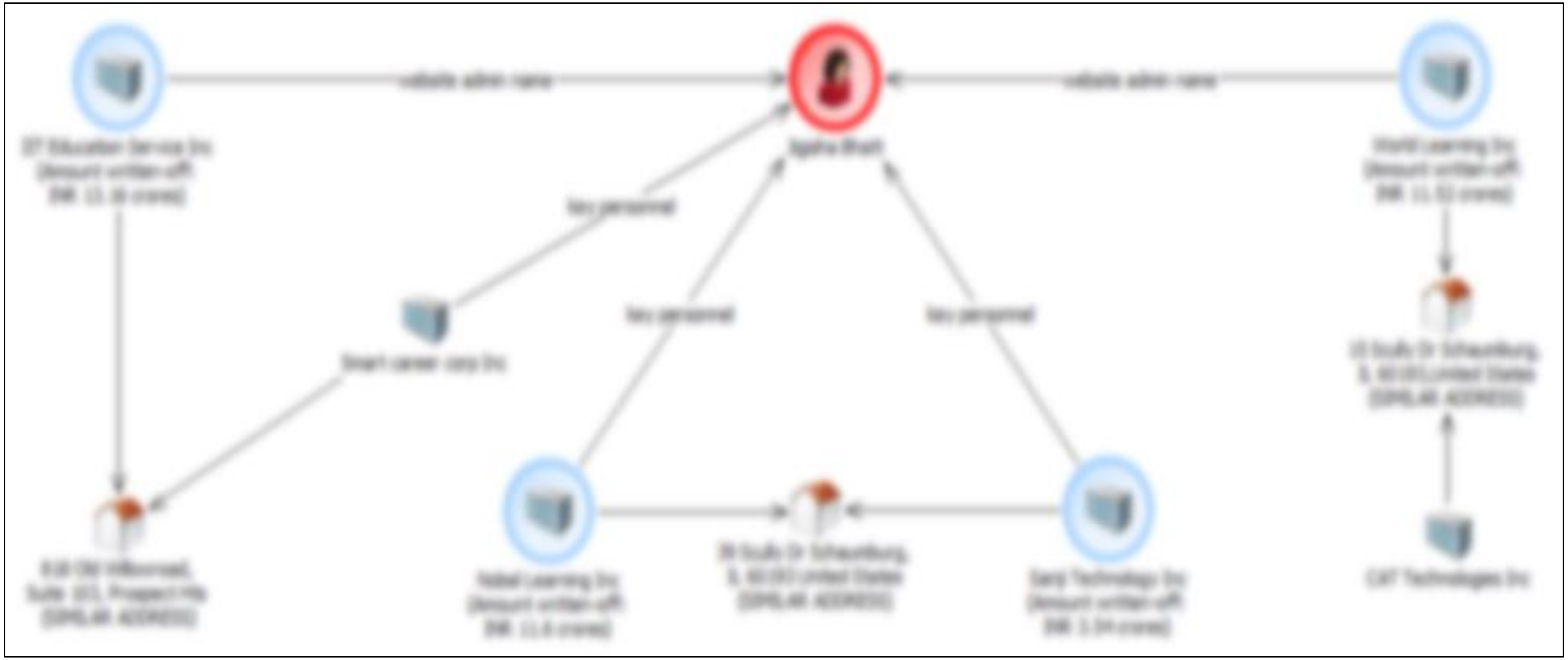
- Investment of over USD 1.20 crores in equity and preference shares of foreign subsidiaries from export receivables of over USD 2.50 crores. Most of these transfers were made on the same day of the receipt of exports receivables.
- Utilization of inward remittances of USD 1.40 crores received by foreign branches to further transfer over USD 1 crores to US subsidiaries against orders for developing IPRs.
- Decrease in receivables statements on account of realization of sales dues without corresponding receipts in the available bank statements depicting a possibility of having additional undisclosed bank accounts.
- During the period April 2011 to September 2013, an aggregate amount of over INR 300 crores paid to parties appearing in the list of 'Suspicious Dealers' published by the Department of Sales Tax. Parties appearing in the list of 'Suspicious Dealers' were amongst the top creditors of the Borrower.
- Adjustment in Debit and credit balances of different parties. MOU entered between such entities was not provided by the Borrower for review.
- Instance of matching concept not followed for revenue recognition wherein revenue was equally recognized over the period of a certain contract. However, entire operating cost incurred during the period was expensed out as cost of the period.

Key Findings

Diversion of Loan funds to associate entities for investment purpose

Key Findings

Write off of Amount Receivables from parties which were related to each other. Sales were continued to be made even after writing off receivables from such parties.



Thank You