

# **Audit of Foreign Exchange Transactions**

March 16, 2019

Seminar on Statutory audit of Bank branches

# Agenda

- **Overview of Forex Transactions**
- Regulatory Framework
- Remittances for Individuals
- Non Individual Transactions (Trade)
- Risks associated with Trade & Forex activity

# Overview of Forex Transactions

Foreign exchange Transactions –

- refer to sale and purchase of foreign currencies.
- is an agreement of exchange of currencies of one country for another at an agreed exchange rate on a definite date to facilitate international trade and remittances.

# Overview of Forex Transactions

Broad categories of inflow and outflow of foreign exchange :

## **Inflow**

Exports

Inward Remittances

Borrowings

Incoming Investments  
(FDI's)

## **Outflow**

Imports

Outward Remittances

Lendings

Outbound Investments  
(ODI's)

# Overview of Forex Transactions

## Components of Trade transaction :-

- Movement of goods
- Movement of documents
- Movement of funds

## Governing laws

Movement of goods- DGFT/Customs

Movement of documents & funds – RBI/FEMA

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# Regulatory Framework

Major policy/regulatory framework international trade are laid down by :-

1. Directorate General of Foreign Trade (DGFT)
2. Reserve Bank of India (RBI)
3. International Chamber of Commerce (ICC)
4. Foreign Exchange Dealers Association of India (FEDAI)
5. Export Credit Guarantee Corporation (ECGC)

# Regulatory Framework

## DGFT -

- Operates under the Ministry of Commerce and lays down policies and regulations relating to physical movements of goods
- Issues Import Export Code (IEC) to entities undertaking import & export of goods and services

## RBI's role in trade is concerned with

- **Exchange control** – oversees the payment and receipts by residents to non residents and vice versa
- **Credit norms** – any credit being extended to another party is controlled by RBI credit norms
- **Foreign Exchange Management Act 1999 (FEMA)** is an important act that lays down the underlying regulations governing all foreign currency transactions



# Regulatory Framework

- **ICC** is an apex international body which formulates the guidelines for smooth functional of trade and forex transactions across countries.

Publication of set of rules such as :-

- Uniform Customs and Practices for Documentary Credit (UCPDC 600)
  - Uniform Rules for Collection (URC 522)
  - Incoterms (CIF, FOB etc.)
- **FEDAI** is an association of banks authorised to deal in forex
    - frames rules governing forex banking transactions
    - advisory body to RBI on forex markets
    - allied activities for the benefit of member banks
  - **ECGC** is a credit insurance company started for export promotion :-
    - provides policies to exporters to protect overseas risk and guarantees to banks protect its finances to exporters

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# Remittances for Individuals

Outward Remittance facility available to resident

Individuals :-

- Travel, Education, Gift, Medical purpose, maintenance of closed relatives etc. and other capital account transactions under Liberalised Remittance Scheme (LRS) -Limit of up to USD 250,000 in a financial year.
- PAN is mandatory for remittance under LRS.
- LRS limit to be tracked through PAN number (Login through RBI portal)
- Maximum foreign exchange in the form of currency is USD 3,000 or equivalent
- Foreign currency not available for travel to Nepal & Bhutan
- Documentation required:-
  - Request letter, Form A2, Copy of PAN card for LRS, Copy of Passport, Tickets

# Remittances for Individuals

## Outward Remittance facility available to Non-resident individuals

- Remittance upto USD 1 million per financial year
- Remittance of Current income viz:- Rent, Dividend, Pension Interest from NRO account (or as per CA certificate where NRO account is not maintained by NRIs)
- Transfer of funds from NRO A/c to NRE A/c.

# Remittances for Individuals

## Inward remittance :

- Purchase of Foreign currency and Travellers cheque from Resident Individuals
- Purchase of Foreign currency and Travellers cheque from Non- Resident Individuals
- Collection of Foreign Currency cheques
- Refund of balance available in prepaid Foreign currency card/Travel card

### Auditors Checklist

- copy of passport with visa and arrival date stamp page
- purpose code updation
- In case of purchase of TC, copies of TC (Travellers cheque)
- Issuance of Encashment certificate

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# Trade transactions for Non individuals

- Import transactions
- Export transactions
- Other Trade transactions
- Trade Financing (Import and Export)
- Inward & Outward remittances
- Capital Account transactions (Approval activities)

# Import Transactions

## Advance payment against Import

- Importer send payment directly to the exporter and waits for the exporter to send the goods.
- Sellers market/Sellers Monopoly (Diamond Mining companies)
- Buyers risk , Money laundering risk
- Due diligence on counter parties (line of activity of overseas party, phantom trade)
- **RBI regulation (Master direction on Import of goods and Services)**
  - Advance payment above USD 200,000 or equivalent requires unconditional Bank guarantee from overseas bank of international repute
  - AD banks can permit advance payment transactions without Bank guarantee upto USD 5 million or equivalent (as per Board approved policy)
- **Auditors Checklist :-**
  - Request letter in prescribed format, NNL declaration, FEMA declaration, IEC of importer, Bank Guarantee (if applicable), Signature verification of authorised signatory



# Import Transactions

## Open account transactions (Direct Import )

- Exporter send goods directly to the importer and waits for the importer to send payment.
- Buyers market.
- Sellers risk
- Due diligence on counter parties (line of activity of overseas party, phantom trade)
- **RBI regulation (Master direction on Import of goods and Services)**
  - Remittance against direct receipt of documents should be made except for the following cases:-
    - Bill value should not exceed USD 300,000 or
    - Received by Wholly Owned Subsidiary or Status Holder exporter/SEZ/EOU, Limited Companies, Private Limited Company
- **Auditors Checklist :-**
  - Request letter in prescribed format, NNL declaration, FEMA declaration, IEC of importer, **Bill of entry (evidence of import - IDPMS)**, Transport document  
Signature verification of authorised signatory

# Import Transactions

## Import Bills under collection

- Foreign seller (exporter) will route the documents through their banker who in turn will send the documents to the Importers bank. The importer Bank will follow the instructions mentioned in the bill schedule and deliver the documents to the buyer.
- Importer bank only handles the documents and assumes no responsibility towards payment of the bill
- **RBI regulation (Master direction on Import of goods and Services)**
  - Banks to receive documents provided it is satisfied with the financial standing and track record of importer
  - Confidential report from credit agencies or Overseas banker for transactions in excess of USD 300,000
- **Auditors Checklist :-**
  - Availability of documents as per covering schedule, Lodgement of documents within timelines, Acceptance on Bill of Exchange, Generation and handling over of Import bill presentation memo, Delivery of original documents to importer, Acceptance to overseas bank.

# Import Transactions

## Letter of credit (LC)

- LC is an arrangement whereby at the request of the importer, its bank issues an irrevocable undertaking in favour of the exporter to honour the payment subject to presentation of credit compliant documents.
- High degree of involvement of banks in handling of documents in LC transactions.
- Bills are drawn under the Letter of credit.
- Issuance of LC is governed under UCPDC 600 of ICC.
- **Auditors Checklist :-**
  - LC application duly stamped as per Stamp duty Act, Underlying documents (Contract, Proforma Invoice etc.), Insurance copies, terms and conditions in LC application is replicated in the LC, Signature verification of authorised official

# Export Transactions

- **Advance remittance against exports**
- **Export Bills**
  - Export bills under LC
  - Export bills under collection
  - Export bills Discounted/Negotiation

## Import Aspects for auditors

- **Export realisation within 9 months**
- **Submission of export documents within 21 days from export**
- **Shipment of goods within 1 year in case of advance received against export**
- **Document of shipment to be handled by AD Bank through which the advance remittance was received**
- **Fema declaration, Bill of Exchange, Invoice, Packing list, Transport document, Shipping Bill from Customs as evidence of export**

# Other Trade Transactions

- **Inland Trade Transactions**

- Inland LC issuance
- Inland Bill discounting
- Inland bills under collection

- **Bank Guarantees**

- Issuance of Bank Guarantee on security stationery
- Adequate stamp duty payment as per State Stamp Act
- Dispatch/handover of Bank Guarantee to beneficiary
- Maintenance of register for stationery

- **Merchanting Trade Transactions**

- Import and export of goods by trader whereby goods does not touch Indian territory.
- Completion of entire transaction within 9 months
- Should not involve forex outlay of more than 4 months
- Import and Export Leg should be handled by the same AD Bank

# Trade Financing Transactions

- **Export**

- Packing Credit (Pre shipment Finance)
- Export Bill Discounting (Post Shipment)

- **Import**

- Buyers credit
- Suppliers credit

# Inward and Outward remittances

- **Outward remittance**

**Auditors Checklist:-**

- Customer request letter
- Documentation requirement as per purpose of remittance
- Form 15 CA and Form 15 CB
- Purpose Code
- Form A2, FEMA Declaration
- Signature verification of authorised Official

- **Inward remittance**

**Auditors checklist :-**

- Documentation requirement as per purpose of remittance
- Signature verification on request letter

# Capital Account Transactions

- Foreign Direct Investment in India (FDI) – Form FCGPR
- Transfer of shares in Indian Companies from Residents to Non residents and vice versa (Form FCTRS)
- Introduction of Single Master Form (SMF) for reporting Foreign Investments
- Investment in JV /WOS (Overseas Direct Investment)
- External Commercial Borrowings
- Remittance towards recurring and non recurring expenditure for Branch offices abroad



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# Risks associated with Trade & Forex activity

- Regulatory risk :-
  - Non adherence to various financial limits and documentation requirements prescribed in RBI
  - Non/Short collection of GST/Stamp duty
  - Errors in regulatory reporting to regulators
- Credit risk :-
  - Non realisation of export bill discounting proceeds, Letter of credit devolvement, Invocation of Bank Guarantee
  - Risk on account of incorrect forex rate applied in transactions
- Operational risk :-
  - Long outstanding entries in Forex Office Accounts and Inter Branch accounts
  - Unreconciled entries between SWIFT and Core Banking System

# Risks associated with Trade & Forex activity

- Reputation risk :-
  - Not honoring the commitments made under Letter of credit, Bank Guarantees to beneficiaries.
- IT risk :-
  - System vulnerability exposed and lack of control (Attempted fraud at Bangladesh Bank SWIFT system)
- Trade Based Money Laundering Risk (TBML)
  - Phantom Trade implying movement of funds without underlying trade transactions
  - Over pricing, under pricing of goods